What Are the Odds of an Interest Rate Hike in 2025?

It seems low now but there are conditions under which the Fed could push rates upwards.

By Erik Sherman

Morningstar says that looking ahead into 2025, the Federal Reserve's rate-cutting will be "shorter and shallower" than previously expected. However, conditions could change, pushing the Fed into a resumption of interest rate hikes, even if seemingly remote.

In mid-December 2024, the Federal Open Market Committee announced a 25-basis-point rate cut, bringing the federal funds rate range from 4.25% to 4.50%, which was expected.

What wasn't on the bingo card for most people was the prediction of upward inflation pressure in the central bank's economic projections. The median expectation for Personal Consumption Expenditure inflation for 2025 jumped from 2.1% in September to 2.5% in the December meeting. Going forward, 2026 went from 2.0% to 2.1%. Under the current view, it will take until 2027 to get back to a 2 percent rate of inflation. Also, Core PCE inflation in the median projection is 2.5% this year, 2.2% in 2026, and 2% in 2027.

Looking at the central tendency in the September 2024, meeting, 2025 PCE inflation would have been 2.1% to 2.2% and then 2% in 2026 and 2027. Core PCE inflation would have been 2.1% to 2.3% in 2025 and 2% thereafter. Now, the PCE inflation range is 2.3% to 2.6% in 2025, 2% to 2.2% in 2026, and 2% in 2027. Core PCE inflation would be 2.5% to 2.7% in 2025, 2% to 2.3% in 2026, and 2% in 2027.

It's a reversal and Fed officials clearly expect the inflation rate to lose what was a steady decline. "The Fed's 25 basis point rate cut provides some relief but reinforces the 'higher-for-longer' interest rate environment, emphasizing that commercial real estate now operates in a fundamentally different landscape than before the 2022 rate hikes," Greg Friedman, managing principal and chief executive of CRE lender Peachtree Group, told GlobeSt.com at the time. "The latest CPI report points to a challenging path toward the Fed's inflation target, with the 10-year Treasury yield potentially climbing further due to market expectations and inflationary pressures from upcoming policy shifts."

"A skip in January could very easily turn into an extended pause," Roger Hallam, global head of rates at Vanguard, told Morningstar. "Our view is that [the Fed] probably [does] have one more [cut] but pauses at or above 4%" in 2025.

The question isn't only one of inflation but of economic growth. Although real gross domestic product for the fourth quarter of 2024 and the entire year isn't in, the economy has been relatively strong, with GDP hitting 3% annualized growth in the second quarter of last year and 3.1% in the third quarter. It seems unlikely that the bottom will have fallen out in Q4.

There have been questions for more than half a year as to whether the so-called neutral rate —

the theoretical short-term interest rate that doesn't stimulate or restrict the economy — has risen, which would suggest a higher federal funds rate would be necessary.

Then there is the potential impact of President-elect Trump's announced economic plans , like tax cuts and tariff hikes, on the economy. No one knows what they will be because there is no sense of how much he might implement. Estimates are that, if fully put into place, the moves could be inflationary.

Morningstar also noted that the labor market has remained relatively strong, which is true. Jobs are currently more important to the Fed than inflation, as it's part of the dual mandate of price stability and full employment.

As Morningstar wrote, the unemployment rate would be a critical consideration for an increased interest rate. Don Rissmiller, chief economist at Strategas, told them that to raise rates, central bankers would need to feel that the unemployment rate wouldn't rise.

"[Rissmiller] adds that considerable research shows that once the unemployment rate starts rising, it tends to keep going," Morningstar wrote. "That would be bad news for the Fed, which has been adamant that it does not want to damage the labor market as it fights to bring inflation back to target." As in November, two-thirds of top metros saw fewer job gains during the past 12 months when compared to the year-ago period.

There's no clear path ahead or guarantee of what the Fed will do. Unfortunately, that also means no promise that interest rates will keep falling, even if more slowly. And given that the yield of the 10-year Treasury might keep rising, that could mean higher mortgage rates anyway, with little matter of what the Fed does.