



Uncertainty creeping into the Fed's outlook

Post- March FOMC report: 4:30PM EST, 19 March 2025

Takeaways

- **Risks rising, but no stagflation:** Despite revising growth lower and inflation higher in their quarterly statement of economic projections, officials still project 1.7% GDP growth for the year – suggesting a slowdown, not stagnation.
- **Slowing balance sheet run-off:** In our view, this meeting was as dovish as could be expected, largely due to the Fed's decision to slow the pace of quantitative tightening (QT). A slower pace of QT should ease financial conditions at the margin.
- **Policy rate on hold for foreseeable future:** With inflation still running warm and with risks to the upside, we expect just one additional rate cut this year *unless financial conditions tighten meaningfully or the growth outlook weakens further*. The market is pricing the first cut for the year in June, and we've updated our Fed cuts checklist below to track the key conditions needed for a pivot.

Uncertainty creeping into the Fed's outlook

The Fed decided to maintain the benchmark rate in the target range of 4.25% - 4.50%. But in its statement and the presser, the Fed acknowledged that uncertainty around the economic outlook has increased – something also reflected in its latest projections.

Fed officials now see slower growth in 2025 (1.7%) than they did in December (2.1%), with slightly higher unemployment and inflation. Chair Powell addressed directly that this widening range of potential outcomes reflects uncertainty raised by tariffs.

While the FOMC continues to signal two additional rate cuts, Powell noted it is too soon to say if the Fed can “look through” price increases related to tariffs. Eight officials now anticipate just one or no cuts this year, up from four in December.

Chair Powell nodded to rising recession risks but tried to strike a reassuring tone, emphasizing that a downturn isn't imminent. He pointed to a split in the data: sentiment-based survey data has weakened, but hard economic activity data remains strong.

For now, uncertainty means the Fed is standing pat, but Chair Powell was perhaps more candid than we'd expected that the path forward looks different than policymakers expected just a few months ago.

Slowing QT is supportive of financial conditions

In our view, this meeting provided as much support to investors as was possible, largely due to the Fed's decision to slow the pace of QT. Starting next month, the Fed will slow the runoff of its Treasury holdings to \$5 billion per month, from \$25 billion per month. By slowing QT, bank reserves will drain more slowly from the system, which is



supportive of looser financial conditions. This doesn't materially change our view on the 10-year Treasury yield which we expect to remain rangebound between 4% and 5%, barring any major downside pressure on growth.

When can we expect rate cuts?

Sticky inflation and higher inflation expectations raise the bar for Fed cuts, even as the market looks to the Fed for a "put" or for calming messaging. The Fed is likely to need to see a stronger deterioration in financial conditions and the economic growth outlook before pre-emptively easing, with inflation figures so strong. Using 2018's "insurance" cuts as a guideline, we would expect that an equity market selloff of 20% or more – marking the entry of U.S. equities into a bear market – would be required to push the Fed to act.

Our Fed cuts checklist: sticky inflation means growth expectations would have to deteriorate by more before the Fed would act

Fed mandate	Indicator to watch	Status
Inflation	Inflation expectations	Short term inflation expectations have de-anchored to the upside in both surveys and market pricing. Consumer surveys for medium term inflation expectations have also moved higher– and in fact are moving lower as investors expect lower growth in the medium term.
	Core PCE inflation	Core inflation has made significant progress towards normalization in the last 24 months, but has likely stabilized above target. Core services such as shelter costs are unlikely to show further progress. Factors contributing to lower CPI, such as disinflation in airfares, are unlikely to provide the same boost to core PCE.
Maximum employment	Unemployment rate	The unemployment rate has hovered near 4.0%, and could move higher as public sector layoffs impact March payrolls figures. The Fed has clearly stated it does not want employment to weaken more, but it is not clear that government layoffs will prompt quicker Fed action unless they continue or unless private sector employment outcomes deteriorate, too. Consumer surveys show a large increase in concern about losing a job.
	Wage growth commensurate with price stability	Wage growth is higher than the 3.5% year-on-year figure that we believe would make the Fed comfortable with maintaining a rate cutting cycle. Stickiness in wages may require a slower pace of rate cuts.

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