Fed Watch

# Fed holds as it waits for further clarity on the effects of policy changes

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## Economic projections still point to 50bp worth of rate cuts later this year, but a rate cut in the near upcoming meetings is unlikely

- **The Fed kept the federal funds rate unchanged within the 4.25-4.50% target range and noted in the policy statement that "uncertainty around the economic outlook has increased."** Despite such a worsened outlook, the policy statement's assessment of recent developments remained unchanged. Even though recent indicators have suggested a moderation in aggregate demand during Q1, the statement continued to characterize economic activity as continuing "to expand at a solid pace," with labor market conditions remaining "solid" amid an "unemployment rate [that] has stabilized at a low level in recent months." Unsurprisingly, the statement continued to note that "inflation remains somewhat elevated" given the lack of further progress in recent months. The Fed announced a further step in reducing its balance sheet by indicating that, from April, it will "slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $25 billion to $5 billion." This decision was unsurprising, having been foreshadowed in the January meeting minutes, which revealed that "various participants noted that it may be appropriate to consider pausing or slowing balance sheet runoff." Powell carefully clarified that this action "isn't sending a signal in any hidden way" regarding the Fed's policy stance. It remains to be seen why Christopher Waller voted against this decision, "who supported no change for the federal funds target range but preferred to continue the current pace of decline in securities holdings."
- **Updated Summary of Economic Projections (SEP): the Fed sees slower growth and higher inflation, but still projects two rate cuts this year.** The Fed lowered its 4Q25 year-over-year (YoY) GDP growth projection from 2.1% to 1.7% and also revised down by (-)0.2 and (-)0.1 percentage points (pp), both to 1.8%, its 4Q26 and 4Q27 YoY growth estimates. At the same time it raised somewhat its unemployment rate (UR) 2025 year-end projection to 4.4% (up from 4.3%), but left unchanged its UR forecasts for the next two years at 4.3%. The median core PCE inflation projection for the fourth quarter is now 2.8% (up from 2.5%). The forecasts for 2026 and 2027 were left unchanged at 2.2%. Long-run projections for these three variables remained unchanged at 1.8%, 4.2% and 2.0%, respectively. **The "dot-plot" still shows two rate cuts in 2025, but also reflects that more members are in no hurry to change the monetary policy stance.** The Fed continued to signal two rate cuts this year and two more next year in spite of heightened uncertainty around the outlook, i.e., the median projection continues to be for the fed funds rate to fall to 3.9% by the end of this year and to 3.4% by year-end 2026, both unchanged from December projections. Yet, range for the dots became narrower, with an overwhelming majority (17) now expecting two or fewer cuts this year and only two members expecting three cuts, as opposed to December's projections when five members were projecting three or more cuts. Moreover, four members are now leaning to no cuts this year, up from only one in December, and four more are pointing to only one cut, up from one in December's SEP projections.

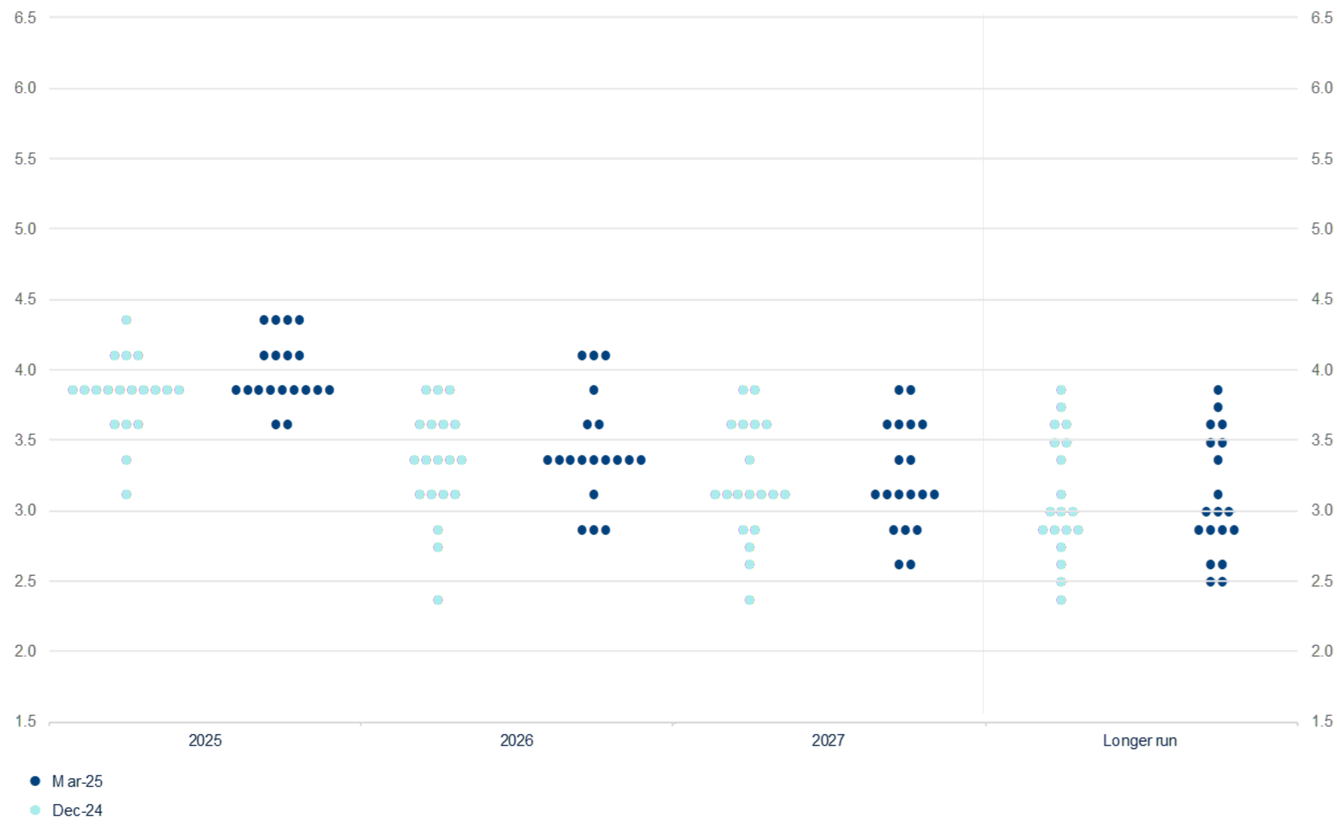
- **Powell signaled in the Q&A two complementary factors behind the unchanged interest rate projections: i) weaker growth but higher inflation which "[...] kind of balance each other out"; and ii) uncertainty.** The Fed will adapt as they go, but for now is "well positioned to wait for further clarity and not in any hurry to adjust the policy stance". Besides, Powell clearly indicated that transitory inflation is the base case for tariffs. Overall, Powell signaled that interest rate projections could change ahead, but for the time being "[monetary] policy is in a good place to react to what comes." Powell also conveyed that the Fed is not concerned about recent signals coming from soft data which show plummeting consumer confidence and increasing short-term inflation expectations. Although he acknowledged that recent data points to moderation in consumer spending, he kind of dismissed recent signs arising from soft data saying that its link with hard data has not been strong recently and explaining that longer-term inflation expectations are mostly well-anchored. He acknowledged that, according to most analysts, recession odds have moved up but are not high.
- **We continue to think that the door to resume the rate cut cycle could open in late 2025 and, thus, we continue to expect two rate cuts this year, but uncertainty is high.** As Powell acknowledged, the Fed could either move sooner if growth falters or inflation moves down, but also could stay on the sidelines for longer if tariffs drive up both inflation and longer-term inflation expectations, decreasing the Fed's confidence that it can look-through tariff-related inflation under a baseline scenario in which inflation would be transitory.

## The updated SEP points to slower growth but higher core inflation that “balance each other out” and, along with uncertainty, allows the median fed funds rate projection to remain unchanged

Table 1. **FOMC PARTICIPANTS’ SUMMARY OF ECONOMIC PROJECTIONS** (MARCH 2025, %)

| Variable | Median | | | | Central tendency | | | | Range | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2025 | 2026 | 2027 | LR | 2025 | 2026 | 2027 | LR | 2025 | 2026 | 2027 | LR |
| **Change in real GDP** | 1.7 | 1.8 | 1.8 | 1.8 | 1.5-1.9 | 1.6-1.9 | 1.6-2.0 | 1.7-2.0 | 1.0-2.4 | 0.6-2.5 | 0.6-2.5 | 1.5-2.5 |
| Dec-24 | 2.1 | 2.0 | 1.9 | 1.8 | 1.8-2.2 | 1.9-2.1 | 1.8-2.0 | 1.7-2.0 | 1.6-2.5 | 1.4-2.5 | 1.5-2.5 | 1.7-2.5 |
| **Unemployment rate** | 4.4 | 4.3 | 4.3 | 4.2 | 4.3-4.4 | 4.2-4.5 | 4.1-4.4 | 3.9-4.3 | 4.1-4.6 | 4.1-4.7 | 3.9-4.7 | 3.5-4.5 |
| Dec-24 | 4.3 | 4.3 | 4.3 | 4.2 | 4.2-4.5 | 4.1-4.4 | 4.0-4.4 | 3.9-4.3 | 4.2-4.5 | 3.9-4.6 | 3.8-4.5 | 3.5-4.5 |
| **PCE inflation** | 2.7 | 2.2 | 2.0 | 2.0 | 2.6-2.9 | 2.1-2.3 | 2.0-2.1 | 2.0 | 2.5-3.4 | 2.0-3.1 | 1.9-2.8 | 2.0 |
| Dec-24 | 2.5 | 2.1 | 2.0 | 2.0 | 2.3-2.6 | 2.0-2.2 | 2.0 | 2.0 | 2.1-2.9 | 2.0-2.6 | 2.0-2.4 | 2.0 |
| **Core PCE inflation** | 2.8 | 2.2 | 2.0 | | 2.7-3.0 | 2.1-2.4 | 2.0-2.1 | | 2.5-3.5 | 2.1-3.2 | 2.0-2.9 | |
| Dec-24 | 2.5 | 2.2 | 2.0 | | 2.5-2.7 | 2.0-2.3 | 2.0 | | 2.1-3.2 | 2.0-2.7 | 2.0-2.6 | |
| **Federal funds rate** | 3.9 | 3.4 | 3.1 | 3.0 | 3.9-4.4 | 3.1-3.9 | 2.9-3.6 | 2.6-3.6 | 3.6-4.4 | 2.9-4.1 | 2.6-3.9 | 2.5-3.9 |
| Dec-24 | 3.9 | 3.4 | 3.1 | 3.0 | 3.6-4.1 | 3.1-3.6 | 2.9-3.6 | 2.8-3.6 | 3.1-4.4 | 2.4-3.9 | 2.4-3.9 | 2.4-3.9 |

Figure 1. **FOMC PARTICIPANTS’ PROJECTED APPROPRIATE FEDERAL FUNDS RATE** (%)

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