MARKET COMMENTARY

The Fed raises its growth forecast but keeps the path for rates unchanged.

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• Faced with the tension between high inflation and cracks in the labour market and the uncertainty created by the Gulf war, the Fed stays put, with no changes to the path for rates. However, the upward revision of the neutral rate estimates and the strong hint that further cuts require solid evidence of disinflation gave a slight hawkish tilt to the meeting.

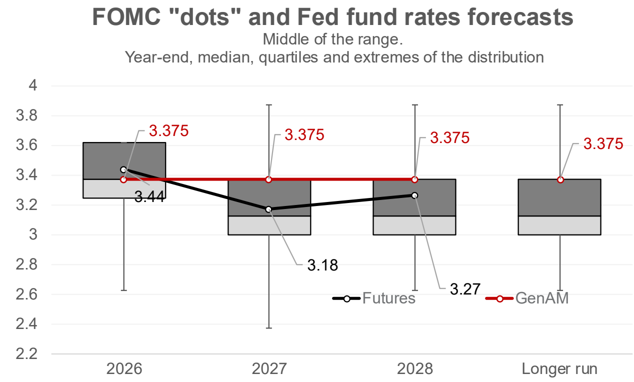
• The impact of the Gulf war is nearly impossible to estimate, but chair Powell recalled that growth remains healthy (projections were revised up) and in the past five years the US economy has withstood well several adverse shocks. With monetary policy only marginally restrictive, the FOMC sees itself in a good place.

• Should Kewin Warsh still without the Senate approval by May, Powell will remain as pro tempore chair. Anyway he will not step down from the FOMC before the investigation against him is completed.

• The Oil shock and the still uncertain timing of the passthrough of tariffs on inflation blur the evidence the FOMC needs to continue normalising rates. We then stick to our call of just another rate cut, no earlier than September.

In a meeting overshadowed by the uncertainty on the fallout of the Iran war on the economy, the Fed kept rates unchanged but signalled a structural, productivity-driven step up in the growth trend, which however should not impact inflation and affect only marginally the unemployment rate. Higher expected productivity is expected to raise the neutral policy rate too.

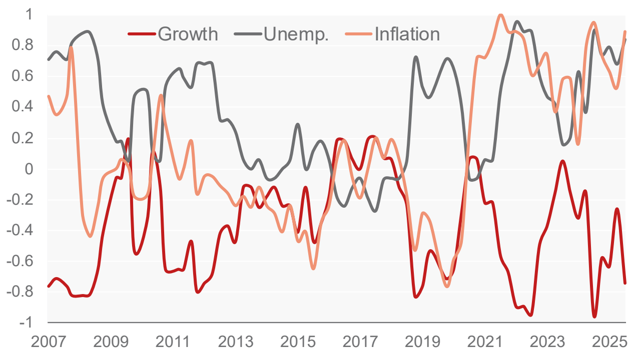
The impact of high energy prices and a possible longer impact of tariffs on good prices was duly reflected in the rise in the short-term projections for both core and headline inflation. Consistent with the view that a central bank should look through an adverse oil shock, the median projection for the policy rate path was unchanged from December, but the balance of risks clearly tilted towards higher inflation and weaker growth and employment.



Source:Federal Reserve Board,NY Fed; Datastream,GenAM estimates

Median Projection	2026	2027	2028	Longer run
Change in real GDP	2.4	2.3	2.1	2.0
Dec. projection	2.3	1.9	1.9	1.9
Unemployment rate	4.4	4.3	4.2	4.2
Dec. projection	4.4	4.2	4.2	4.2
PCE inflation	2.7	2.2	2.0	2.0
Dec. projection	2.4	2.1	2.0	2.0
Core PCE inflation	2.7	2.1	2.0	
Dec. projection	2.6	2.1	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	3.4 →	3.1 →	3.1 →	3.1 ↑
Dec. projection	3.4	3.1	3.1	3.0

FOMC projections: balance of risks



Source: FRB, GenAM

The press release contained few changes above the acknowledgment that the labour market has stabilise. Only Governor Miran, as expected, dissented on the decision, calling for a cut.

> Available indicators suggest that economic activity has been expanding at a solid pace. Job gains have remained low, and the unemployment rate has ~~shown some signs of stabilization.~~<u>been little changed in recent months.</u> Inflation remains somewhat elevated.
>
> The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook remains elevated. <u>The implications of developments in the Middle East for the U.S. economy are uncertain.</u> The Committee is attentive to the risks to both sides of its dual mandate.

The dots continued to reflect high uncertainty on the appropriate policy path and if anything, as highlighted by Chair Powell, the distribution turned a little bit more hawkish, with eight members calling for no cuts (or even hikes) in 2027.

Distribution of the projected year-end Fed funds rate
Estimate of year-end appropriate rate by each FOMC member, by meeting. Boxed: median

2026		2027		2028		Long term	
Dec-25	Mar-26	Dec-25	Mar-26	Dec-25	Mar-26	Dec-25	Mar-26
3.88	3.63	3.88	3.88	3.88	3.88	3.88	3.88
3.88	3.63	3.88	3.63	3.88	3.63	3.75	3.75
3.88	3.63	3.63	3.63	3.63	3.63	3.63	3.63
3.63	3.63	3.63	3.63	3.63	3.63	3.50	3.50
3.63	3.63	3.38	3.38	3.38	3.38	3.38	3.38
3.63	3.63	3.38	3.38	3.38	3.38	3.38	3.38
3.63	3.63	3.38	3.38	3.13	3.38	3.25	3.25
3.38	3.38	3.13	3.38	3.13	3.13	3.13	3.13
3.38	3.38	3.13	3.13	3.13	3.13	3.13	3.13
3.38	**3.38**	**3.13**	**3.13**	**3.13**	**3.13**	**3.00**	**3.13**
3.38	3.38	3.13	3.13	3.13	3.13	3.00	3.00
3.13	3.38	3.13	3.13	3.13	3.13	3.00	3.00
3.13	3.38	3.13	3.13	2.88	3.13	3.00	3.00
3.13	3.38	2.88	3.13	2.88	3.13	3.00	3.00
3.13	3.13	2.88	2.88	2.88	2.88	2.88	3.00
2.88	3.13	2.88	2.88	2.75	2.88	2.75	2.88
2.88	2.88	2.63	2.88	2.63	2.88	2.63	2.88
2.63	2.88	2.63	2.63	2.63	2.63	2.63	2.63
2.13	2.63	2.38	2.38	2.63	2.63	2.63	2.63

Source: Federal Reserve Board, GenAM

The Q&A was dominated by questions about the impact of the spike in oil prices and the possible consequences of the economy. As expected, Powell did not have much to say. It is too early to make an assessment as nobody knows the size and duration of the crisis. The FOMC will know much more by the time of the next meeting, in six weeks' time. However, Powell recalled that over the last six years, the US economy proved very resilient to a series of adverse supply shocks and to the sharp increase in the policy rate.

Activity is expanding at a solid place, with the housing sector being the only weak spot. Productivity rise is helping and the FOMC ascribes it to the labor-saving investment and changes in the way people work put in place during and after the pandemic. It is way too early to assess the impact of Generative AI and Powell warned that periods of persistently high growth productivity are rare and often revised down. Despite the solid growth outlook job creation has stalled. As the curb in immigration virtually brough labour force growth to a halt, unemployment has changed little since September. The labor market is in balance, but Powell stressed that it is not a comfortable one and large downside risks persist.

However, these risks are not stronger than those on inflation, he added. Core PCE inflation should have climbed to 3% yoy in February, but this is largely due to the push from tariffs to goods prices. Once goods inflation falls from the current 2% to the level prevailing before tariffs (0% or slightly negative) disinflation will restart. However, the FOMC remains unsure about how long it will take from the rise in the price level to go away from the inflation calculation.
The impact of tariffs on inflation remains the most important focus of the Fed and the possibility that it will ultimately look through the oil shock depends on that and on the consideration that inflation has overshot the target for five years, which at some point may lead expectations to disanchor.

Monetary policy remains borderline between neutral and restrictive, as the policy rate is within the upper bound of the neutral estimates: the FOMC feels in the right place to be, as it manages to balance the strong tension between inflation and unemployment. Powell stressed that any further rate cut will be strictly conditional on signs of disinflation. But “stagflation” is too strong a word to characterize the current situation.

Powell will serve as interim FOMC chair until his replacement, Kevin Warsh, is confirmed by the Senate. Anyway, he will not leave the board before the investigation launched against him by the Department of Justice is finished: the DoJ early this week appealed against the decision of a federal judge to dismiss the care, so the situation may drag on for a while. He has not yet decided whether to remain in the board after his term as chai ends his term runs until May 2028.

We stick to our call of an extra cut, to be delivered no earlier than September. Powell reiterated the need for strong evidence on disinflation, and the oil price shock stands in the way of clarity. The new chair, provided that he passes the Senate scrutiny in a reasonable amount of time, is very unlikely to persuade quickly the rest of the FOMC of the need to cut rates quickly.

With no significant news coming from the data and above all, the uncertainty from the Gulf war, the meeting was overall unsurprising. The two-year yield increased marginally (3 bps) and the S&P hit a day low on the news.

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