

Economics

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Fed announcement: Doing nothing and saying little

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The Federal Reserve did nothing, as expected, in terms of policy today, but also said very little regarding the possible path ahead as policymakers bought time to assess the impact of the conflict in the Middle East and its effect on oil prices. At the moment, the Summary of Economic Projections implies that the median expectation is for a fairly short-lived conflict and a limited impact on inflation by year-end, which will still allow for one interest rate cut this year and a follow up reduction in 2027. However, there is greater uncertainty regarding that view, and like the rest of us FOMC members may have to refine their expectations in the weeks and months ahead if oil prices remain elevated.

The decision to hold the policy rate steady at 3.50-3.75% today was widely expected even before the conflict in the Middle East muddied the inflation outlook, due to conflicting data suggesting a possible softening in the labour market but at the same time stronger core inflation readings. For now inflation continues to be described as "somewhat elevated", and the unemployment rate "little changed". The implications of developments in the Middle East are simply described as "uncertain". The statement reiterated that the FOMC was attentive to risks to both sides of its dual mandate, and only one member (Miran) voted in favor of a 25bp reduction in interest rates this time around.

Perhaps surprisingly given the increasingly uncertain global backdrop, the Summary of Economic Projections highlighted relatively minor changes compared with the last iteration back in December. Indeed, GDP and unemployment forecasts for the end of the current year are either little or unchanged. The median forecasts for inflation are, understandably, higher, albeit by only two and three ticks for core and headline PCE respectively. The range of expectations was wider (2.3-3.3% for headline versus 2.2-2.7% in December) presumably reflecting differing assumptions for the persistence of high oil prices, but it appears that the majority of participants are factoring in a fairly short-lived spike with limited passthrough to core price pressures. That appears to fit in with the expected profile for interest rates, as median dot plot projections were unchanged from December and continued to point to one cut this year and a further reduction in 2027.

Having said that, the dot plot projections were not quite as skewed towards lower rates as they were in December, despite the median forecast remaining unchanged. Seven of the 19 participants are assuming no further cut this year, and only five expecting two or more (down from eight in December). During the press conference, Powell suggested that there was a discussion as to whether the next move may need to be up rather than down, although the "vast majority" didn't think that would be the case. Powell also suggested that upwards revisions to CPI forecasts were largely a function of recent upward surprises, rather than assumptions of higher oil prices and pass through to other items persisting until year-end. He reiterated that the Fed is committed to a 2% inflation target and officials will be looking towards inflation expectations as a guide to whether policymakers are able to look through a hopefully temporary oil price shock or not.

Re: Economic forecast — For now the tone from the Fed and the median expectations for the economy and monetary policy doesn't appear to have changed too much, although the Fed like the rest of us will need to reassess its assumptions the longer the Middle East conflict and period of elevated oil prices persists. We continue to expect two rate cuts from the Federal Reserve during the second half of the year, which will bring rates down close to a neutral level, but that forecast rests on the assumption that the ongoing conflict in the Middle East is fairly short-lived, meaning that gasoline prices will have moderated again by then and pass-through to core inflation will be limited.

Re: Markets — Bond yields dipped initially after the decision, however rose back in line with and then above their pre-decision level during the press conference due to a perceived more hawkish tone than was expected.

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