Fed Watch

The Fed sticks to its plan for three rate cuts this year…

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… but projects one less rate cut in 2025 and a slightly higher neutral rate in the long run

- **The FOMC kept the fed funds rate unchanged at 5.25-5.50% and suggested they remain relatively confident around the disinflationary process.** The policy statement remained broadly unchanged. On the assessment of recent developments, the FOMC continued to state that economic activity "has been expanding at a solid pace." A slight dovish bias, which noted that job gains had "moderated since early last year," was removed from the statement. The Committee continued to judge that "job gains remained strong, and [that] the unemployment rate has remained low." The Committee decided not to add any hawkish bias to its view around the recent evolution of prices ("inflation has eased over the past year but remains elevated"), even after recent evidence of a likely slowdown of disinflation of core prices partially driven by a puzzling rebound of shelter inflation that is at odds with more timely data from newly-signed rental contracts. It seems to have been the case, as we argued (see), that continued evidence of a still strong but gradually cooling labor market wouldn't warrant a significant hawkish shift in today's statement. The FOMC continued to consider that "the risks to achieving its employment and inflation goals are moving into better balance." With the FOMC's unchanged expectation that it will not "be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%", today's statement suggest that the Fed still expects disinflation to run its course this year, but for now it remains in wait-and-see mode as some uncertainty has emerged around the near-future evolution of core prices.

- **The updated Summary of Economic Projections (SEP) and dot-plot show that the Fed still expects three rate cuts this year despite faster short-term growth and somewhat higher core inflation.** Extended economic strength drove FOMC participants to significantly revise its median projection for real GDP growth (Q4oQ4) to 2.1% this year (up from 1.4%). FOMC participants are likely feeling more confident on the possibility of achieving a soft landing in the medium term, which is reflected by a slightly above-trend 2% real GDP growth rate for both 2025 and 2026 (up from 1.8% and 1.9%, respectively). The only change for headline PCE inflation was a slight upward revision for 2025 (to 2.2% from 2.1%), and the upgraded outlook for growth coupled with the recent stickier-than-expected core inflation figures likely drove the median FOMC participant to revise up her core PCE inflation to 2.6 from 2.4%. In a different context, these changes would have warranted a revision for the projected appropriate policy path to the upside, however, amid more balanced risks around their dual mandate of price stability and maximum employment, the median FOMC participant continued to anticipate a cumulative 75bp of rate cuts this year, followed by three rate cuts in 2025 (down from four), and three more in 2026 (Table 1). A closer look at the dot-plot (Figure 1) shows that 10 participants (out of 19) anticipate three rate cuts or more (down from 11 in December) and 9 project two rate cuts or less (up from 8), which means that, at the margin, there was a slightly more hawkish outlook for monetary policy this year, which, however, was not reinforced by the statement nor by Powell's comments.

- **In the press conference, Powell signaled there's no compelling reason to start cutting rates soon but also that the Fed still thinks it will need to start easing back policy restraint this year**, even with faster growth and somewhat higher core inflation by year end. As in his testimony to Congress two weeks ago, Powell refrained from signaling a significantly more hawkish Fed after the disappointing inflation figures in the first two months of the year: "we're going to let the data show [...] if this is a bump in the road or something more." Instead, he insisted that it will likely be appropriate to begin dialing back policy restraint at some point this year, and acknowledged that the economy "has made considerable progress." Moreover, he pointed out that "strong job growth is not a reason for [the Fed] to be concerned about inflation." On quantitative tightening (QT), Powell said the Fed will keep the pace at which it is reducing its asset holdings for now. Their plan is slowing the pace of run-off "fairly soon," but that "does not mean [the] balance sheet will ultimately shrink by less than it would otherwise." It thus seems that the Fed would like to slow the pace of QT when it starts to cut rates, likely in June.

- **Markets welcomed the Fed sticking to its plan of three rate cuts this year after a few weeks of uncertainty around the possible reaction of FOMC participants to recent core inflation prints.** Both 2-year and 10-year Treasury yields edged down by 9 and 2 bps following today's decision (to 4.60% and 4.28%, respectively). Major stock indexes closed up by around 1%, and the US dollar depreciated slightly. The futures market continued to rule out the possibility of a rate cut in May (8% probability of such an outcome), likely reflecting the market's opinion that the relatively scarce upcoming data over the intermeeting period (one jobs report and one CPI report) won't provide the Fed enough confidence to conclude by then that either core inflation is resuming a clear downward trend or that the labor market is weakening abruptly. Implied chances for a rate cut in June jumped to 75% (from 60% over the last few days), with an almost fully priced-in rate cut by the July meeting (90% chance).

- **With the fed funds rate at its peak and more balanced risks, the Fed is likely to proceed cautiously in determining the timing of a first rate cut.** Although the inflation figures for the last two months confirmed that the road back to 2% inflation might be bumpy and suggests there are still some risks to the progress of (lower) inflation, the Fed still thinks they will need to cut rates this year. With a strong economy and still high inflation, the Fed thinks they can approach the question on when to start cutting rates "carefully." Probably the main takeaway from today's meeting is the absence of any hawkish surprise. The fact that Powell declined several opportunities during the Q&A to take a harder line on inflation and instead stressed his continued confidence that it will come back to 2% over time, pointed to the fact that risks are two-sided, and suggested that the Fed is now mostly equally concerned about doing too much too soon or too little too late. This suggests that the Fed is on track to start easing policy at the June meeting and that it plans to proceed cautiously once it starts to cut rates. A more aggressive strategy or a sooner policy response would require something not foreseen now, such as an "unexpected weakening in the labor market."

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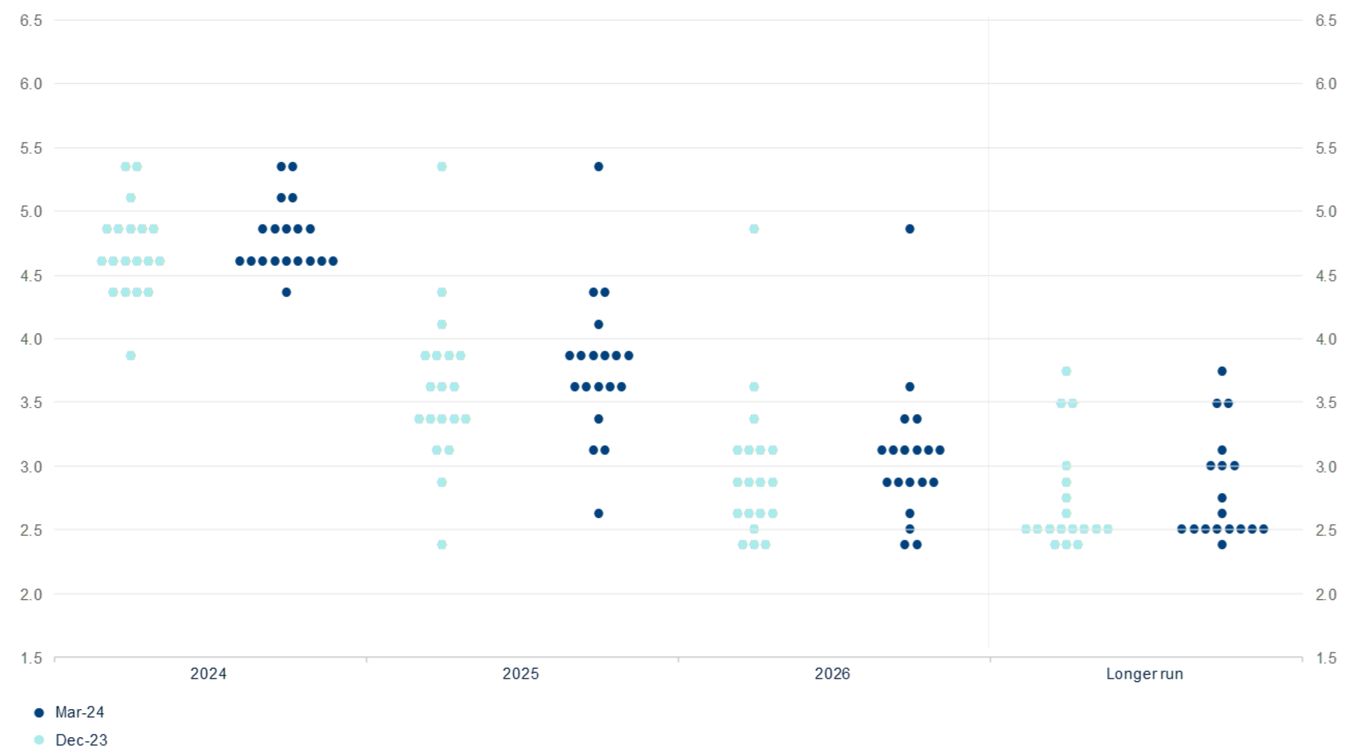
Table 1. **FOMC PARTICIPANTS' SUMMARY OF ECONOMIC PROJECTIONS** (MARCH 2024, %)

Variable	Median				Central tendency				Range			
	2024	2025	2026	LR	2024	2025	2026	LR	2024	2025	2026	LR
Change in real GDP	2.1	2.0	2.0	1.8	2.0-2.4	1.9-2.3	1.8-2.1	1.7-2.0	1.3-2.7	1.7-2.5	1.7-2.5	1.6-2.5
Dec-23	1.4	1.8	1.9	1.8	1.2-1.7	1.5-2.0	1.8-2.0	1.7-2.0	0.8-2.5	1.4-2.5	1.6-2.5	1.6-2.5
Unemployment rate	4.0	4.1	4.0	4.1	3.9-4.1	3.9-4.2	3.9-4.3	3.8-4.3	3.8-4.5	3.7-4.3	3.7-4.3	3.5-4.3
Dec-23	4.1	4.1	4.1	4.1	4.0-4.2	4.0-4.2	3.9-4.3	3.8-4.3	3.9-4.5	3.8-4.7	3.8-4.7	3.5-4.3
PCE inflation	2.4	2.2	2.0	2.0	2.3-2.7	2.1-2.2	2.0-2.1	2.0	2.2-2.9	2.0-2.5	2.0-2.3	2.0
Dec-23	2.4	2.1	2.0	2.0	2.2-2.5	2.0-2.2	2.0	2.0	2.1-2.7	2.0-2.5	2.0-2.3	2.0
Core PCE inflation	2.6	2.2	2.0		2.5-2.8	2.1-2.3	2.0-2.1		2.4-3.0	2.0-2.6	2.0-2.3	
Dec-23	2.4	2.2	2.0		2.4-2.7	2.0-2.2	2.0-2.1		2.3-3.0	2.0-2.6	2.0-2.3	
Federal funds rate	4.6	3.9	3.1	2.6	4.6-5.1	3.4-4.1	2.6-3.4	2.5-3.1	4.4-5.4	2.6-5.4	2.4-4.9	2.4-3.8
Dec-23	4.6	3.6	2.9	2.5	4.4-4.9	3.1-3.9	2.5-3.1	2.5-3.0	3.9-5.4	2.4-5.4	2.4-4.9	2.4-3.8

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



Source: BBVA Research based on data by the Federal Reserve and Haver Analytics.

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