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Fed Watch: Big picture remains intact

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The Fed keeps key rates constant and maintains a low profile on when to expect a first rates cut. Greater confidence in achieving price stability is still needed. Higher than expected inflation readings in January and February are no game-changer but rather part of a bumpy road towards the inflation target. Looking at the Fed's projections 75 basis points in rate cuts remain the base case for 2024 (unchanged to December). It is unlikely that key rates will be lowered at the next meeting in May. What will be done, however, is to slow the pace of quantitative tightening. The balance sheet will continue to decline, yet slowing the pace will allow the Fed to better assess when 'enough is enough'. For markets it was a dovish meeting given the hawkish positioning in advance.

Summary of Economic Projections by FOMC members: March 2024

	2024	2025	2026	longer-run
GDP Growth	2.10 ▲	2.00 ▲	2.00 ▲	1.80 ▬
prior	*1.40*	*1.80*	*1.90*	*1.80*
Unemployment Rate	4.00 ▼	4.10 ▬	4.00 ▼	4.10 ▬
prior	*4.10*	*4.10*	*4.10*	*4.10*
Inflation	2.40 ▬	2.20 ▲	2.00 ▬	2.00 ▬
prior	*2.40*	*2.10*	*2.00*	*2.00*
Core Inflation	2.60 ▲	2.20 ▬	2.00 ▬	
prior	*2.40*	*2.20*	*2.00*	
Policy Rate	4.60 ▬	3.90 ▲	3.10 ▲	2.60 ▲
prior	*4.60*	*3.60*	*2.90*	*2.50*

Projections represent the median of FOMC members. GDP growth and inflation rates refer to Q4/Q4 growth rates of the respective year, while the unemployment rate corresponds to the Q4 average. The policy rate shows the mid-point of the target range of the Federal Funds Rate. Inflation rates are based on the PCE price index and core inflation excludes energy and food prices.

Source: Federal Reserve, Refinitiv, RBI/Raiffeisen Research

The Federal Reserve decided to **keep key interest rates constant** at the **target range between 5.25 and 5.5%**. This is no surprise and has been widely expected both by investors and economists alike. Nevertheless, it is interesting that the **monetary policy statement** has not been changed at all compared to the statement in January. Economic growth is seen as solid, the labour market as strong and inflation as having eased yet remaining elevated. Given the acceleration in inflation momentum since the last FOMC meeting (January and February data) one could have expected a stronger word of caution. This was not the case, which suggests that the Fed does not see the situation materially different now compared to two months ago. Further, the FOMC decided to keep its short-term forward guidance for key interest rates unchanged. This states that "the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably towards 2%". Thus, no rate cut at the next meeting on May 1st is planned.

Anyway, the focus was on the **updated economic projections**, particularly on the expectations for the federal funds rate. The median projection for 2024 remained unchanged, which is three 25 bp rate cuts until year-end, probably starting in June. Yet,

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the distribution has shifted slightly to the hawkish side and for 2025 also the median drifted upwards, suggesting three not four rate cuts (similar to 2026). On other variables, the projection for GDP growth has been revised to the upside, most strongly for 2024 (2.1 instead of 1.4%). Also inflation forecasts have been revised to the upside but this was done rather selectively. The upward revision in PCE core inflation from 2.4 to 2.6% for 2024 is most noticable in that respect. This most likely reflects the higher starting point with higher than expected inflation releases for January and February. Overall, the FOMC's economic projections were in line with our expectations of broadly confirming the outlook from December but also reflecting some hawkish risks.

The **market reaction** can be described as dovish. Treasury yields declined, particularly short maturities, and the US dollar weakened. We see this mainly as a reflection of the market's positioning for hawkish surprises in the days prior to the meeting. While the direction on markets was quite clear for short-term bonds and the currency, the 10-year yield was quite volatile and undecided. The slightly higher view on the Fed's longer-run rate might have been a source for investors being more hesitant to take on duration risk.

As in most FOMC meetings, the **press conference** added important details. Chair Powell described the higher inflation readings of January and February as unpleasant but no cause for panic. The higher inflation prints haven't changed the overall story but rather confirmed that the road to price stability is a bumpy one. Thus, the FOMC sees this as a confirmation to remain cautious after the inflation optimism during the last quarter of 2024 when inflation prints came in below expectations. On the outlook, the Fed needs to gain greater confidence to start cutting rates. On when this greater confidence might be reached, Chair Powell gave not hints, emphasizing the Fed's data-driven / meeting-by-meeting approach. What is worth noting, is that Powell emphasized the labour market a bit more this time. An unexpected worsening in labour market conditions could also cause the Fed to cut interest rates, so Powell. For markets, interest rate volatility will remain high around important inflation and labour market data releases. **We continue to see a first rate cut in June as the most likely scenario.**

On a final note it is important to consider the **balance sheet**. It indeed seems to be that a decision on the balance sheet will be taken earlier than on key interest rates. While the official monetary policy statement kept the same language on the balance sheet rundown (following the pre-announced plan), Chair Powell was quite outspoken that a decision can be expected at the next meeting. The FOMC started its discussion to slow the pace of the Fed's security rundown at this meeting. A decision will be taken "fairly soon", which strongly hints to the next meeting. Topics regarding changes to the balance sheet's composition (shift from MBS to Treasuries or from long-term to short-term maturities) should not be expected (yet). The motivation to slow the pace of QT is to avoid a situation like in 2019 when the supply of reserves turned scarce much earlier than expected. Slowing QT will give the Fed time to monitor markets for signs of scarcity not only in the aggregate but also in the distribution.

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