

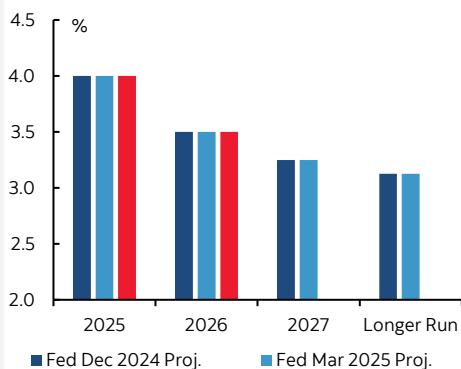
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Chart 1

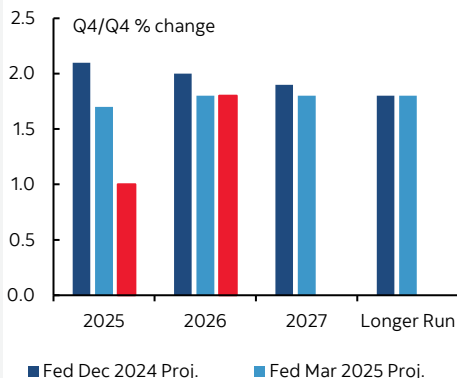
Fed Policy Rate Forecast Comparison



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 19, 2025).

Chart 3

US Real GDP Forecast Comparison



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 19, 2025).

Treasury Yields Mildly Decline on FOMC Taper, Unchanged Rate Guidance, Forecast Updates

- The policy rate was left unchanged as expected and so was forward rate guidance
- Powell also effectively ruled out a cut in May
- Growth forecasts were downgraded, inflation temporarily raised
- The pace of Treasury securities run-off was tapered by \$5B/month
- Powell relies too much on long-term inflation expectations...
- ...and it's too early to tell the effects of tariffs and other policy risks

The FOMC held the policy rate unchanged as widely expected while retaining unchanged guidance on where the rate may go in future. Quantitative tightening was tapered again and uncertainty factored more heavily in revised projections. Markets reacted by pushing the 2-year Treasury yield down 10bps, the 10s yield down 7bps, the S&P500 up a touch, and the dollar is slightly weaker. Markets are still probably somewhat over-pricing fed funds rate moves in my opinion.

The statement is [here](#). The Summary of Economic Projections including the 'dot plot' is [here](#). The NY Fed's accompanying statement explaining the decision to taper Treasury run-off is [here](#). The appendix includes a statement comparison showing changes.

FORWARD RATE GUIDANCE

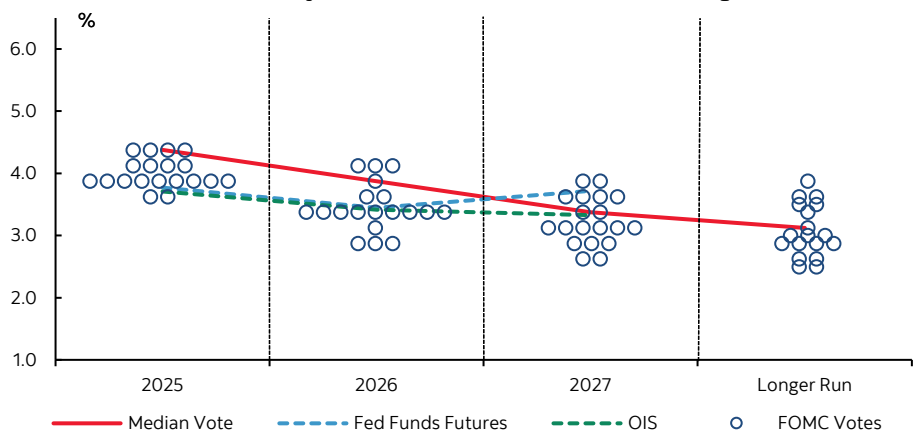
Forward rate guidance was left entirely unchanged as expected (chart 1).

- The median Committee member's projection continues to expect 50bps of rate cuts this year with the upper limit of the fed funds target range ending the year at 4% which is our forecast as well. Markets remain on the fence between 2–3 cuts this year.
- 2026 forward guidance continues to point to another 50bps of cuts in 2026 (again, matching our forecast).
- The 2027 projection is also the same with one cut still shown. The neutral policy rate remains at 3%.

There is a moderate dispersion of opinions around the expected rate path (chart 2). Nine of 19 FOMC members expect 50bps of cuts this year, 4 expect only one 25bps cut, and four expect no cuts while two expect 75bps of cuts. Nine members expect another 50bps next year but with more dispersion around the tails. There is higher dispersion and

Chart 2

March FOMC Projections for the Federal Funds Target Rate



Note: OIS & Fed Fund Futures as of Mar. 19, 2025.

Sources: Scotiabank Economics, US Federal Reserve.

March 19, 2025

uncertainty in 2027 and also around what is the longer-run neutral rate.

When Chair Powell was asked about a potential cut in May, he said "we're not going to be in any hurry to move. We're well positioned to wait for further clarity." That confirms our expectation they will hold at the next meeting. We see the Fed on hold until at least Q3 pending data and the administration's policy changes.

MACRO FORECASTS

Growth forecasts were reduced throughout the projection period (chart 3). The FOMC now expects 1.7% growth this year on their Q4/Q4 convention (2.1% previously), 1.8% in 2026 which is down two-tenths, and 1.8% again in 2027 which is down one-tenth. The long-run potential growth rate is still estimated at 1.8%.

The FOMC's core PCE inflation forecast was revised up by three-tenths to 2.8% this year and left at 2.2% in 2026 and 2% in 2027 (chart 4). Chart 5 shows total PCE inflation forecasts.

The unemployment rate projection was revised up a tick to 4.4% in 2025 and left unchanged at 4.3% in each of 2026 and 2027 with the long-run natural rate still at 4.2% (chart 6). Overall this is a trivial change to UR expectations.

POWELL OVER EMPHASIZES INFLATION EXPECTATIONS

During his press conference, Chair Powell was frequently asked about measures of inflation expectations. He gave the standard answer that he has previously shared, being that shorter-term measures have risen, but longer-run market measures of inflation expectations remain reasonably well anchored (chart 7).

In my opinion, Powell exhibits too much confidence in these measures. Markets thought above-target inflation was the biggest risk throughout the GFC and for years afterward and then in the pandemic thought that long-run inflation was dead in the water. Traders are making blind guesses about what inflation will be in the Fed's preferred measure of inflation expectations 5 years out from now over the ensuing five years.

So are consumers. The UofM gauge shows how unreliable it is when broken down by party affiliation (chart 8). Democrats think Trump is doomed to repeat devastating inflation, while Republicans think there will magically be none at all! This just shows how polarized America is now; beware folks who dismiss one response by political affiliation and not the other as it likely just reveals their own political bias!

THE ROLE OF TARIFFS

There were several questions about tariffs including how much of the upward revision to inflation forecasts this year was due to tariffs and whether the Committee is looking through the tariff effects on inflation as transitory. Powell said this:

"It is going to be very difficult to have a precise assessment of how much is coming from tariffs. Goods inflation moved up this year but it's very challenging to trace it back to non-tariff inflation versus tariff inflation. In terms of looking through, it's too soon to say that. Sometimes

Chart 4

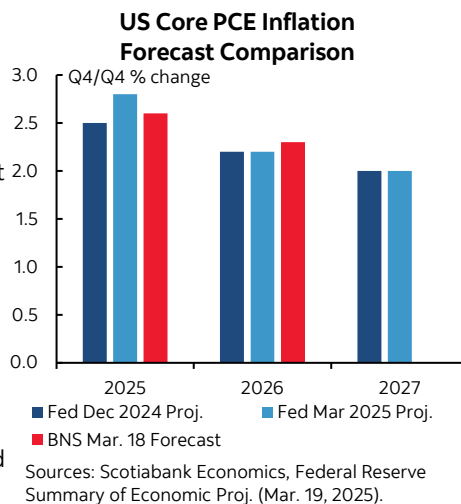


Chart 6

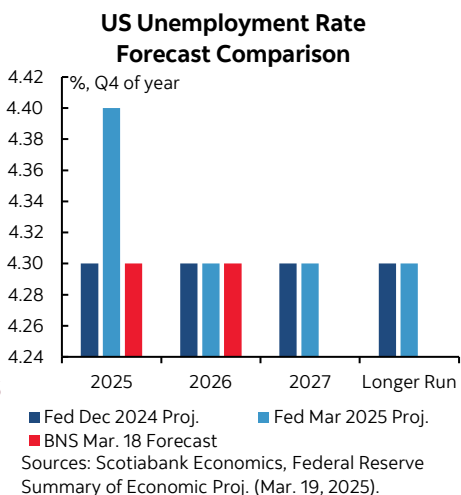


Chart 5

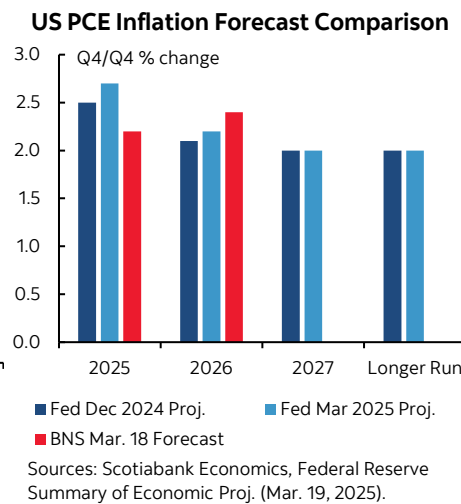


Chart 7

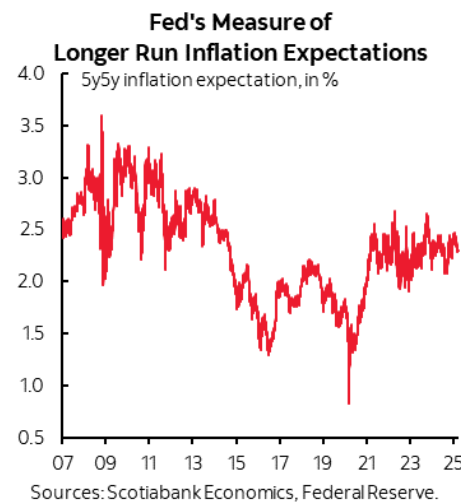
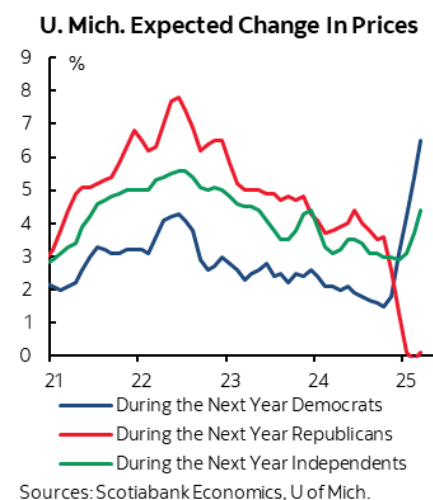


Chart 8



March 19, 2025

it's appropriate to do that. That would depend on tariff inflation moving through pretty quickly and longer-term inflation expectations being well anchored."

He went on to note that "We were getting closer and closer to price stability but we were not at that. The arrival of further tariff inflation could delay this. The forecast does show us getting into the low 2s further out." And so the message is that for now they are erring on the side of caution by raising inflation and becoming more patient on timing further easing.

I would add several caveats to Powell's response. For one, don't put much stock in the Committee's longer-run expectation that inflation will be anchored at 2%. Central bankers always say that. To show otherwise is admitting in advance that they fully expect to foul up and don't plan to do anything whatsoever about it!

For another, we haven't had enough information on tariffs yet. We don't know how much will truly be implemented and for how long and the degree of retaliation. Trump et al are simply far too volatile.

For another, while Powell cited past experience that inflation from tariffs was transitory, the effects depend on your starting point which today is marked by excess demand. They also depend on the degree and forms of retaliation, whether they are one-off adjustments or unfold in serial, spiralling fashion, the degree of pre-existing ongoing supply chain problems, how workers react etc. Also key in the US case is the sheer enormity of the domestic economy that is much less trade reliant than other industrialized economies and not to mention how the wild mixture of other Trump administration policies may unfold and interact with tariffs.

STATEMENT CHANGES

There were three main changes to the statement itself (see appendix) but also interesting is what could have changed but did not.

- The second paragraph flags the Committee's view that "Uncertainty around the economic outlook has increased." That should surprise no one based on the Trump administration's volatility so far this year.
- The third paragraph flags a change to quantitative tightening parameters I'll come back to.
- The final change was the Governor Waller dissented against the Committee's decision because he "preferred to continue the current pace of decline in securities holdings." It's uncommon for a Governor to dissent.

What could have changed, but did not, was the opening sentence that still describes economic growth as proceeding "at a solid pace." The clear signal is that—at least for now—the Committee is looking through Q1 weakness including the Atlanta Fed's 'nowcast' that currently shows a -1¾% contraction.

TAPERED QUANTITATIVE TIGHTENING

The pace at which maturing holdings of Treasury securities is allowed to roll off the Federal Reserve's balance sheet has been reduced by \$5 billion effective next month. The statement said "Beginning in April, the Committee 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. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at \$35 billion."

Governor Waller dissented because he didn't want to change QT parameters. It's uncommon for a Governor to dissent.

Chair Powell's press conference explained the reasoning for reduced Quantitative Tightening by saying "we have seen some signs of increased tightness in money markets."

He went on to say that "we still think reserves are abundant" and the Treasury General Account is emptying out so reserves are higher and we can't see the underlying signal. The decision has no implications for monetary policy, it's not sending a signal in any hidden way. It's very consistent with the principles we laid out on how QT would unfold, and it's the second time we slowed the pace."

When asked whether the Committee envisions tapering MBS run off, Powell basically said no. He said "There is no plan to do that. We haven't made any decisions about that. We want the MBS to roll off our balance sheet. We really strongly desire that." That's in reference to the goal of multiple central banks to get back to a more normal composition of their balance sheets

When it was pointed out to Powell that the minutes to the last meeting indicated that slowing the pace of QT could be temporary until the debt ceiling is resolved but that this doesn't seem to be the communication now, Powell said "People really came to be strongly in favour of slowing. It was the TGA flows that got us thinking about this. The original discussion was about the debt ceiling but it's really broader than that and consistent with our principles and plans. It's a common sense adjustment to slow down a little bit again."

RELEASE DATE: March 19, 2025

Recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ***Uncertainty around the economic outlook has increased.*** The Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. ***Beginning in April, the Committee 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. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at \$35 billion.*** The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Adriana D. Kugler; Alberto G. Musalem; and Jeffrey R. Schmid. ***Voting against this action was Christopher J. Waller, who supported no change for the federal funds target range but preferred to continue the current pace of decline in securities holdings.***

RELEASE DATE: January 29, 2025

Recent indicators suggest that economic activity has continued to expand at a solid pace. ***The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.***

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

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