MONETARY AFFAIRS:

Review: FOMC Keeps Rates Unchanged,

US War-Related Uncertainty Looms Large

by

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Executive Summary

- **Decision Made**: *The Fed kept US interest rates unchanged in March.* The FOMC kept its target Fed funds range at 3.50% - 3.75%. The Fed maintained its data-dependent approach. The FOMC remained divided: Powell and ten members supported the move, while Miran pushed for a 25 bp cut. On *forward guidance*, future decisions will be data-dependent and made meeting by meeting, not on a preset path. The Fed will continue to buy US Treasury Bills and short-term bonds "to maintain an ample level of reserves".
- **Policy Discussion**: *The Fed faces a difficult balancing act, with labor market weakness pointing to rate cuts while inflation risks argue for keeping policy tight.* Powell stressed the Fed is near the upper end of its neutral rate or the lower end of moderately/modestly restrictive policy and that any easing is not guaranteed, remaining dependent on further inflation progress. Rising oil prices from the Iran conflict have added inflationary pressure while weighing on growth, creating a classic policy trade-off. Although inflation is still expected to ease over time, the process is slower and more uncertain. The U.S.'s role as a net energy exporter may partly offset the shock, but only if higher prices persist and drive increased production.

  Powell rejected "stagflation" concerns, noting that unemployment remains near normal and inflation only modestly above target, with stronger growth supported by productivity gains. Meanwhile, political pressure has intensified. Trump has pushed for rate cuts and nominated Kevin Warsh as a more dovish successor. A legal dispute over the Fed's headquarters has further complicated matters, with Powell pledging to remain in his role until the investigation concludes and a successor is confirmed.
- **Changes to Economic Forecast:** *The dot plot points to one rate cut this year and another in 2027, though timing remains unclear, with seven of 19 participants now expecting no cuts this year.* The median path still sees rates settling around 3.1% over the longer term. Uncertainty from the Iran conflict—particularly risks to oil supply via the Strait of Hormuz—has kept inflation elevated and led markets to scale back expectations from two cuts to at most one in 2026. Higher oil prices have further complicated the outlook, with inflation above target even as the labor market softens. The Fed now expects GDP growth of 2.4% this year and 2.3% in 2027(a 0.1% and a 0.3% increase respectively from the December projections, given to expected productivity gains). Inflation is projected at 2.7% (up from 2.4% in December) this year before easing toward 2%, while unemployment is still seen at 4.4% by year-end despite weak payroll data.

Key Picture: US Federal Reserve Forecasts – 2025-2028

	2026*f*			2027*f*		2028*f*		Longer Run	
	Latest Reading	March Report	December Report	March Report	December Report	March Report	December Report	March Report	December Report
GDP *(real growth, y-o-y)*	2.0	2.4	2.3	2.3	2.0	2.1	1.9	2.0	1.8
Unemployment rate *(%, y-o-y)*	4.4	4.4	4.4	4.3	4.2	4.2	4.2	4.2	4.2
PCE Inflation *(%, y-o-y)*	2.8	2.7	2.4	2.2	2.1	2.0	2.0	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	3.1	2.7	2.5	2.2	2.1	2.0	2.0	-	-
Federal Funds Rate *(%)*	3.75	3.4	3.4	3.1	3.1	3.1	3.1	3.1	3.0

Source: Federal Reserve '*Summary of Economic Projections' March 2026 and December* 2025. *Note:* 1. GDP reading for Q4-2025; 2. Unemployment rate as of February 2025; 3. PCE and core PCE inflation as of January 2026; 4. Projections reflect the median of FOMC projection

Analysis

- **DECISION MADE**: *On March 18, the US Federal Reserve's kept its Fed funds range at 3.50% - 3.75%.* The FOMC was divided: Powell and 10 others voted for the policy; voting against the action was Stephen Miran, who favored a 25-basis-point rate cut. This marked Miran's fifth straight dissent, while Waller returned to vote with the majority after his dissent on January.

  Since September 2025, the policy rate was reduced by 75 basis points, bringing it into a range consistent with estimates of neutral. The committee made only minor revisions to its economic outlook in the post-meeting statement, projecting slightly stronger growth and higher inflation for 2026.

  Regarding *forward guidance*, the Fed continues to be data-dependent with decisions being made meeting by meeting. The post-meeting statement reused language from last year's FOMC communication. It said: "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".

  Regarding *balance sheet policies*, the Fed said it will sustain ample reserves through Treasury bill purchases, roll over maturing securities, and keep the primary credit rate at 3.75%.

- **POLICY DISCUSSION:** *Powell said the Fed faces a difficult balancing act, with downside risks to the labor market arguing for rate cuts, while upside inflation risks suggest keeping policy tight.* Despite heightened uncertainty, officials still signal limited easing ahead. During the press conference, he noted that the Fed is effectively at a borderline, near the lower end of restrictive policy, requiring careful weighing of both risks before making any move. He also made clear that rate cuts are not guaranteed. Although projections suggest further easing, any cuts will depend on inflation continuing to decline; if progress stalls, the Fed is likely to hold rates steady.

  The Fed faces a renewed inflation risk stemming from the Iran conflict, primarily through higher oil prices and supply disruptions in the Middle East. Powell noted that short-term inflation expectations have already risen, signaling that energy-driven price pressures are feeding into the broader outlook. Longer-term inflation expectations have remained broadly unchanged. While inflation is still expected to ease over time, partly as tariff effects fade, the pace of disinflation is slower than anticipated, and uncertainty remains elevated. At the same time, the oil shock introduces a classic policy trade-off. Higher energy prices are likely to push inflation up while weighing on growth, as rising costs dampen household spending and labor market conditions. This complicates the Fed's policy path, as tightening risks exacerbating the slowdown, while easing could entrench inflation.

  However, Powell emphasized that the U.S.'s position as a net energy exporter provides a partial buffer. Higher oil prices could support domestic energy investment, profitability, and potentially output. Still, any supply response will depend on whether firms view the price increase as persistent, limiting the extent to which this channel can offset the broader negative demand effects.

  Powell dismissed comparisons to stagflation, arguing the US economy is far from the severe conditions of the 1970s. He noted that unemployment remains near normal levels and inflation is only modestly above target. While the Fed has raised its inflation forecast, it has also upgraded growth expectations, which Powell attributed to anticipated productivity gains.

  President Donald Trump has intensified pressure on the Fed to cut rates, criticizing Chair Powell for not calling an emergency meeting despite elevated inflation and war-related uncertainty. Powell, whose term ends in May, may be nearing his final meetings, with former Governor Kevin Warsh nominated as his successor and seen as more dovish. Tensions have escalated further due to a legal dispute, as the Justice Department subpoenaed Powell over the Fed's headquarters renovation. Powell resisted, calling it political pressure, and a judge dismissed the case—though an appeal is planned. Meanwhile, Senator

Thom Tillis has threatened to block Warsh's confirmation until the issue is resolved. Powell said he intends to remain as Fed chair until the investigation into the central bank's headquarters is fully resolved and will stay in place until a successor is confirmed. He added that he has not yet decided whether he would continue serving as a governor afterward, noting that the decision will depend on what he believes is best for the institution and the American people.

Asked whether he would agree with Warsh's assessment that AI may cause productivity gains that may warrant rate cuts now, Powell actually argued the opposite: in an initial phase, the construction of data centres may put a stress on resources causing higher inflation, not lower. In a subsequent phase, if AI does increase productive capacity, this may lead to a dis-inflationary phase that may translate in rates being held kept lower than otherwise.

- **CHANGES TO ECONOMIC FORECASTS**: *The "dot plot" points to one rate cut this year and another in 2027, though timing remains uncertain.* Compared to January, the FOMC statement, says that the unemployment rate has been "little changed in recent months" (vs "has shown signs of stabilisation"). And also a sentence on the uncertainty around the implications of the war in the Middle East was introduced. Of the 19 FOMC participants, seven now expect no cuts this year—one more than in December. While projections vary, the median path sees rates settling around 3.1% over the longer term. The Fed also flagged uncertainty stemming from the Iran conflict, with risks to oil supply via the Strait of Hormuz keeping inflation elevated. Reflecting this backdrop, markets have scaled back expectations from two cuts to at most one in 2026, following higher oil prices and persistently firm inflation data.

  The recent oil price spike, driven by the Middle East conflict, has complicated the Fed's outlook, with inflation still above its 2% target even as the labor market softens. In updated projections, Fed officials now expect GDP to grow 2.4% this year, slightly faster than in December, and 2.3% in 2027, marking an upward revision mostly due to expected efficiency / productivity gains. They also raised their inflation forecast, with both headline and core PCE seen at 2.7% this year, before easing back toward the 2% target in coming years as tariff and war-related pressures fade. The unemployment rate is still projected at 4.4% by year-end, despite recent weak payroll data.

- **ECONOMIC ASSESSMENT:** *The economic impact of the Middle East conflict remains uncertain*. Higher energy prices may lift inflation in the near term, but the scale and duration are unclear. Economic activity continues to expand at a solid pace, supported by resilient consumer spending and steady business investment, though housing remains weak. The Fed now expects GDP growth of 2.4% this year and 2.3% next year, slightly stronger than in December.

  The labor market is stable but softening. Unemployment stands at 4.4% and is expected to remain around that level, with slower job growth partly reflecting weaker labor force expansion due to Trump's immigration policies. Other indicators, job openings, hiring, layoffs, and wage growth, show little recent change.

  Inflation has declined from its 2022 peak but remains above target. PCE inflation is running at 2.8% (3.0% core), partly driven by tariffs and rising oil prices linked to Middle East tensions. The Fed expects inflation at 2.7% this year and 2.2% next year, with long-term expectations still anchored near 2%.

- **OUR TAKE:** *Fed on hold in May, and most likely in June as well.* Powell clearly looked relieved from the results of the judicial case brought against him and quite relaxed for the continuation of the investigation, which will likely result in a no further action. Actually, things played in his favour, because the appeal requested by the DOJ has stopped the confirmation process of Kevin Warsh, which meant that Powell may remain as pro-tempore Chair for longer, if that process is not concluded by May 15th (which is unlikely). He also didn't rule out to remain in the board of governors after the end of his tenure as a Chair. For that reason, during the press conference he made a number of jokes that the journalists clearly appreciated.

Desguised in central bank lingo, a not-so-veiled criticism to Trump's policies emerged: Powell said that the one thing that the Fed will look at over the coming year is "goods price inflation," to observe what happens to inflation when the price-level impact of tariffs will be washed out of the calculation. So, he pointed at tariffs as the one reason why the Fed has not yet achieved its goal on price stability. On maximum employment, he said that the Trump's immigration policies have caused job growth to be "net zero", which is the right balance when job supply has diminished, for "the first time in [US] history", but that would suggest downside risks to employment.

Finally, the war in the Middle East has caused such an increase in uncertainty that a number of FOMC participants would have happily skipped this round of forecasts (journalists giggled). So, in his own diplomatic language, Powell managed to criticize all the key pillars of Trump's policies (tariffs, immigration and war in the Middle East) and indicate them as the reason why the Fed can't easily achieve its dual mandate, which is complicated by the fact that these are all self-inflicted supply-side shocks, which accompany the genuine exogenous shocks, such as the pandemic and the war in Ukraine.

Coming to monetary policy, this means that his views may be maintained for longer: no action in March, May and – most likely – June if Warsh is not confirmed (and actually, even if he's confirmed). The earliest meeting in which a cut may occur is in September, assuming that inflation expectations are anchored and economic activity has fallen. In the opposite case, one cannot rule out a rate hike (and Powell didn't) – it would be ironic if it was Warsh to be forced to hike rates, when he was chosen specifically to cut them. And – *a fortiori* – if this action was caused by Trump's policies on war, tariffs and immigration.

- **MARKET REACTION AND IMPLICATIONS:** *The Federal Reserve delivered a hawkish hold*, with most officials now expecting only one rate cut in 2026, well below earlier market expectations, which had priced in around 60 basis points of easing by mid-February. *In the fixed-income space,* the 10-year yield climbed over 3 bp to 4.26%, the 2-year rose about 6 bp to 3.75%. *In the currency space,* the US dollar index hovered around 99.8. EUR/USD slipped around 0.2%. *In the equity space,* the stocks fell to session lows after Powell said inflation progress has been weaker than expected. The Dow dropped over 714 points (1.5%), reaching a new low for the year, while the S&P 500 and Nasdaq each declined about 1.2%.