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Economic INSIGHT

Federal Reserve Reiterates *"Solid"* Economy, Base Case *"Transitory"* Fiscal Policy Impact

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As expected, the Federal Reserve (Fed) opted to keep rates unchanged at the March Federal Open Market Committee (FOMC) meeting for the second consecutive month in a range of 4.25% to 4.50%. Widely anticipated to hold policy steady after moving to the sidelines in January, the accompanying statement this week indicated a consistently solid assessment of current conditions. Furthermore, with the expectation for recent heightened uncertainty and disruptions resulting from fiscal policies likely to be temporary in nature, the Committee remains optimistic it can – and should – provide additional policy relief by year-end and achieve its longer-run goal of price stability over the medium term.

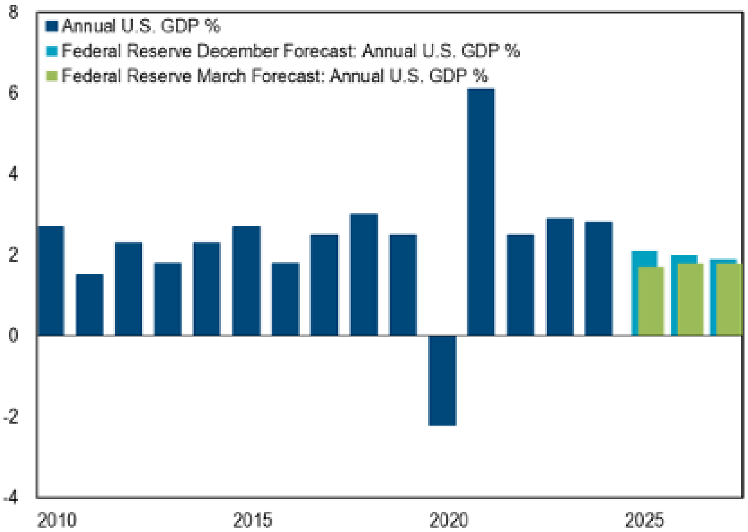
POLICY AND BROAD-BASED ASSESSMENT STEADY

After cutting rates a total of 100 basis points (bps) from September to December last year, the Fed opted to move to the sidelines in January. This month, amid growing uncertainty and ample unknowns surrounding a plethora of Washington policy initiatives, the Fed again elected to maintain its *"wait and see approach,"* keeping rates steady at an upper bound of 4.50%.

The accompanying statement reiterated a relatively positive characterization of the current economy; however, the updated Summary of Economic Projections (SEP) underscored ongoing risks and *"uncertainties"* likely to weigh on the consumer, retard the realized level of growth and activity, and boost inflation, at least in the near term.

"While there have been recent developments in some of these areas, especially trade policy, uncertainty around the changes and their effects on the economic outlook is high." – March 19 FOMC Press Conference

According to the March FOMC statement, at least in hindsight, the U.S. economy continues to expand at a *"solid pace,"* but indications of waning momentum have emerged. Following a 2.8% growth rate in 2024, the Fed now forecasts a slower but still positive pace of activity near 1.7% for 2025. Such a reduction in topline activity from a previous forecast of 2.1% as of December is driven by a pullback in the consumer, as households adjust spending patterns lower amid elevated prices and the anticipation

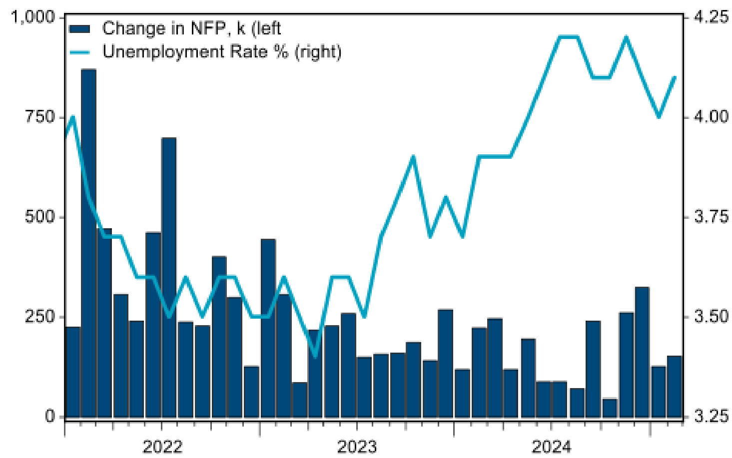


Source: Bloomberg/Federal Reserve

of further cost increases. While still spending on goods and services, the average household has curtailed expenditures with consumption off 0.2% in January, following a more robust gain of 0.8% at the end of 2024.

"Recent indications, however, point to a moderation in consumer spending following the rapid growth seen over the second half of 2024."
– March 19 FOMC Press Conference

Despite the rising anxiety of consumers and businesses, however, the March FOMC statement noted hiring activity remains *"solid"* with the unemployment rate *"stabilizing"* at a low level. Losing momentum from a 323,000 rise in December, the strongest monthly gain since January 2023, a combined total of 276,000 new payrolls have been created in 2025, keeping the three-month average near 200,000. Furthermore, the jobless rate remains stubbornly low, near 4%, as it has since the start of 2022, the jobs-to-workers gap has held *"steady"* since October, and real wage growth remains positive. While there has been some increased volatility in the employment figures reflecting recent weather-related traumas and at least in part an effort by the White House to adjust immigration flows, reduce the number of federal employees, and sever government contracts, the current trend of payroll growth remains on par with the expansionary pace of the previous three cycles.



Source: Bureau of Labor Statistics/Haver Analytic

"Overall, a wide set of indicators suggests that conditions in the labor market are broadly in balance. The labor market is not a source of significant inflationary pressures."
– March 19 FOMC Press Conference

INFLATION UNCERTAINTY

On the inflation front, the Committee openly acknowledged the further progress still needed to reinstate price stability. While noticeably down from earlier peak levels,

GLOSSARY

CPI – Consumer Price Index

EOP – End of Period

FOMC – Federal Open Market Committee

GDP – Gross Domestic Product

MBS – Mortgage-Backed Securities

NFP – Nonfarm Payrolls

PCE – Personal Consumption Expenditures

PPI – Producer Price Index

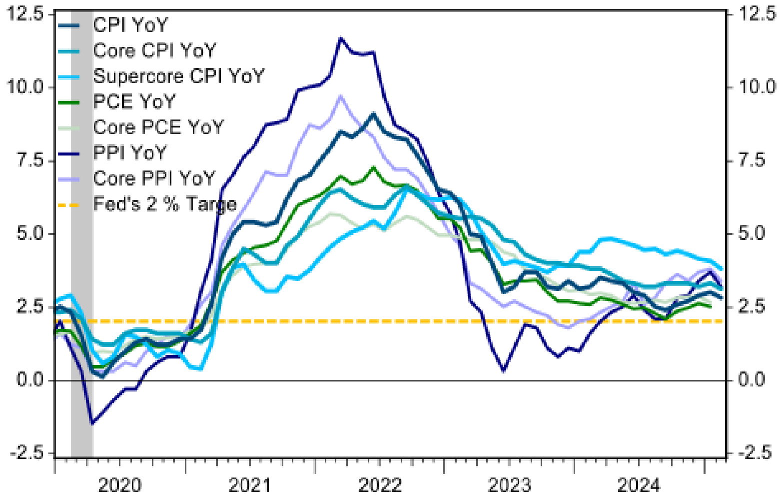
SAAR – Seasonally Adjusted Average Rate

SEP – Summary of Economic Projections

UST – U.S. Treasury

YoY – Year over Year

inflation remains *"somewhat elevated,"* the March FOMC statement reads, omitting any suggestion of "progress" towards the Committee' 2% goal for the second consecutive meeting. The latest inflation reports were encouraging with both the Producer Price Index and Consumer Price Index cooling more than expected in February, following a welcome decline in the January Personal Consumption Expenditures, negating the need for a more hawkish sentiment emphasizing further limited improvement. Nevertheless, nominally still elevated near 3%, after several months of acceleration, a minimal one month's reduction does little to quell fears of further upside price risks or instill confidence in reestablishing a sustained disinflationary trend.



Source: BLS, BLS/H, BEA/Haver

Fed Chairman Jerome Powell, however, made clear during the press conference that inflation expectations *"remain well"* anchored, at least in the longer run. He attributes much of the recent uptick in near-term price forecasts, including a 140 basis points jump in consumer inflation expectations since the start of the year, to the uncertainty and unknowns surrounding tariffs, as opposed to a changed assessment based on realized price increases. The real impact, Powell noted, will likely prove *"transitory."* Quantifying the potential short-lived disruptions from fiscal policy initiatives, the Summary of Economic Projections (SEP) showed an increased forecast for headline inflation from 2.5% to 2.7% and the core from 2.5% to 2.8% in 2025. The longer-term outlook, meanwhile, was little changed from the December forecast with headline and core inflation both projected at 2.2% for 2026 before reaching the coveted 2% target in 2027.

"It can be the case that it's appropriate sometimes to look through inflation if it's going to go away quickly without action by us, if it's transitory. And that can be the case in the case of tariff inflation." – March 19 FOMC Press Conference

The last time the Fed assessed price pressures as *"transitory"* was during the Covid era. At that time, the Fed arguably underappreciated how engrained price increases were becoming in the economy, resulting in an elevated level of costs that consumers and businesses are still contending with today. Thus, despite the Committee's optimism to the contrary, longer-term upside inflation risks remain.

POLICY GOALS AND RISKS

In pursuing the goals of maximum employment and stable prices, the Committee noted it will remain *"attentive to the risks to both sides of its dual mandate."* Removing language that such risks *"are roughly in balance,"* the statement instead underscored a rising level of *"uncertainty."* As noted in the January FOMC meeting minutes, a number of officials pointed to the latest fiscal policy agenda as a specific source of uncertainty both for the consumer and inflation as well as the pathway for monetary policy.

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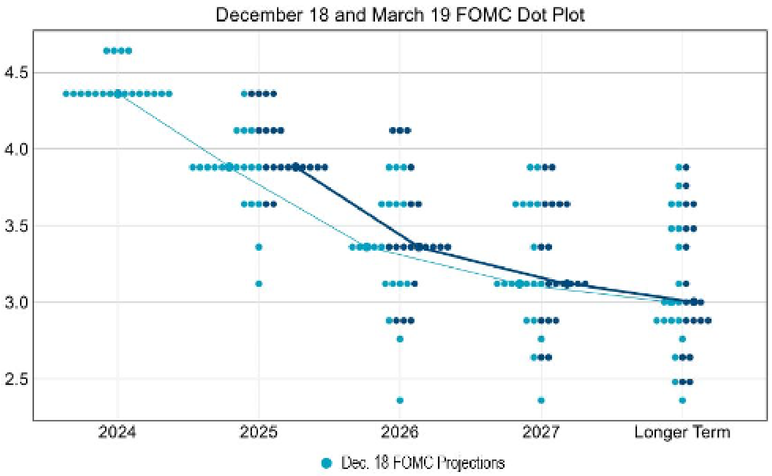
"Members viewed the economic outlook as uncertain and agreed that they were attentive to the risks to both sides of the Committee's dual mandate."

– January 28-29 FOMC Meeting Minutes

Amid opposing forces of potential emerging weakness in the broader economy and upside risks of rising price pressures, the Committee maintained a relatively steady outlook for policy through the next several years, unchanged from the December outlook. Based on the latest dot plot, the majority of Committee members continue to anticipate two rate reductions by year-end, potentially moving policy closer or into *"neutral"* territory. Alternative forecasts this month, meanwhile, were more compressed towards the hawkish end of the spectrum. In December, for example, five officials anticipated more than two cuts in 2025, now there are only two. Alternatively, only one member anticipated no further adjustment to rates in the current year as of December, while the March plot shows four members now anticipate policy potentially on hold through year-end.

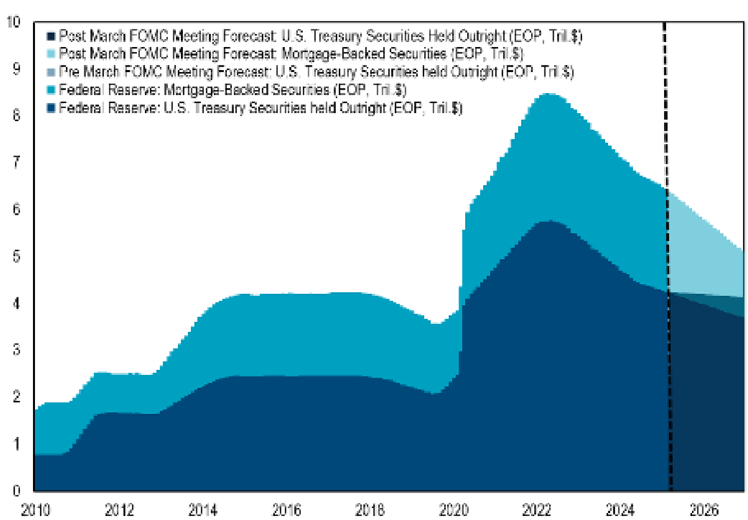


Source: Bloomberg

Of course, policy is not on a preset course and will continue to evolve as the data unfolds and the Committee is better able to assess the realized impact of fiscal policy initiatives, particularly tariffs. Nevertheless, the Fed maintains it may be appropriate to provide at least some further policy relief in the coming quarters.

ADDITIONAL ADJUSTMENTS IN POLICY

As foreshadowed in the January FOMC meeting minutes, the Fed opted to slow the pace of roll off from the balance sheet this week, reducing the cap on monthly U.S. treasury reductions from $25 billion to $5 billion, while maintaining the cap on mortgage-backed securities at $35 billion. Largely a reflection of the growing uncertainty in the marketplace regarding fiscal policy as well as the federal government's handling of the balance sheet, and the lack of a clear measure to gauge liquidity in the



Source: Federal Reserve/Haver Analytics/Stifel marketplace, Fed members voiced concerns about allowing reserve balances to get *"too low."* Thus, in anticipation of a resolution to the debt ceiling debate eventually coming to fruition sometime mid-year and as a result, prompting a – potentially sizable – adjustment in Treasury issuance, the Fed appears to be taking an *"out of the way"* approach. Powell described the decision as a *"technical"* and *"common sense"* move with few implications for the broader pathway or intent of monetary policy.

Support for erring on the side of caution and slowing the pace of runoff sooner than later, however, was not unanimous; Fed Governor Christopher Waller dissented in favor of holding steady the current pace of securities runoff.

CONCLUSION

While the Fed remains relatively optimistic about current economic conditions, it is wary of some potential headwinds, particularly those stemming from fiscal policy initiatives. Despite those concerns, the majority of policy makers appear convinced that any disruption to economic activity will be temporary and a disinflationary trend will resume sooner than later, hence justifying at least some further easing by year-end.

That being said, the Committee has proven relatively resilient in its longstanding outlook for inflation to retreat back to 2% without success, at least as of yet. Thus, while some investors fear potential weakness, and as a result have increased bets of additional rate cuts coming down the pipeline potentially as early as June, others are justifiably concerned policy makers may again be neglecting the appropriate action needed to ensure a return of price stability. In fact, when asked if the Fed was willing to heed the lessons from the 1970s and risk a recession to *"break the back of inflation,"* Powell simply responded "fortunately," we are not facing that difficult decision.

"… *I don't see any reason to think that we're looking at a replay of the '70s or anything like that. You know, inflation, underlying inflation is, you know, still running in the twos, with probably a little bit of a pickup associated with tariffs. So, I don't think we're facing, I wouldn't say we're in a situation that's remotely comparable to that.*"

– March 19 FOMC Press Conference

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