MARKET
SIGHT*LINES*

The Fed Holds Rates Steady As Financial Conditions Tighten And Markets Further React to the Conflict

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March 20, 2026

Last week, we shared **four possible scenarios** on how the **2026 U.S./Israel-Iran conflict** may progress from here. In past times of trouble, when markets have reacted, the Federal Reserve has stepped in to lower rates and provide other support to help in a more fragile environment. But the Fed met this week and left its policy unchanged, so no support just yet. This isn't surprising, since one element of the Fed's dual mandate is reasonable prices – or lower inflation – and its restrictive policy is designed to help with that problem, which is being aggravated by energy prices. But even as the meeting came to a close, oil prices jumped further in response to attacks on energy infrastructure, and equity markets declined. In this Sight|Lines, we discuss the key learnings from this month's Fed meeting, provide an update on the fast-moving markets responding to real-time military actions, and discuss the implications of these for future Fed policy.

THE TAKEAWAY: THE FED STANDS PAT BUT DISCUSSES RATE CUTS … OR HIKES, AS CONFLICT IMPACTS MARKETS

The Fed leaves policy rates unchanged but considers looser and more restrictive policy, even as attacks shake the energy and stock markets. In summary:

- The Fed left its policy rate unchanged, acknowledging increased uncertainty around the Middle East conflict.
- The Fed's Summary of Economic Projections (SEP) signaled expectations for higher inflation, yet higher economic growth and varying views on future monetary policy.
- As the Fed concluded its March meeting, the conflict in the Middle East escalated, with increased attacks from both sides on energy infrastructure in the region.
- Energy prices have risen since the start of the conflict, and they are rising further given these recent attacks.
- U.S. stocks, which had been resilient through much of the conflict, have declined some as attacks increase.
- Non-U.S. stocks, areas that are more dependent on Middle East oil, have declined further since the conflict began.
- Other closely watched measures, like the VIX Index, have increased as well.
- Financial conditions have tightened some this month, signaling some stress on parts of our financial system.
- Attacks on energy infrastructure are more serious, as rebuilding will take time and delay supply recovery.
- Traders of Fed funds futures are no longer pricing in any chance of a Fed rate cut in 2026.
- The Fed may have limited tools to help with rising inflation and worsening economic conditions.

IN-DEPTH: THE FED LEAVES POLICY UNCHANGED BUT DISCUSSES THE POSSIBILITY OF RATE CUTS OR RATE HIKES IN THE FUTURE, AS THE CONFLICT CONTINUES TO IMPACT MARKET CONDITIONS IN REAL TIME

The Fed takes no policy action at its meeting but discusses potential rate cuts and rate hikes as geopolitical conflict drives energy prices higher and stocks lower. Going deeper:

- The Fed took no action at its March meeting, but it acknowledged increased uncertainty around the Middle East conflict:
  - The Fed maintained its target range for the federal funds rate at 3.50%-3.75%.
  - In its statement, the Fed said the "implications of developments in the Middle East for the U.S. economy are uncertain."

- The Fed updated its SEP, which offers insights into the thinking of individual Fed officials:
  - The median view for 2026 PCE inflation increased to 2.7%, from 2.4% in December, likely reflecting higher energy costs.
  - The median view for changes in real GDP in 2026 increased from 2.3% in December to 2.4%.
  - The Fed dot plot shows seven officials expect the funds rate to end the year unchanged, seven officials expect one quarter-point cut, and five officials see more cuts, with one of those forecasting cuts totaling 1% by year end.

- As the Fed concluded its March meeting, the Middle East conflict escalated with increased attacks on energy infrastructure:
  - Israel struck Iran's South Pars gas field, which is Iran's largest natural gas processing facility.
  - Iran then attacked Qatar's Ras Laffan facility, home to the world's largest liquefied natural gas (LNG) export plant.

- Key market measures impacted by the conflict have reacted further to these infrastructure attacks, and this month:
  - Brent Crude and TTF LNG, Europe's sources of energy, have jumped 42% and 63%, respectively, since the conflict began (February 28) through this Tuesday.
  - Since then, Brent Crude and TTF LNG have risen an additional 5% and 20%.
  - The non-U.S. MSCI EAFE Index fell -7.2% from the start of March through Tuesday, and another -2.3% since then.
  - U.S. WTI Oil and LNG rose 44% and 6%, respectively, through Tuesday. Since then, WTI has fallen -0.1% while LNG has risen 4.4%, a more muted response to the escalation compared to Europe.
  - The S&P 500 Index fell -2.3% from the end of February through Tuesday, and another -1.6% since then.
  - The VIX Index, a measure of stock market volatility, was up 12.6% through Tuesday, and another 7.5% since then.

- The Bloomberg Financial Conditions Index fell -0.175 this month through Tuesday, and another -0.088 since then:
  - The month-end level of 0.504 and current level of 0.242 still represent modestly loose financial conditions.

WHAT WE THINK

The Fed left monetary policy unchanged, while acknowledging the heightened uncertainty stemming from the ongoing conflict in the Middle East. The situation has created volatility in both energy and capital markets, with escalating attacks on energy infrastructure amplifying market reactions. Energy costs have risen meaningfully in the U.S., and even more so abroad – particularly in Europe given its reliance on Middle East oil and LNG. Equity markets have seen increased volatility in the U.S. and more pronounced declines in non-U.S. markets. Market expectations for monetary policy have shifted as well, with investors now pricing out rate cuts this year as inflation risks tied to energy move higher. This leaves the Fed navigating a familiar tension: rising inflation expectations argue for maintaining restrictive policy, while heightened geopolitical stress and potential growth risks could, over time, warrant a more accommodative stance. How policy evolves will depend on which of these forces proves more persistent in the months ahead.

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