

At the March meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds policy rate unchanged at the current range of 4.25-4.50%. There were no dissents on that issue.

The formal statement showed a removal of language that “risks to achieving its employment and inflation goals are roughly in balance,” to a slightly downgraded “uncertainty around the economic outlook has increased.” Qualitative tightening was also cut (reducing the monthly redemption cap of Treasury bond roll-off from \$25 bil. to \$5 bil., although the \$35 bil. roll-off rate for agency mortgages was kept, with a desire of the Fed to further exit the mortgage market). The QT question did end up with one dissent, from FOMC member Waller, who voted to continue the prior pace.

The quarterly Summary of Economic Projections (SEP) with input from all FOMC members (aka the ‘dot plot’), showed an assumed median year-end 2025 Fed funds rate of 3.9% (unchanged from December), 3.4% for 2026, 3.1% for 2027, and an unchanged long-term rate estimate of 3.0%. In other recent comments, Fed members have described the current rate as at least moderately ‘restrictive,’ which implies a continued bias towards easing if/when possible and/or needed. That latter condition is the crux of today’s uncertainty about Fed policy.

CME Fed funds futures began the year with one assumed rate cut for 2025, consistent with an environment of moderate economic growth and easing inflation—but no sharp slowdown. In recent weeks, with heightened uncertainty around the administration’s tariff policies and potential negative implications for both inflation and growth, odds have vacillated but still don’t show high odds of sharper recession-driven easing. For June, markets assume one cut to 4.00-4.25%, and one more by December to 3.75-4.00%. The furthest-out estimate, December 2026, shows two cuts for next year as well, getting to a 3.25-3.50% range. If that soft landing pace holds true, the Fed would be able to ease the rate back towards its long-term rough target fairly slowly.

Economy. In the Fed’s SEP, estimated median 2025 GDP growth was downgraded substantially to 1.7% (from 2.1% in December), 1.8% for 2026 (from an earlier 2.0%), 1.8% for 2027, and an unchanged 1.8% trend rate for the long-term. The Atlanta Fed GDPNow real-time indicator reversed from above-trend growth in the positive 2-3% range early in the year to the most recent contractionary -1.8% reading for Q1. Are we on the cusp of a recession? While the personal consumption growth anchor has indeed slowed, other elements have remained positive, with the overwhelming detractor being a sharp drop in net exports (contributing a -4% to the total growth number). Some of this was no doubt caused by a flood of imported industrial supplies (jumping the gun on possible tariffs), but also the expatriation of European gold into U.S. vaults for the same reason. However, shifting gold storage between different countries isn’t ‘producing’ anything to the degree suitable for inclusion in GDP, so the official government report will likely reflect that nuance. That aside, other indicators and estimates from a variety of private economists do show some reductions from the faster pace of recent quarter, but only to a rough range of 1-2% growth. That lies a bit below the long-term trend but still doesn’t point to recession as of this moment. On the downside, there are less optimistic leading indicators, such as very poor consumer sentiment (tied to politics and tariffs), that could weigh on prospects looking ahead to Q2 in a few weeks. Much of this remains ‘soft’ data that the Fed no doubt considers but isn’t yet reflected as ‘hard’ numerical data.

Inflation. Headline CPI decelerated by several tenths to 2.8% for the trailing year ended in February, as did core CPI ex-food and energy to 3.1%. Core PCE has also shown improvement but continued to run above-target at 2.6% for January. The Fed's SEP for core PCE assumed 2.8% for year-end 2025 (up from 2.5% in December), 2.2% for 2026, and an unchanged 2.0% for 2027 and over the long term, in line with policy objectives. Official inflation measures continue a slow grind toward normalcy, with the last mile to target proving frustratingly long. The potential impacts of higher tariffs remain a risk, although more of the variety of a one-time price bump than a continued headwind caused by other structural supply chain, fiscal, or monetary factors.

Employment. The unemployment rate came in at 4.1% for February, having vacillated within a tight half-percent range of 3.7-4.2% over the last year. The SEP showed an expected rate of 4.4% for year-end 2025 (up a tenth from the December estimate), unchanged 4.3% for 2026 and 2027, along with 4.2% over the long term. There have been signs of concern due to DOGE's efforts to streamline Federal government employment, although cuts have not shown up yet meaningfully in official statistics. Other data shows a mixed picture, inferring a labor market that is slowing gradually. Data shows that over three-quarters of job gains in the last two years have come from the healthcare, education, and government sectors, which could be affected by DOGE, although most of these jobs are driven on a state and local level. Slower immigration this year would not show up as job losses but could weigh on the supply/demand balance in labor over time.

The Fed appears content to remain on the sidelines until the administration's trade policy is further clarified and refined, and as more concrete effects on the economy are seen. The threat of tariff rates rising is real, with the next deadline for major action coming in early April. All else equal, the Fed could err toward easing to get ahead of potential negative effects from the shift in trade policy—these being the uncertainty and inconsistent messaging around future policy (as we're seeing today) and actual tariff actions—although they may need to see signs of adverse impacts first.

There remain two types of rate cuts possible moving forward, as we first noted back when the Fed first began their easing regime—(1) continued 'moderation' or 'insurance' cuts in a move back towards a more normal Fed funds rate, as measured from a long-term real yield vs. history, or (2) faster and more dramatic cuts in response to economic slowing. Time will tell which of these two paths wins out.

The past month has been unpleasant for U.S. equity investors, with the S&P 500 reaching -10% correction territory at one point. This has been in reaction to economic uncertainty surrounding the administration's tariff policies, coupled with higher starting multiples for the Magnificent 7 growth stock group, and uncertain payback for market-driving new technologies related to artificial intelligence. On the other hand, international stocks have celebrated signs of stronger growth and fiscal stimulus in Europe and China. Bonds have also contributed to diversification and returns, with higher starting yields having fallen a bit but remaining robust. For asset allocation portfolios, diversification has been especially effective as leadership between groups has shifted.

The path of the Fed this year is likely reliant on the give-and-take between potentially higher inflation impulses brought on by changes in global trade relationships offset by the severity and length of any U.S. economic slowdown. Labor is an especially sensitive point of focus, given its enhanced focus as one of the two Fed mandates. So far, these risks have been kept at bay, although financial markets have been quick to respond to these changing dynamics.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.

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