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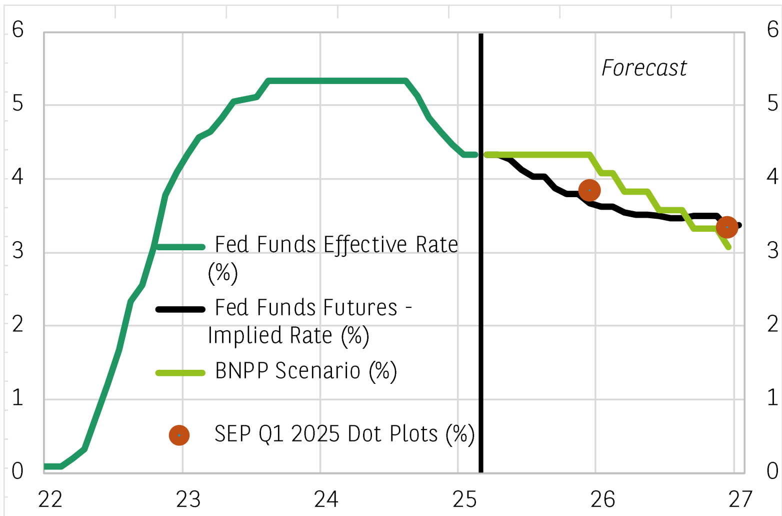
EcoFlash

FOMC, A Strange Stability

The FOMC kept the target range for the Fed Funds rate at 4.25% - 4.5% at the 18-19 March meeting, as widely expected. Jerome Powell and the committee have started to price in downward risks to economic activity and upward risks to inflation. In the short term, the stability of the dot plots, the downplaying of the long-term tariff related risks and the consistent message of patience are aimed, implicitly, at providing stability in the midst of the current turmoil. In our scenario, the FOMC is expected to cut the rates quite sharply in 2026.



Source: Bloomberg, Federal Reserve, BNP Paribas

Everything Changes, Yet Nothing Changes: Concerns over economic activity have led in the Summary of Economic Projections to a downside revision of the 2025 GDP growth forecast, lowered from +2.1% to +1.7% y/y in Q4 (v. BNP Paribas: +1.9% to +1.2%). Meanwhile, the actual and expected rise in tariffs has included an upward revision to PCE inflation forecast (+2.7%, +0.2pp). An overwhelming majority of FOMC members now believe that the risks to inflation are tilted to the upside while those to growth are tilted to the downside. However, SEP projections remained unchanged regarding rate cuts (two in 2025, two in 2026), which Powell notably explained by the balance between growth and inflation revisions. In this respect, the core message remains that the current stance is well positioned and that the FOMC faces no hurry, which provides it the ability to wait for the « net-effect » of policy changes to materialize before taking action.

A Haven of Stability: Jerome Powell has surprised by aligning with the view of the « transitory » impact of tariffs on inflation (« baseline scenario »), which was advocated by U.S. Treasury Secretary Scott Bessent. These remarks were part of a wider effort aimed at reassuring economic and financial players, particularly by maintaining the anchoring of market inflation expectations, which are rather stable to date unlike those of households. In this respect, the mission is accomplished this time in view of market reactions, as the S&P 500 and Treasury bonds rallied. Nevertheless, this did not prevent Donald Trump from forcefully reiterating his call for rate cuts.

BNP Paribas Scenario - No Cut in 2025, Significant Easing in 2026: We forecast a rise in inflation over the coming quarters, with the CPI reaching +3.7% y/y in Q4 2025 (v. +3.4% in our previous forecast), driven by a faster-than-anticipated implementation of tariffs. Moreover, above-potential 2024 growth (+2.8%, 1pp above the FOMC's long-term estimate) allows to delay rate cuts despite the ongoing slowdown. As a result, the FOMC would hold the policy rate steady throughout 2025. Only a sharp and unexpected deterioration in the labour market could accelerate rate cuts, which is neither the Fed's baseline scenario, nor ours. In addition, the negative supply shock, linked to the administration's immigration policy and which also contributes to an upside inflationary risk, suggests a lowering of the threshold below which the pace of nonfarm payrolls implies a significative worsening of job conditions, notably through a rise in the unemployment rate. The start of an easing in inflation in Q1 2026 would open the door to a resumption of rate cuts, with a cumulative -125bps over the year.

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