

Fed suggests rate cuts remain more likely than not

The Federal Reserve held rates steady, but continues to project 25bp rate cuts in both 2026 and 2027 as they seek to optimise policy to deal with upside price risks from energy, set against a jobs market that has cooled and faces more headwinds



US Federal Reserve Chair Powell at today's press conference explaining why rates remain on hold

Fed believes in the productivity boom

There is nothing particularly surprising from the Federal Reserve outcome. A "no change" decision with a target range of 3.5% to 3.75% with only Stephen Miran dissenting by voting for a 25bp cut. Everyone else wanted stable rates, but the Fed continues to think a rate cut this year is more likely than not. The Fed appears prepared – for now – to look through a near-term energy price shock, believing that this won't become a broader, more persistent inflationary problem that needs action.

The accompanying statement acknowledges that "uncertainty about the economic outlook remains elevated. The implications of developments in the Middle East for the U.S. economy are uncertain". Chair Powell also heavily emphasised the problems with making projections in the current challenging situation, but he believes economic activity remains "solid". For now, though, the updated forecasts show they have retained the 2026 rate cut they had from their December

update and continue to have a further 25bp rate cut in 2027.

Interestingly, they have revised up GDP growth a touch for fourth quarter 2026 to 2.4% year-on-year versus 2.3% while their fourth quarter 2027 GDP growth prediction is now 2.3% versus 2.0%. 2028 is also up, while, perhaps most significantly, the Fed revised its long run GDP projection to 2% from 1.8%, suggesting they are buying into the productivity boosting effects of AI/technology investment. After all, their inflation forecasts have only been revised a little higher for this year (2.7% vs 2.5% previously for the core PCE deflator in fourth quarter 2026 with fourth quarter 2027 0.1 percentage point higher at 2.2% with 2% retained for 2028. Unemployment forecasts are little changed with long run Fed funds revised up 0.1pp to 3.1%.

Greater chance inflation is indeed “transitory” this time round

It looks as though the Fed are adopting a similar stance to 2021 when they believed inflation would be “transitory” during a supply shock, and they needn't raise rates. However, back then robust hiring, soaring wage growth, pent-up demand coming out of lockdowns and stimulus checks meant consumer spending jumped significantly and inflation spiralled higher. The Fed then had to play catch-up, hiking rates 525bp between March 2022 and July 2023.

Today, the labour market is in a far weaker position with job creation and real household disposable income stalling over the past six months. At the same time, confidence has been eroded by tariff worries and job security fears, so there isn't the same demand impetus to fuel inflation. While tax refunds are expected to be quite substantial this year (around \$4000 on average versus \$3200 last year), we would likely need to see a larger fiscal boost, such as stimulus checks, to generate enough demand that would entrench inflation pressures and trigger Federal Reserve rate hikes. Chair Powell did suggest that the possibility that the Fed's next move could be a hike came up in discussion, but the "vast majority" don't see that as being the base case.

We think there is a greater chance that today's energy shock is demand destructive in that households have less discretionary spending power. This should diminish the chances of broader, more persistent inflation. Moreover, the second part of the Fed's dual mandate of preserving price stability and maximising employment is facing greater challenges. The 92,000 drop in February non-farm payrolls and the 69,000 downward revisions to jobs for January and December suggest the Fed may have been premature in downplaying the risks to jobs at the January FOMC meeting. If the jobs market was stalled when the economy was looking in decent shape, an overlay of heightened geopolitical, economic and market angst is not going to incentivise business to suddenly start hiring now.

In an environment where monetary policy is still viewed as being mildly restrictive, we continue to forecast two 25bp rate cuts for 2026. One in September and one in December, which is in line with the Fed's projection, albeit a little earlier.

USD: Fed ambiguity leaves FX market entirely oil-dependent

We had identified this FOMC announcement as an upside risk event for the dollar – but there was simply not enough guidance (and crucially, no changes to the Dot Plot) for the dollar to react very aggressively. We are incidentally cautious in drawing longer-term conclusions for FX from this meeting. The Fed is explicitly warning there is a high degree of uncertainty and offering no guidance for now on what the inflation-activity balance could look like.

All this leaves some freedom for markets to keep guessing the policy response based on geopolitical and oil price developments. But for now, that doesn't seem to matter for the USD more than the oil price and broader risk sentiment swings themselves at this stage.

If anything, some early signs the Fed is inclined to look through this inflation bump and still expects to cut this year reinforce our call for a weaker USD into year-end. We have recently [updated our FX forecasts and views](#), and discuss [here](#) how our baseline for EUR/USD can change in alternative war/commodities scenarios.

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