US Federal Reserve seeks clarity as it leaves rates on hold

The Fed remains in no hurry to cut interest rates, but President Trump's spending cuts and trade protectionist policies are hurting growth prospects and will likely force the central bank's hand later in the year

Fed Chair Powell at today's press conference announcing that rates remain on hold

No change, but two 25bp cuts remains the Fed's base case

The Federal Reserve has left monetary policy unchanged as widely expected with the Fed funds target rate range remaining at 4.25% to 4.5%. The accompanying statement repeats the phrasing that "inflation remains somewhat elevated" and that both growth and labour market conditions remain "solid". However, the Fed has decided to slow the pace that it is shrinking its balance sheet. While they will continue to run it down by a maximum $35bn of agency securities each month, they have reduced the cap on the redemption of Treasuries per month to $5bn from $25bn. While the policy rate decision was unanimous, Governor Chris Waller wanted to keep the pace of balance sheet reduction unchanged.

In terms of their new economic forecasts, the dot plot continues to have two 25bp cuts this year, two next year and one in 2027 with the long run Fed funds rate still seen at 3%. The table below shows they have cut their 2025 GDP growth forecast down to 1.7% from 2.1% and 2026 to 1.8%

from 2% and 2027 to 1.8% from 1.9%. This likely reflects the growth drags from government spending cuts and the prospect of significant tariffs squeezing profit margins and household spending power. However, they have revised up inflation with core PCE expected to end the year at 2.8% versus 2.5% in their December forecast, presumably on tariffs putting upside pressure on prices, but their 2026 forecast remains 2.2%.

Federal Reserve's economic forecasts

	2025	2026	2027	Longer run
Change in real GDP (4Q YoY%)	**1.7**	**1.8**	**1.8**	**1.8**
Previous Fed projection (Dec)	2.1	2.0	1.9	1.8
Unemployment rate (% year end)	**4.4**	**4.3**	**4.3**	**4.2**
Previous Fed projection (Dec)	4.3	4.3	4.3	4.2
Core PCE inflation (4Q YoY%)	**2.8**	**2.2**	**2.0**	**-**
Previous Fed projection (Dec)	2.5	2.2	2.0	-
Federal funds rate (year end)	**3.9**	**3.4**	**3.1**	**3.0**
Previous Fed projection (Dec)	3.9	3.4	3.1	3.0

Source: Federal Reserve, ING

Fed acknowledges the risks, but needs to see weakness in hard data before acting

There was some speculation ahead of time that weaker economic and sentiment data and weakness in the performance of risk assets would translate into a softening of the Fed's stance, but this does not appear to be the case. This always looked doubtful to us given Chair Powell's comments in his 7 March speech that "we do not need to be in a hurry, and are well positioned to wait for greater clarity." Chair Powell frequently mentioned uncertainty in the press conference, but until we see actual weakness in the hard data the Fed will sit and wait.

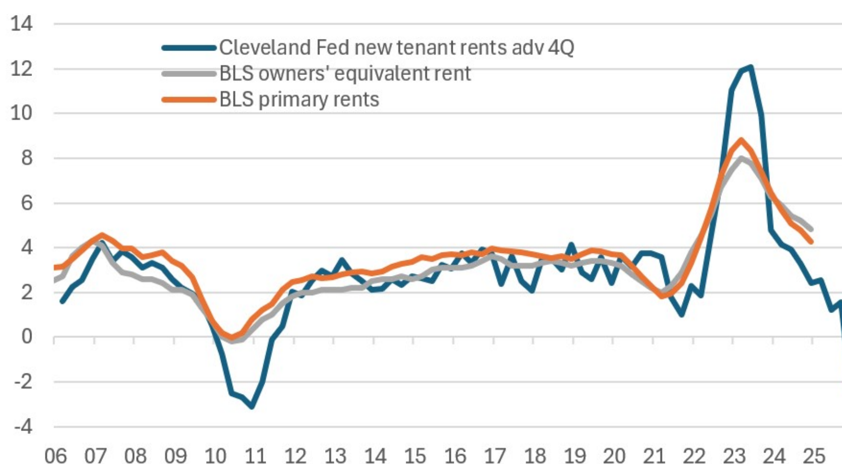
Moreover, some claims that the Fed would signal a willingness to ease policy should risk assets continue to slide looked well wide of the mark. The Fed would only ever do so if financial stability was at risk or it threatened to trigger a recession and there is no sign of that happening.

In terms of our view on the Fed, the fact that the economy is growing, unemployment is low and inflation is still tracking hot means interest rates will be on hold through to late summer. In any case, the Fed have already cut rates 100bp so have made policy less restrictive.

Nonetheless, the outlook for growth is cooling with escalating tariffs – 2 April is set to see the US implement tariffs more broadly – threatening to squeeze both household spending power and corporate profit margins. Reciprocal tariffs from foreign governments and consumer boycotts will compound the problems for US exporters. At the same time, government austerity risks prompting weakness in the jobs market and slower spending more broadly in the economy.

The Fed will be wary of moving too soon though given the prospect of higher inflation rates. However, we are closely following developments in the Cleveland Fed's measure of new tenant rents that should translate into lower CPI housing inflation prints in late 2025, which will mitigate much of the inflation threat from tariffs. This should give the Fed the room for interest rate cuts in September and December with a third 25bp move in March next year.

Housing inflation measures (YoY%)



Source: Macrobond, ING

The Fed becomes a bigger net buyer of Treasuries from April

The Fed, from April, will have a monthly redemption cap of US$5bn. That's practically zero. It's not clear why the Fed did not just decide to go to zero, apart from not giving the market the news story that quantitative tightening (QT) in Treasuries was fully over. This is still big news. Remember, up till now, the redemption cap for Treasuries was US$25bn. Before that, it was US$60bn. What that means is the Treasury has virtually no redemption cap. The redemption cap itself meant that the Fed would re-invest an amount equal to the full roll-off minus the redemption cap.

The full roll-off tends to be anywhere from US$25bn to US$75bn per month, but in many months it can be lower. If there was no redemption cap at all, the Fed would simply reinvest these amounts back out the curve, broadly equating to the maturity profile of outstanding bonds. With the US$5bn cap, the outcome is virtually the same, but adjusted by the US$5bn (which is not a significant amount). Bottom line this equates to the Fed being a (bigger) net buyer of Treasuries from April onwards.

The Fed continues to have a redemption cap of US$35bn for mortgage backed securities. So, the overall redemption cap is $40bn. This can mean that the QT programme can stretch a tad beyond our targeted end by mid-year, likely now drifting into the third quarter. The key floor here is US$3tn for bank reserves. These are now around US$3.5tn, but artificially inflated by the spend down by the US Treasury, as they are constrained from engaging in net issuance by the debt ceiling. By mid-year we expect this to have been resolved, and for bank reserves to be approaching US$3tn. But that approach will be slowed by US$20tn a month due to the cut in the cap on Treasury redemptions (from US$25tn to US$5tn).

Still, Treasuries are viewing this early move on QT as bullish, with an impact reaction for lower yields. It's not a dramatic reaction though, which makes sense. The notion of the Fed being a buyer of Treasuries is an important factor, but it's not unusual for the Fed to be active in the Treasury market, on both sides. And there are other bigger issues out there that can push Treasuries around. So don't expect this impact reaction to be the structural one. It's the right reaction. But should broadly be a one-day one, at least based off this factor alone.

FX: Still looking for a dollar recovery

The dollar had its strongest day of March right before the FOMC announcement, likely on the back of some last-minute hawkish repricing. The dot plot revision to two cuts and signals of heightened unemployment uncertainty has knocked around 0.25% off DXY since the statement release, but the index remains in positive territory for the day.

With the Fed still not signalling greater urgency to cut rates and the 2-year USD swap rate having moved only marginally lower compared to the past few days, we are not looking to change our dollar call. We expect a broad recovery in the greenback in April as US recessionary risk may not be fully endorsed by data while US tariffs throw cold water on European sentiment. The path forward points to a correction in the overvalued EUR/USD into the summer before making fresh attempts at a structural shift above 1.10 in late 2025.

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