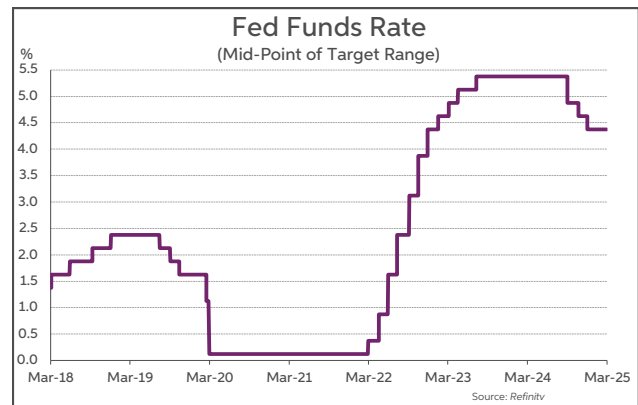


## Fed remains in no hurry to cut rates further

The March meeting of the US Federal Reserve Open Market Committee (FOMC) saw the central bank leave policy on hold. The target range for the Fed funds rate was maintained at 4.25-4.50%. The decision by the FOMC to leave rates unchanged was unanimous and very much in line with market expectations. This was the second consecutive meeting where the Fed did not alter its key interest rate. Prior to this, the Fed reduced rates by 100bps over the course of its final three meetings of 2024. The Fed did announce a change to its quantitative tightening (QT) process though. From April, it will slow the pace of its balance sheet reduction by “reducing the monthly redemption cap on Treasury securities from \$25 billion to \$5 billion”.

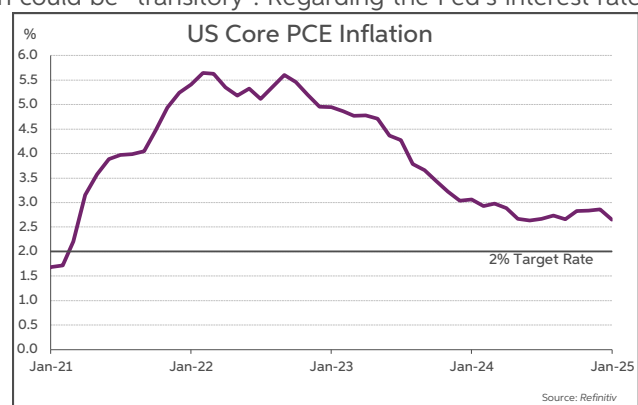
The March FOMC statement contained relatively limited changes from its January version in terms of its characterisation of the US economy. The Fed continued to state that incoming macro data indicates that “economic activity has continued to expand at a solid pace” and “labour market conditions remain solid”, while “inflation remains somewhat elevated”. It did acknowledge though that “uncertainty around the economic outlook has increased”.



With no expectations of interest rate changes from the March FOMC, a key point of focus for markets was the Fed’s updated interest rate projections (i.e. dot plot). The latest ‘dots’ were unaltered from their December edition, thereby continuing to indicate a very gradual pace of rate cuts. The median projection is that rates will decline to a 3.75-4.00% range by end-2025. In other words, 50bps of rate cuts this year. However, there was a hawkish shift in the dispersion of the dots. Four FOMC members now expect no cuts this year (from one in December), while four policymakers now anticipate just one 25bp cut (vs. three members in December). Rates are envisaged to be cut by a further 50bps in 2026 and by 25bps in 2027, falling to a 3.00-3.25% range.

Meanwhile, the updated macro forecasts suggest that some FOMC members have started to factor in the potential impact from tariffs, with near term inflation projections revised higher, while GDP growth was downgraded. On the inflation front, core-PCE is now seen at 2.8% (from 2.5%) in Q4 of this year. The Q4 2026 and 2027 core inflation forecasts were left unchanged, at 2.2% and 2.0%, respectively. On the growth outlook, the Fed is now pencilling GDP growth of 1.7% (was 2.1%) for the last quarter of this year. For Q4 2026, the Fed is forecasting GDP to increase by 1.8% (from 2.0%). Further out, GDP is expected to expand by 1.8% (was 1.9%) by Q4 2027.

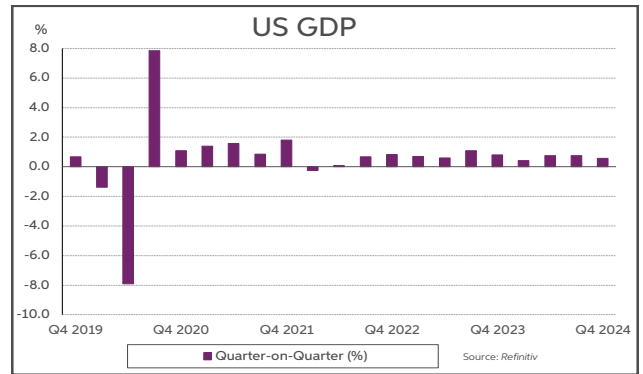
In the post-meeting press conference, Chair Powell’s comments struck a balanced tone. On the impact on inflation from US trade protectionism he said that tariff related inflation could be “transitory”. Regarding the Fed’s interest rate policy, Chair Powell noted that amid the “really high uncertainty” regarding the economic outlook, the Fed remains of the view that its monetary policy is “well positioned to wait for further clarity”. He stated that the Fed’s policy stance is in a “good place to react to what comes”. At the same time, he emphasised that the Fed is no rush to cut rates again, commenting that “I think we are not going to be in any hurry to move”.



In terms of market expectations for this year, there was between 5-10bps of softening in rate pricing in the aftermath of the March FOMC, while still remaining broadly aligned with the Fed’s guidance for a gradual pace of easing. Futures contracts are consistent with around 65bps of rate cuts in 2025. This would see official rates end the year in a 3.75-4.00% range. The first rate cut of the year is not fully priced-in until July. Of course given the elevated level of uncertainty, market pricing on the timing/extent of rate cuts could experience some volatility as traders react to any significant changes in US trade and fiscal policy over the coming weeks/months.

## US economic outlook clouded by policy uncertainty

**The US economy continued to perform very strongly in 2024.** GDP expanded by 2.8% in the year, marginally below the 2.9% increase seen in 2023. Consumption and a sharp rise in government spending were the main drivers of growth throughout 2024. Meantime, a strong increase in non-residential investment also boosted GDP, although this was undercut by a decline in residential activity. In terms of net trade, imports have continued to grow at a faster pace than exports, resulting in a negative contribution from net trade to GDP in 2024.

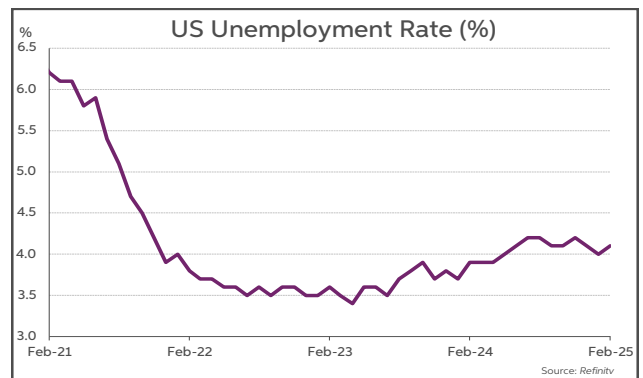


**However, survey data available for Q1 have been somewhat mixed.** The manufacturing PMI returned to expansion mode in January for the first time since last June, and rose to 52.7 in February. Similarly, the manufacturing ISM edged just above the key 50 level in the opening two months of the year, having been in contraction territory since October 2022. Meantime, the services PMI and the non-manufacturing ISM both remained consistent with rising activity levels at the start of 2025. Elsewhere, consumer sentiment has deteriorated sharply, with the Conference Board indicator and the Michigan measure both falling markedly. The former declined to its lowest level since June in February, while the latter dropped to its weakest reading since July 2022 in March. Like-wise, homebuilder sentiment and small business confidence have waned throughout the first quarter of the year.

**Meanwhile, the limited available hard data for the opening months of the year have been volatile.** Retail sales contracted by 1.2% in January before rebounding by a modest 0.2% in February. However, the control group measure - a key underlying sales metric which feeds directly into the GDP calculation - jumped by 1% in February, all but erasing a similar sized fall at the start of the year. At the same time, industrial output rose by 0.3% and 0.7% respectively over the same period, and if you also include the December data, it shows that industrial output has increased for three consecutive months for the first time since Q3 2022.

**In terms of the labour market, conditions appear to be little changed so far in 2025, having softened somewhat in 2024.** The unemployment rate was at 4.1% in February, having oscillated between 4.0-4.3% since last May. Meanwhile, the pace of payroll expansion has slowed slightly. Payroll growth has averaged 138k per month in the first two months of 2025, down from 209k in Q4 and 168k during the full year 2024. At the same time, there are signs that labour demand has cooled. The number of job openings stood at 7.7m in January, up from a 7.5m in December, but down from 8.5m at the start of 2024. Amid the softening in labour demand, average earnings growth has eased marginally, albeit it remains elevated, at +4.0% y/y in February, down from +4.2% y/y a year ago.

**Meanwhile, the disinflationary process has lost steam.** Headline CPI trended down to a low of 2.4% last September, before printing at 2.6-3.0% in the past five months. It stood at 2.8% in February. Meantime, core-CPI fell to 3.1% in February, having been stuck in a narrow 3.2-3.3% range since last June. Similarly, core-PCE edged down to a low of 2.6% in June, but rose throughout the second half of the year, to 2.9% in December. In January though, it declined to 2.6%, matching the aforementioned low in 2024. Looking ahead, the Fed expects core-PCE to rise to 2.8% in Q4, before edging slowly back to 2% in 2027.



**To summarise, the US economy maintained strong growth momentum last year.** Meantime, a softening in labour market conditions and slowly waning inflation saw the Fed to cut rates by 100bps. **Thus, the economy entered 2025 on a firm footing.** However, disinflation has stalled recently. At the same time, survey data in the opening months of 2025 indicate a clear deterioration in sentiment, albeit activity levels remain robust. High levels of uncertainty regarding US economic policy, especially trade policy is also clouding the outlook. These policies (tax cuts, restricted immigration, trade tariffs) are likely to add significantly to an already yawning fiscal deficit, and to inflation, and may limit the Fed's ability to cut rates further. Against this backdrop, recent forecasts for US growth have been scaled back. The OECD now sees the US economy expanding by 2.2% this year and by 1.6% in 2026, down from 2.4% and 2.1% previously.

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