Fed Policy Monitor

Economics and Strategy

NATIONAL BANK OF CANADA FINANCIAL MARKETS

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Elevated uncertainty = policy paralysis

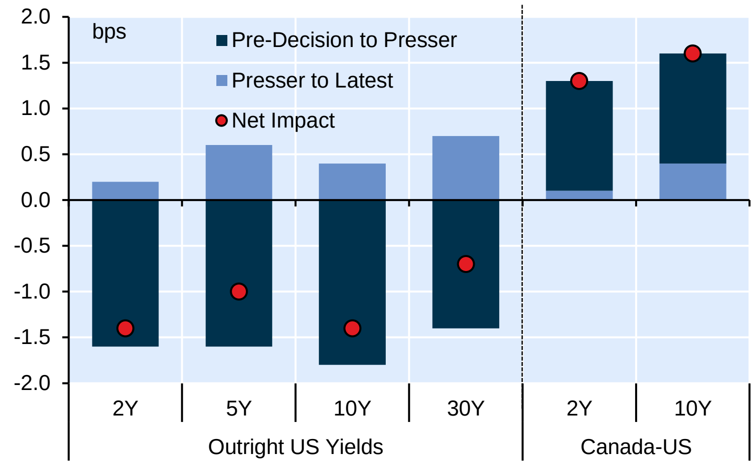
By Taylor Schleich & Ethan Currie

Decision Details & Rate Statement

- The FOMC kept the target policy range unchanged at **4.25-4.50%,** in line with market pricing and a unanimous consensus.
  - There were no dissents on the rate decision.
  - This is the 3rd consecutive 'hold', leaving the policy rate 100 bps below last year's peak.
- The statement suggests that uncertainty about the economic outlook has "increased further". The Committee judges that the "risks of higher inflation and unemployment have risen" and conceded that "swings in net exports have affected the data", though economic activity continues at a solid pace.
- There were no changes to the forward-looking segment of the rate statement: "In considering the extent and timing of additional adjustments to the [policy rate], the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks."

Bonds retract a dovish response to the rate statement

Change in yields / differentials: Pre-decision to presser, presser to current



Sources: NBC, Bloomberg | Note: Latest as at 3:40pm EST

Press Conference

Just like the rate statement, there was *very* little new information contained in the press conference. Powell reiterated that the economy remains in solid shape, unemployment is low, and inflation is still slightly elevated though risks to both sides of the mandate have risen. He acknowledged deteriorating soft data but said it "remains to be seen" how and when this might impact the economy. Similarly, inflation is expected to rise but it's not clear when, by how much and if increases would be one-off or more persistent. He did note that, beyond the next year or so, most measures of inflation *expectations* are consistent with the price stability mandate.

The Fed Chair recognized that coming decisions could be difficult as their dual mandate goals may come into tension. But given the competing nature of the risks, pre-emptive rate cuts wouldn't be appropriate. For now, Powell sees the FOMC as "well positioned" to wait for greater clarity before making any policy rate changes. The costs of waiting in Powell's view are low. That appears to be a widely held belief as he stressed that everyone on the committee supported today's decision.

If the Fed does find itself in a situation where the two goals are in tension, he said they'll have to assess "how they far they are from the goals, how far they're expected to be from the goals, what's the expected time to get back to the goals." Powell also refrained from offering insight into what the committee's dot plot might look like today.

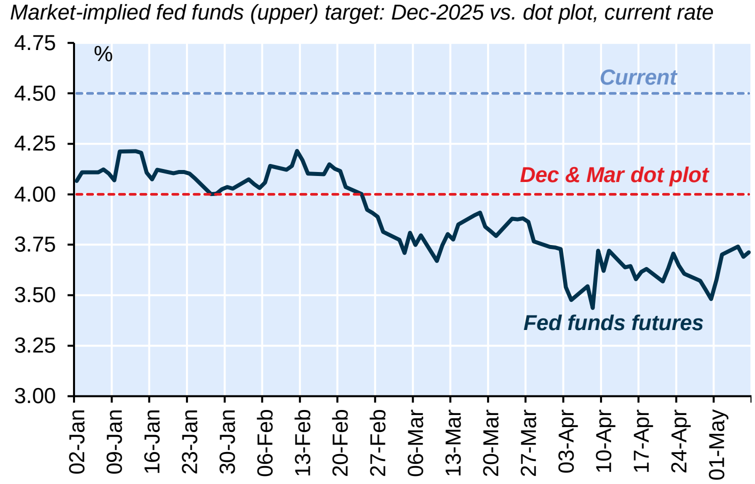
Bottom Line

The FOMC held its policy rate steady as widely expected, and in light of immense uncertainty opted to make only modest changes to their press release vis-à-vis March. There's still an acknowledgement that growth is solid (although trade swings have muddied GDP), the unemployment rate is low, and inflation is somewhat elevated. The main addition to the statement was a nod to rising upside inflation and unemployment risks. The initial bond reaction was modest, yields coming down a couple of basis points. Powell's post-decision press conference didn't offer much new information. He continues to see policy as being in a good place and well positioned to deal with risks to either side of the mandate. He repeated ad nauseam that the appropriate stance is to wait until there is greater clarity.

What's to come? For now, there's no incentive for the Fed to deviate from its current stance or guide towards near-term rate cuts given a still heightened level of uncertainty on growth, employment and inflation. And

Markets still betting on three cuts in 2025

Market-implied fed funds (upper) target: Dec-2025 vs. dot plot, current rate



Sources: NBC, BBG, FRB | Note: Fed funds futures, dot plot adjusted to upper bound while we've heard policymakers, including Powell, advance the idea that any tariff-related inflation could be transitory, it's still too early to be sure of that assessment. The still-fresh bruises from their incorrect assessment of post-COVID inflation is likely weighing on them too. It's similarly unclear what the growth/labour market impact will be especially since hard data, thus far, has held up reasonably well (most notably, April jobs data). That's led to a reduction in June rate cut odds, which retreated to ~30% pre-decision and moved closer to 20% after the press conference was said and done. Post-liberation day, a June cut was fully priced and even as that moderated, implied cut probability remained above 50% for most of the lead-up to this decision.

Despite what should be a "hawkish" Fed in the near-term, which could lead to a fourth straight 'hold' in June, markets continue to expect a relatively quick pace of cuts in the second half of the year (there's roughly three cuts discounted through the end of 2025). While this may seem out of line with the Fed's current stance, we see that as a reasonably likely outcome assuming economic data begins to stumble as we expect it will. Given that the policy rate remains in restrictive territory (by most measures of neutral), we don't think initial rounds of easing will be too controversial (as long as the inflation uptick doesn't come in well above expectations).

Here is the Interest Rate Statement:

Federal Reserve issues FOMC statement

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook has increased further. The Committee is attentive to the risks to both sides of its dual mandate and judges that the risks of higher unemployment and higher inflation have risen.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Neel Kashkari; Adriana D. Kugler; Alberto G. Musalem; and Christopher J. Waller. Neel Kashkari voted as an alternate member at this meeting.

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