

# Patiently Waiting

The Federal Reserve (Fed) once again held rates steady against a mixed backdrop of elevated inflation, a stabilizing labor market, and stable growth (for now). Amid rising geopolitical risk, time will tell how U.S. fundamentals are affected.

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## Topic

Market Events

## Key takeaways

- **Inflation to stay sticky:** While the underlying drivers may shift, inflation has been above target for close to half a decade. Volatility in inflation expectations matters more.
- **Stay in the range:** Markets are pricing no change to monetary policy, and we expect the belly of the curve to remain in a (wide) range.
- **The dual mandate will bite:** The labor market is showing signs of stabilization, but the structural forces at play still loom large in the background.

## Federal funds rate stays at 3.50–3.75%

Today, the Federal Open Market Committee (FOMC) announced it has kept interest rates unchanged, holding the federal funds rate at 3.50–3.75%. The FOMC continues to focus on a data-dependent approach. For now, it is looking through geopolitical risks and treating the energy price shock as “transitory” rather than a rolling series of pressures on consumers. Market consensus has priced nothing into the U.S. yield curve for the bulk of this year. Risks remain symmetric, with both future hikes and cuts possible depending on the balance of the Fed’s dual mandate and the policy philosophy of the future Fed leadership.

Growth in the U.S. disappointed in the fourth quarter, but forward-looking measures show the labor market and recent retail sales data point to slight reacceleration for the first quarter. We continue to expect U.S. growth to moderate from the lofty levels of 2025 as the impact of price shocks feeds through the economy and may slow down the artificial intelligence build-out that buoyed gross domestic product significantly last year. Consumer health remains weak, and the peak of fiscal easing has likely already been felt. Pending further measures, we expect more volatility ahead.

## Inflation remains elevated

Core inflation (excluding food and energy) rose to 2.6% year over year in March based on the Fed’s preferred consumption-based inflation measure. This was broadly in line with expectations but shows that, even before the geopolitical escalation, it has been difficult to bring U.S. inflation back to target. With already-slowing growth and a pull forward in demand likely ahead, the inflation picture is coming more into focus. Unlike the past two years when higher-than-target inflation was offset by above-trend growth, absent further fiscal easing, it is difficult to see how this might continue to persist.

Historically, the Fed tended to view volatile energy prices and their impact on consumers as a short-lived tax, focusing instead on measures of core inflation. Overall inflation expectations have increased lately but remain well below 2022 levels. We believe it would take a longer period of elevated commodity prices to influence inflation expectations more meaningfully—and, crucially, this would need to be accompanied by higher growth expectations.

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