Situation analysis

March 19, 2025

Fed holds rates steady, expects further easing this year

Key takeaways

- The Federal Reserve maintained its policy interest rate range of 4.25%-4.50%, with the intent of bringing inflation closer to its 2% target.
- The committee slightly downgraded its economic outlook for 2025, projecting slower economic growth and modestly higher inflation due largely to tariff policy uncertainty.
- The Fed's median projections call for 0.50% of rate cuts in 2025, which generally aligns with bond market pricing.

> *It's really hard to know how this (tariff policy) is going to work out. And again, we think our policy is in a good place ... (and) we can move in the direction where we need to. But in the meantime, it's really appropriate to wait for further clarity. And, of course, you know the cost of doing that, given that the economy is still solid, is very low.*
> ***– Fed Chairman Jerome Powell***
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> Source: Federal Reserve, 3/19/2025

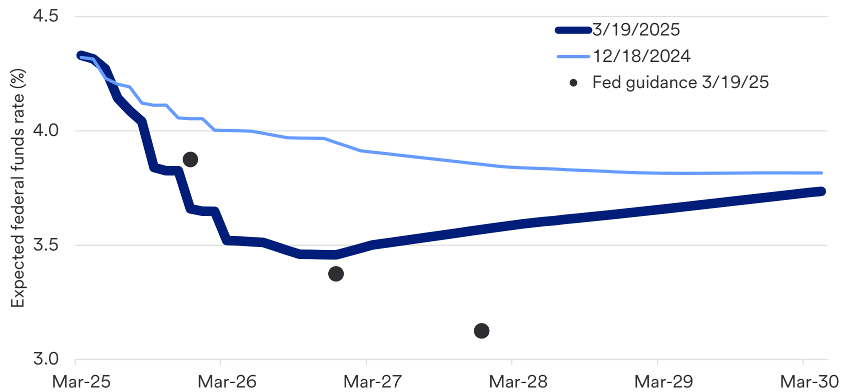
The Federal Reserve (Fed) held its target federal funds interest rate in a range of 4.25%-4.50% following its regularly scheduled two-day meeting, a widely anticipated outcome. The Fed has held rates steady since previously cutting rates by a total of 1% in 2024's second half. The updated official statement said, "Uncertainty around the economic outlook has increased," which Fed Chair Jerome Powell later qualified as relating to tariff policy uncertainty. The Fed's projections indicate a somewhat downgraded economic outlook for the next few years but maintained expectations for two additional rate cuts this year. The Fed continues to believe policy rates should remain somewhat restrictive for now to dampen inflation.

Many investors are worried about potential tariffs' impact on both inflation and economic growth prospects. These concerns translate into gloomier economic forecasts and consumer and business surveys but have yet to show in economic data. During Powell's press conference, he highlighted that the Fed's higher inflation projection derives from tariff uncertainty, but longer-term inflation expectations remain well-anchored.

Aggressive policy tightening in the form of rate hikes between early 2022 to mid-2023 helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% year-over-year in 2022 to 2.6% in January.

The Fed announced it will slow the pace of reduction in its $6.4 trillion bond holdings next month. The bond holdings peaked at $8.5 trillion in 2022, and the Fed has allowed them to run off, or mature without replacement, up to $25 billion per month of Treasuries and $35 billion per month of mortgage bonds. On April 1, this pace will fall to $5 billion per month in Treasuries, while remaining at $35 billion per month in mortgage bonds. Slower or no balance sheet runoff improves market liquidity, which refers to the amount of money readily available to buy goods, services and financial assets in an economy. Strong liquidity can also provide a cushion against unforeseen financial market shocks, and liquidity measures remain constructive for now.

Market pricing of the expected path of the federal funds rate

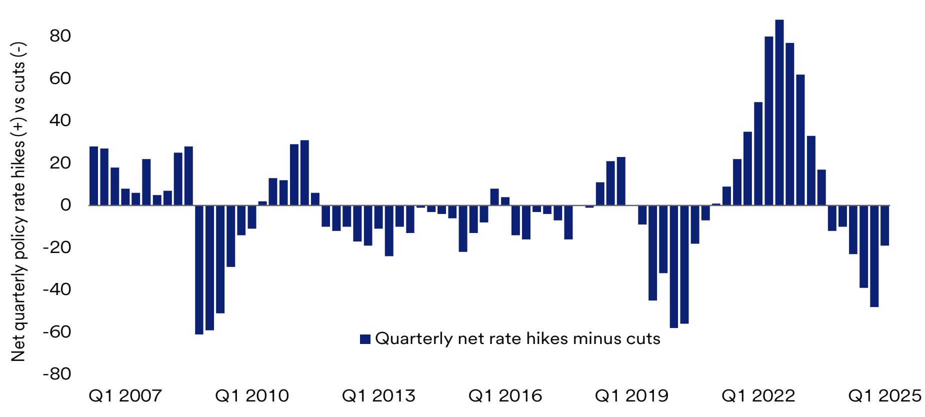


Source: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg.

Stock prices rose Wednesday, with most gains coming after the Fed's communication began. Large stocks, represented by the S&P 500, rose 1.08% while small stocks rose 1.57%. Treasury bond yields fell for most maturities. Ten-year Treasury bond yields dropped 0.04% to 4.25%, while two-year Treasury yields dropped 0.06% to 3.98%.

Monetary policy, defined as central bank target interest rates, remains restrictive in most geographies around the globe. However, policy has been easing overall, with central bank rate cuts exceeding hikes starting in the fourth quarter of 2023 and continuing through the current quarter. Several other major central banks in addition to the Fed have already or are expected to cut rates this year, including the Bank of England, European Central Bank, Bank of Canada and the Reserve Bank of Australia.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Source: U.S. Bank Asset Management Group Research, Factset; 4/1/2006-3/19/2025.

We retain a positive outlook for diversified portfolios due to solid corporate profits, constructive economic growth trajectories and our expectation for further global monetary condition easing. We remain cognizant of deteriorating surveys from consumers and businesses with respect to inflation and growth prospects. However, we favor awaiting evidence that a potentially gloomier outlook has translated to weaker economic activity. We have previously noted the weak historical relationship between surveys and future economic activity, as Powell noted during the press conference today. In aggregate, consumer activity remains near normal historical levels, though driven disproportionately by wealthier cohorts. Moderating medium-term inflation trends remain clear but are vulnerable to potential tariff implementation. We will keep you informed of our views as new data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can.