The Daily Dish

Message from the Fed

DOUGLAS HOLTZ-EAKIN | MARCH 20, 2025

There are some things that are easy to understand. Large-scale tariffs raise prices for consumers and businesses (that ultimately pass these costs along to consumers) and manifest themselves as higher near-term inflation. The reduced purchasing power of household income diminishes demand and the pace of near-term growth. In terms of the Federal Reserve, this amounts to threats to both the price stability (i.e., inflation at the 2-percent target) and full-employment (i.e., steady and strong employment gains) mandates. So, what should it do? Raise rates and fight inflation? Or, cut rates and spur demand overall and business' incentives to hire more employees? That depends on how large these impacts might be.

The Fed's answer yesterday: Do neither. Instead, the Federal Open Market Committee (FOMC) voted to keep rates unchanged. The real information, however, was in the survey of economic projections released along with the statement. They showed that the Fed believes inflation will be higher in 2025 than it thought in December – 2.8 percent, up from 2.5 percent in December. And it thinks that growth will be slower – marked down from 2.1 percent to 1.7 percent. But neither change is large enough to change the fact that it still expects two rate cuts (of 25 basis points) this year.

As a footnote, the FOMC voted to cut the pace at which it runs off the portfolio of Treasury securities from $25 billion a month to $5 billion a month. This very slightly dovish stance was rejected by Governor Waller, who was the only dissenter to the decision.

There has been a lot of ink spilled over the on-again, off-again, bigger, smaller, sooner or later tariff policies of President Trump. They have created uncertainty in the business community (and the survey of economic projections reflected this with a much wider range of projections). They have sapped consumer sentiment. But the message from the Fed is that this bad news does not yet add up to a recession or a restart of inflation. The U.S. economy will simply muddle through a soft patch.

The next big benchmark is April 2, when the administration will release its review of trade practices; may implement the 25-percent tariffs on Canada and Mexico; may implement the tariffs on autos, pharmaceuticals, and chips; and will reveal and launch the “reciprocal tariffs.” That may force a revision to the Fed’s outlook.