Major reduction in Fed’s US growth forecast

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The US Federal Reserve made a sharp downward revision in its forecast for US economic growth this year at its meeting yesterday amid what chair Jerome Powell referred to as “high uncertainty” surrounding the effect of the economic policies of the Trump administration.

Projections by Fed officials cut the growth forecast for this year to 1.7 percent from the 2.1 percent forecast last December, a significant reduction. They also forecast a rise in the Fed’s measure of inflation from 2.5 percent to 2.7 percent with the main reason being the tariff increases so far and the threat of more to come.

Powell said it was not possible to separate out the causes of the elevation but a “good part” of it was coming from tariffs and “there may be a delay in further progress” in bringing inflation down to the Fed’s target of 2 percent.

In his prepared remarks he said the new administration was implementing “significant changes” in trade, immigration, fiscal policy and regulation which would matter for the economy and monetary policy. “[U]ncertainty around the changes and their effects on the economic outlook is high.”

The Fed, as expected, decided to hold interest rates at their present level while projecting two cuts by the end of the year.

It also decided to slow the pace of its balance sheet reduction from $25 billion a month to $5 billion because of “some signs of tightness in money markets.” The Fed wants to avoid the situation which developed in September 2019, when an earlier rundown of its Treasury bond holdings led to a major spike in interest rates in the ultra-short term repo market that required its intervention.

The meeting was held amid a major shift in economic prospects. The year began with expectation that “American exceptionalism”—a growth rate higher than other major economies and an elevated stock market—would continue. Three months later the economic landscape has dramatically shifted.

Recession, which was then regarded as a negligible risk, is now a real prospect. Consumer spending is down, consumer confidence is falling, business planning and investment decisions have become more difficult because of tariff uncertainty and the effect of government spending cuts, and the stock market is down around 10 percent from its high of a month ago.

And in a sign of longer-term concerns about the stability of the US financial system and the position of the dollar, the price of gold continues to reach record highs.

The sharp downturn in the US economy and the impact of uncertainty over Trump’s policies was highlighted by a survey of leading economists conducted by the *Financial Times* (FT), published earlier this week.

The median forecast for US growth from the 49 economists surveyed was 1.6 percent this month, down from 2.3 percent in a survey conducted in December and a marked reduction from the growth rate of 2.8 percent for 2024.

The extent of the transformation in the US economic outlook was highlighted by economist Robert Barbera of Johns Hopkins University.

“Tariffs, tax cuts, government employment and expenditure cuts, assaults on education funding and [Fed] independence all are in play. Nothing of this sort has been in play in my 50 years of forecasting,” he said.

Karen Dynan, a professor at Harvard University, said while economists had struggled in the past to find evidence of how uncertainty affected the economy, it was “so high now that it seems likely to reduce investment. How much will depend on how long it persists.”

After he went to the election pledging his policies would produce a new “golden age,” Trump and members of his administration are now touting the benefits of a recession.

In an interview with Fox News last Sunday week, Trump refused to rule it out, saying there was a “period of transition.” He was followed two days later by commerce secretary Howard Lutnick who told CBS News that Trump’s policies were “worth it” even if they led to a recession.

The Trump agenda of economic war against the rest of the world and the working class at home is starting to impact on the global economy with the OECD, the grouping of more than 30 major economies, warning it would slow global growth this year and next.

“The message is clearly that trade uncertainty and economic policy uncertainty are having a significant toll,” OECD chief economist Álvaro Pereira told the FT.

It cut the growth forecast for 12 of the G20 group, with the largest falls in Canada and Mexico as a result of tariff hikes. The growth forecast for Canada for this year and next was more than halved to just 0.7 percent, while Mexico is now predicted to fall into recession this year and contract by 1.3 percent.

And the tariff war has only just begun.

Anxious to try to avoid any conflict with the Trump administration, Powell, while forced to refer to tariffs in his remarks, did not utter a word about the April 2 deadline set by Trump for the unleashing of his so-called “reciprocal tariff” agenda.

The basis of this plan is that the US will impose retaliatory measures not just against tariffs on its goods but in response to any policies of other countries which it deems to be inimical to the profit interests of US corporations. This could include measures such as the value added tax in Europe, regulations on the high-tech social media giants as well as the pharmaceutical benefits scheme in Australia.

Apart from the effect on the real economy, the OECD warned that a resurgence of inflation as a result of tariff increases, which by their very nature are inflationary, could trigger a “rapid repricing” in financial markets.

In his press conference Powell maintained that while it might take longer, the inflation rate was trending down, implying that the effect of Trump’s tariffs was transitory. He was reminded by one questioner that the last time the Fed had put forward such a claim was during the pandemic price hikes.

They were the start of an inflation cycle, the highest for 40 years, which continues to impact on the wages and living standards of millions. Powell tried to bat away the question by maintaining that the current circumstances were very different.

Evidence of potential financial turbulence warned of by the OECD emerged this week in a closely watched survey conducted by the Bank of America (BofA) of major investment firms. They made their “biggest ever” cut in allocations to US equity markets.

The drop was 40 percentage points as the surveyed firms went from 17 percent overweight in US equities in February to 23 percent underweight in March. The turnaround was the largest since the fall in March 2020 at the start of the pandemic.

Elyas Galou, senior investment strategist at the BofA, said that at the beginning of the year investors were all “raging bulls” on the US but this had now changed “significantly.”