

US Macro Strategy: March FOMC Preview *Not in a hurry to get worried*

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U.S. Desk Strategy publication coordinated and produced by:

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Fed Views

Not in a hurry to get worried

Fed | Scenarios & Mkt Impact: *Not in a hurry to get worried*

Scenario	Probability	Assessment
<i>Hawkish Message</i>	10%	<ul style="list-style-type: none"> • <i>SEP Updates: The one neutral to slightly hawkish message if they shift the long-run dot higher by 1/8 % up to 3.125%</i> • <i>Presser: Although Powell has mentioned that the Fed “is not in a hurry” to cut rates again, if he stresses it, could be hawkish</i> • <i>Market Implication: Given market sensitivity, it amps risk-off</i>
<i>Neutral Message</i> <u><i>Base-Case</i></u>	50%	<ul style="list-style-type: none"> • <i>SEP median dots may just end up remaining unchanged given it is Q1 and there is not enough data to change view since Dec24</i> • <i>Presser: Confident economy solid enough to weather recent vol</i> • <i>Market Implication: Continuation of range trade, low vol event</i>
<i>Dovish Message</i>	40%	<ul style="list-style-type: none"> • <i>SEP Updates: The rates median projections will likely remain unchanged for '25 but some submissions may drop, making it a close call between 2-3 cuts (aligned w/market pricing), and GDP growth estimates for the later forecast years are reduced</i> • <i>Presser: Powell expresses worry over recent market vol that may dampen growth given recent financial conditions tightening</i> • <i>Most dovish news is the official end of QT. Most noteworthy if reallocating MBS proceeds to USTs (with a front-end bias)</i> • <i>Market Implication: Bull steepener but MBS spreads widen</i>

Fed | Dot Scenarios: Steady as it goes (where it counts in '25)

We believe the bar is high for the terminal median rates ('25, '26 & '27) to change (up or down) for this first SEP of calendar year 2025. However, we do anticipate the long run dot to continue drifting slightly higher.

Midpoint of Target Range (%)	2025 (Dec24)	2025 (Mar25)*	2026 (Dec24)	2026 (Mar25)*	2027 (Dec24)	2027 (Mar25)*	Longer run (Dec24)	Longer run (Mar25)*
4.5								
4.375	•							
4.25								
4.125	•••	••						
4								
3.875	••••••••••	••••••••••	•••	•	••	••	•	•
3.75							•	•
3.625	•••	•••••••	••••	•••••	••••	••••	••	••
3.5							••	••
3.375	•	••	•••••	•••••••	•	•	•	•
3.25								
3.125	•	•	••••	••••	•••••••	•••••••	•	•••
3							•••	•••
2.875			•	•	••	••	••••	••
2.75			•	•	•	•	•	•
2.625					•	•	•	•
2.5							•	•
2.375			•	•	•	•	•	•
2.25								
Median	3.875	3.875	3.375	3.375	3.125	3.125	3.000	3.125
Change Dec24-Mar25*		0.000		0.000		0.000		0.125

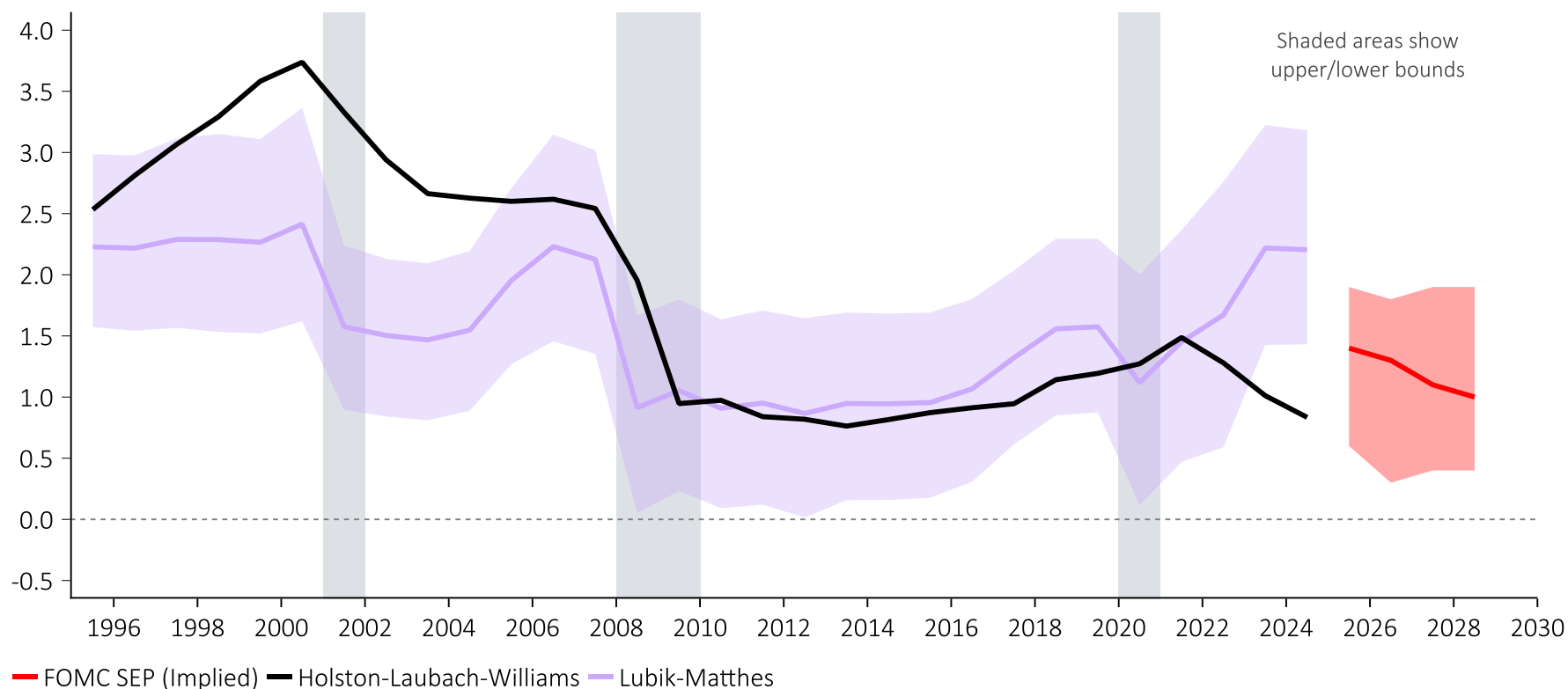
Source: Federal Reserve Board and MUFG US Macro Strategy

*MUFG Expectations

Fed | Overall, Fed members expect a low long-run neutral rate

The current environment is highly uncertain, with leading neutral rate estimates diverging since the start of 2022, though most Fed members expect the long-run real rate to fall near pre-pandemic levels by 2028

Neutral real rate estimates and implied FOMC SEP neutral real rate projections (as of December 2024)

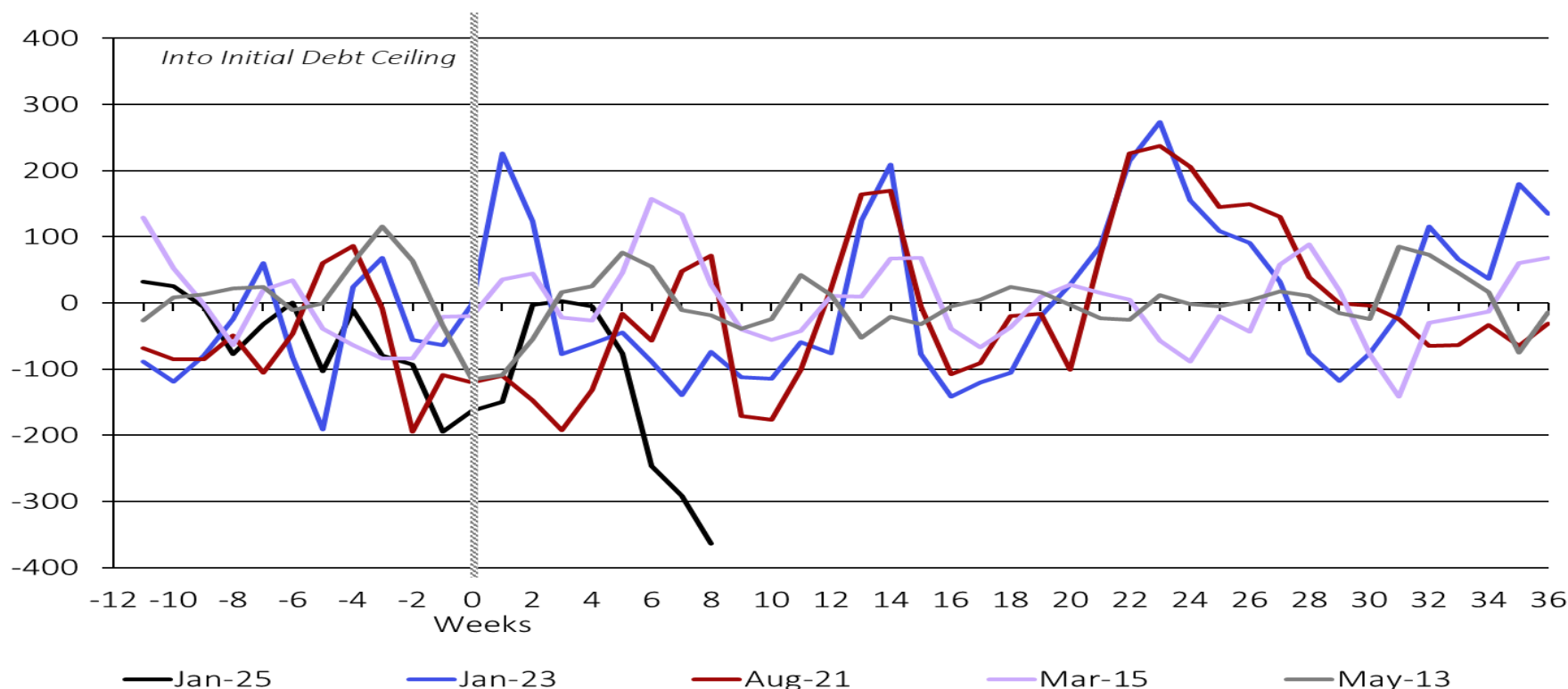


Source: Federal Reserve and MUFG US Macro Strategy

Fed | Quick TGA changes could also drive the Fed to end QT

After extraordinary measures were announced in January, the TGA has seen drawdowns of over \$300bn. With the US budget/debt ceiling still unresolved, major swings in TGA could serve as a catalyst to end QT.

Aggregated WoW Change of TGA (i.e. Treasury Cash Account) 12 Wks Prior to Extraordinary Measures



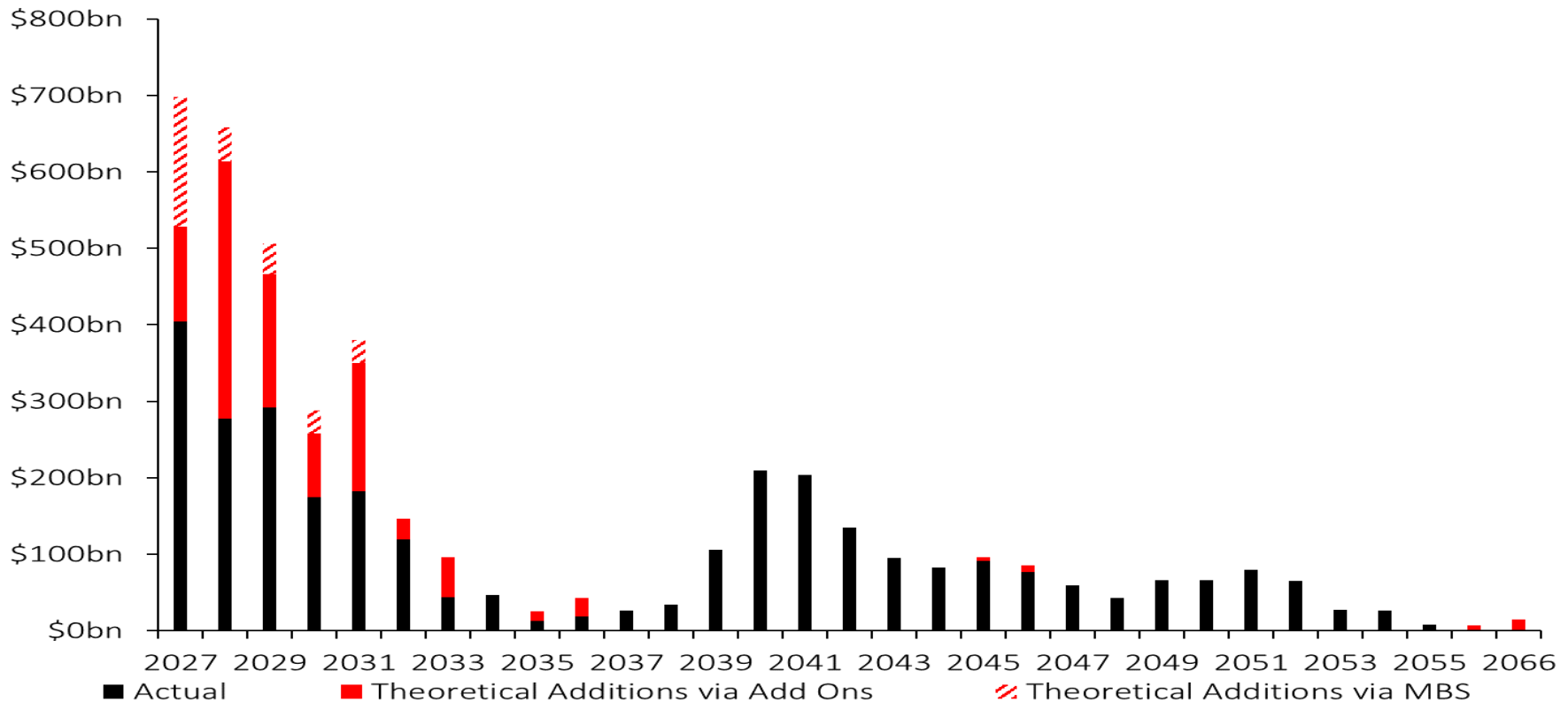
Source: Bloomberg and MUFG US Macro Strategy

Fed | End of QT provides, on the margin, support for USTs

In the January FOMC minutes, the Fed signaled the possibility of using MBS proceeds to fund secondary UST purchases (via open market operations), which could total \$300bn (depending on prepay) in volumes by 2027 and \$1tn in primary add-ons. This should shorten Fed's portfolio, which has a WAM of ~12.3 to ~9.3.

Net, Net: Coming soon, we'll likely see announcements QT is ending in '25, which will offer support to USTs.

Est. Fed SOMA UST Allocations (assumes larger add-ons & secondary purchases using MBS proceeds)



Note: This assumes that auctions sizes remain static and add ons are more front-end focused as per pre-GFC approaches by the Fed in balance sheet management

Source: Federal Reserve and MUFG US Macro Strategy

Fed | Uncertainty up in Beige Book, Minutes see QT tweak...

March Beige Book

*“Consumer spending was lower on balance, with reports of solid demand for essential goods mixed with **increased price sensitivity for discretionary items, particularly among lower-income shoppers.**”*

*“Labor availability improved for many sectors and Districts, though there were occasional reports of a tight labor market in targeted sectors or occupations. Contacts in multiple Districts said **rising uncertainty over immigration and other matters** was influencing current and future labor demand.”*

*“Prices increased moderately in most Districts, but **several Districts reported an uptick in the pace of [price] increase** relative to the previous reporting period. Input price pressures were generally greater than sales price pressures, particularly in manufacturing and construction. Many Districts noted that higher prices for eggs and other food ingredients were impacting food processors and restaurants. Reports of substantial increases in insurance and freight transportation costs were also widespread. Firms in multiple Districts noted difficulty passing input costs on to customers. However, **contacts in most Districts expected potential tariffs on inputs would lead them to raise prices, with isolated reports of firms raising prices preemptively.**”*

January Minutes

*“Under all scenarios considered, the maturity composition of Treasury holdings in the SOMA portfolio moved into closer alignment with the maturity composition of the outstanding stock of Treasury securities. The scenarios differed on how quickly this alignment would be achieved and, correspondingly, on the **assumed increase over coming years in the share of Treasury bills held in the SOMA portfolio.**”*

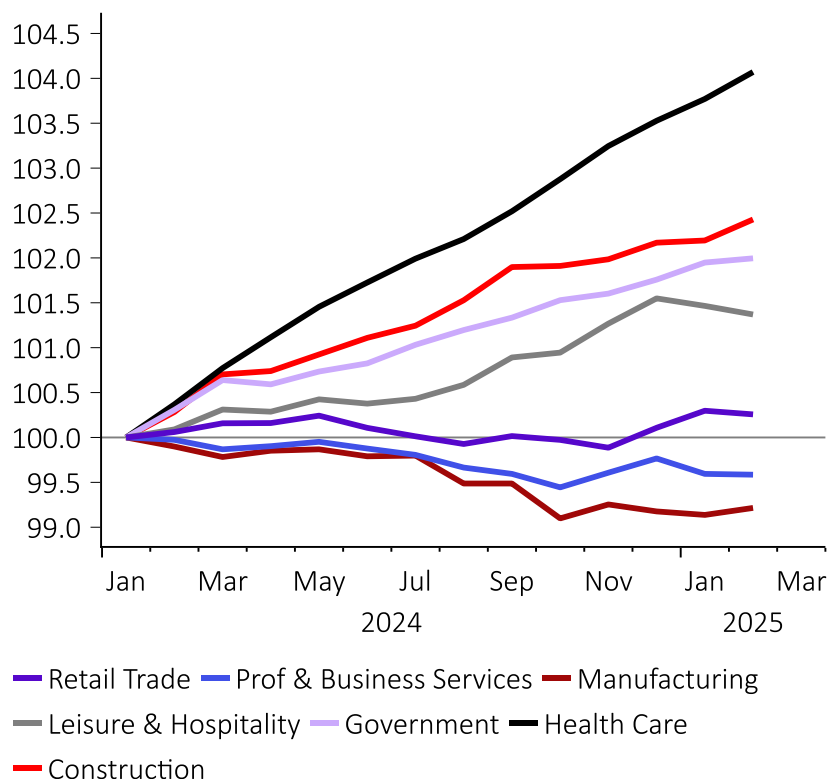
Macro

*Balance of risk shifting back to
concerns over growth/labor data*

Labor | Government's outsized jobs growth likely to end

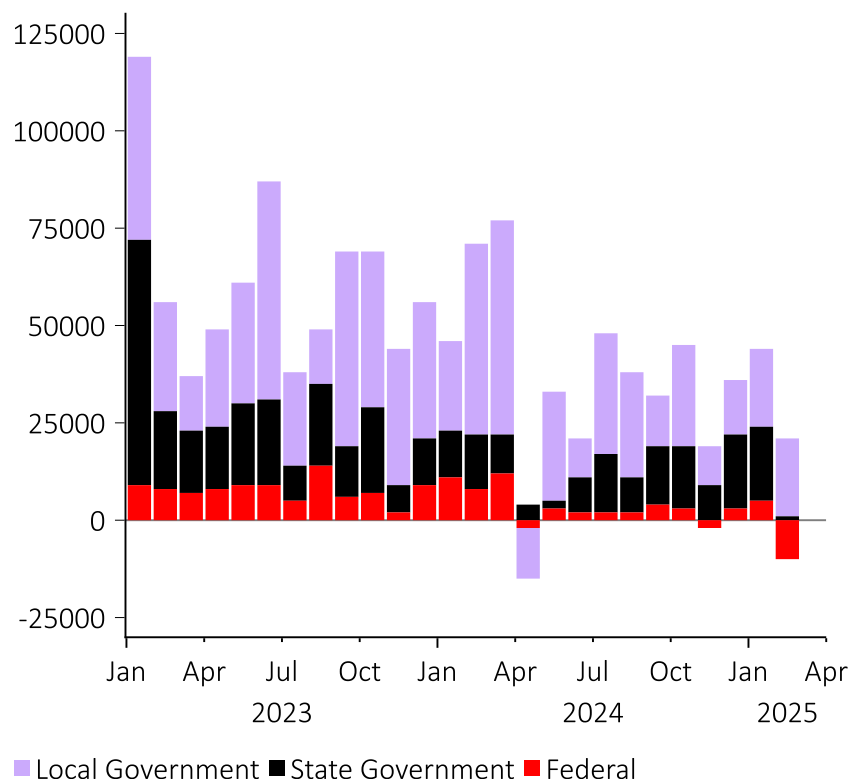
Government has, both directly and indirectly, buoyed the solid US job gains seen over the past several years. However, the current administration has shifted focus towards cost cutting, and the federal workforce has already begun to shrink. Effects are expected to spill over into other industries in the coming months too.

NFP Growth by Industry, Index 2024=100



Source: Macrobond and MUFG US Macro Strategy

Monthly Jobs Growth, Government

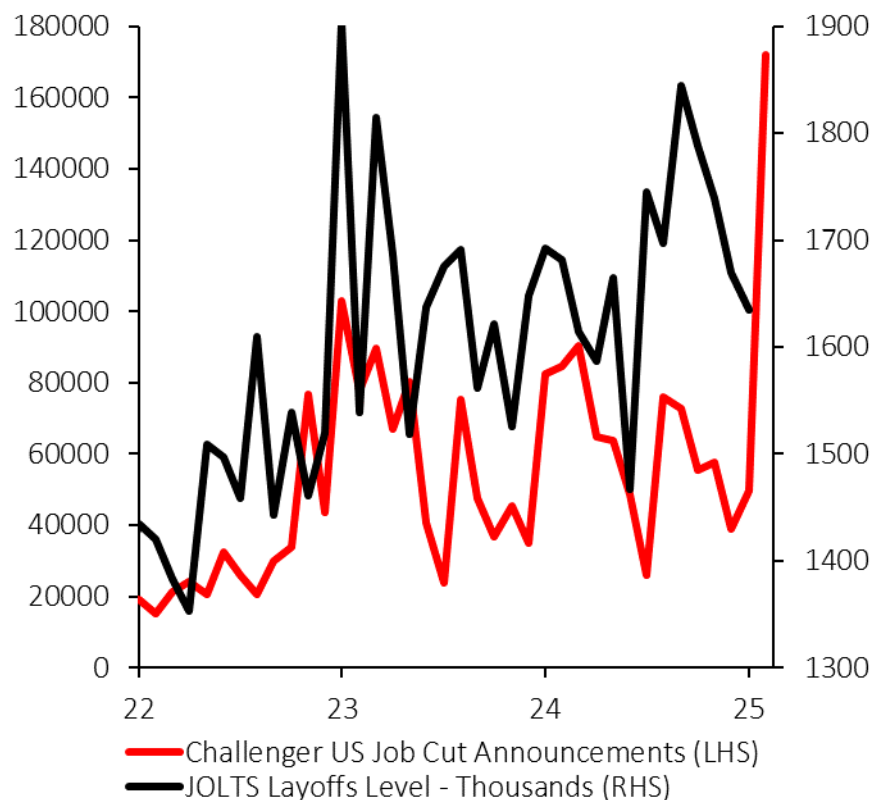


Source: BLS and MUFG US Macro Strategy

Labor | Spike in job cut announcements highlights weak labor

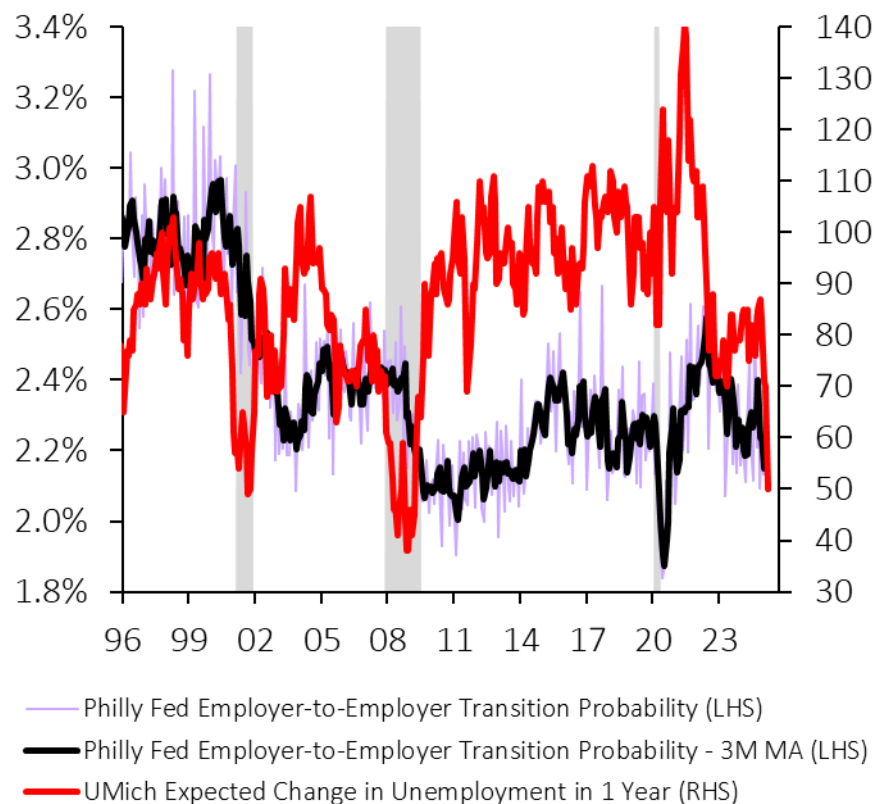
US employers announced a flurry of layoffs in Feb, concentrated in government, retail, and tech. So far this year, employers have announced 221K job cuts, the highest YTD total since 2009. Meanwhile, direct job switches are near a four year low, and expected change in unemployment is the worst since the GFC. This shift in tone in the labor market has impacted employee/job seeker sentiment, as seen in the second chart.

CG&C Job Cut Announcements vs JOLTS Layoffs



Source: Bloomberg and MUFG US Macro Strategy

Philly Fed Employer-to-Employer Probability vs UMich Expected Change in Unemployment

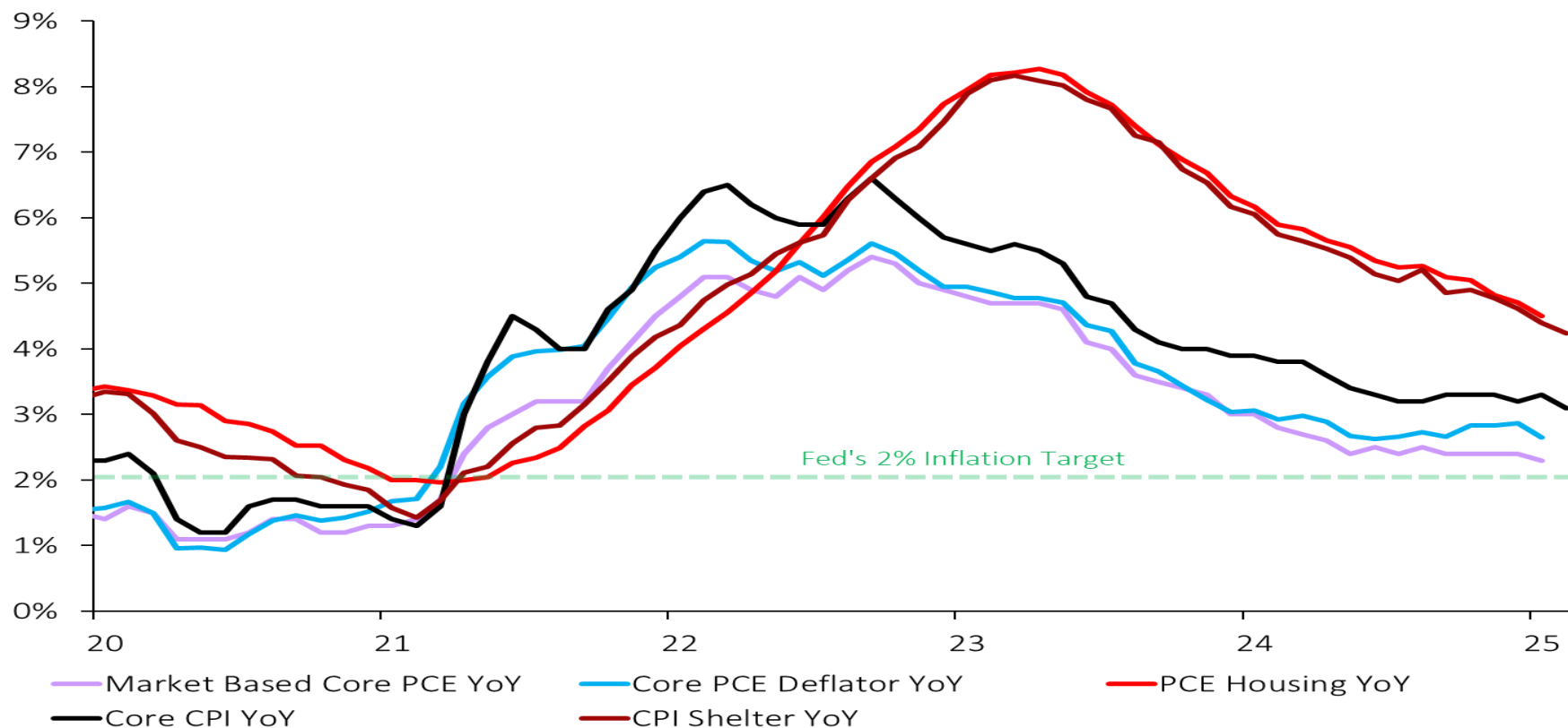


Source: Bloomberg and MUFG US Macro Strategy

Inflation | Annual inflation metrics converging with 2% target

While shelter inflation has remained sticky, core inflation has made significant progress towards the Fed's target. Market-based core PCE (actual prices rather than imputed) at 2.3% year-over-year is nearly there.
























Select PCE and CPI Metrics



Source: Bloomberg and MUFG US Macro Strategy

Inflation | However, monthly PCE readings will jump around

While PPI & CPI both printed softer than expectations in February, some components that feed into the Fed's preferred gauge, core PCE, came in slightly hotter. We do not think this will change their outlook on policy.

	(Month-over-Month % Chg)	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25	Trend	3M Avg	6M Avg	2024 Avg	3M Avg Momentum*
PPI Final Demand		0.4%	0.5%	0.1%	0.5%	0.0%	0.4%	0.0%	0.3%	0.3%	0.2%	0.2%	0.5%	0.6%	0.0%		0.4%	0.3%	0.3%	0.0%
PPI Final Demand Less Food & Energy		0.4%	0.3%	0.1%	0.5%	0.3%	0.5%	-0.1%	0.4%	0.4%	0.4%	0.0%	0.4%	0.5%	-0.1%		0.3%	0.3%	0.3%	0.0%
Select PPI Items That Feed Through to Core PCE:																				
Hospital Outpatient Care (NSA)		1.4%	0.5%	0.0%	-0.2%	0.3%	0.2%	0.3%	0.7%	0.0%	0.4%	0.0%	0.0%	0.5%	0.2%		0.2%	0.2%	0.3%	-0.4%
Hospital Inpatient Care (SA)		0.6%	0.2%	0.1%	0.2%	0.5%	0.3%	0.3%	0.3%	0.3%	-0.1%	0.2%	0.0%	-0.5%	1.0%		0.2%	0.2%	0.2%	-0.1%
Physician Care (SA)		0.5%	0.0%	0.3%	0.1%	0.2%	0.3%	-0.1%	0.1%	0.6%	0.5%	0.1%	0.2%	-0.4%	0.1%		0.0%	0.2%	0.2%	-0.3%
Portfolio Management (NSA)		6.8%	0.1%	0.7%	4.2%	-1.5%	1.2%	2.5%	0.0%	0.7%	2.8%	-0.7%	1.8%	0.5%	0.5%		0.9%	0.9%	1.6%	-1.6%
Nursing Home Care (SA)		0.3%	0.1%	0.2%	-0.6%	0.2%	0.0%	0.0%	0.3%	0.4%	0.6%	0.1%	0.9%	0.4%	0.1%		0.4%	0.4%	0.2%	0.3%
Airline Passenger Services (SA)		-0.1%	2.4%	2.2%	-3.9%	-3.1%	0.0%	0.5%	-0.5%	1.0%	1.9%	-0.5%	5.0%	0.1%	0.0%		1.7%	1.3%	0.4%	0.2%
Home Health, Hospice Care (SA)		-0.1%	0.1%	0.0%	0.0%	0.1%	0.2%	0.3%	0.0%	2.9%	0.6%	-0.2%	0.2%	-0.2%	0.3%		0.1%	0.6%	0.3%	0.1%
Headline CPI		0.3%	0.4%	0.3%	0.3%	0.0%	0.0%	0.1%	0.2%	0.2%	0.2%	0.3%	0.4%	0.5%	0.2%		0.3%	0.3%	0.2%	0.0%
CPI Less Food & Energy		0.4%	0.4%	0.4%	0.3%	0.1%	0.1%	0.2%	0.3%	0.3%	0.3%	0.3%	0.2%	0.4%	0.2%		0.3%	0.3%	0.3%	-0.1%
Select CPI Items That Feed Through to Core PCE:																				
Owners Equivalent Rent of Primary Residence (SA)		0.5%	0.4%	0.4%	0.4%	0.4%	0.3%	0.4%	0.5%	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%		0.3%	0.3%	0.4%	-0.2%
Major Appliances (SA)		1.0%	-1.6%	0.2%	-1.2%	-1.0%	1.0%	0.2%	-0.1%	-0.1%	0.5%	-1.1%	-2.9%	-1.1%	1.4%		-0.9%	-0.5%	-0.4%	-0.7%
Prescription Drugs (SA)		-0.8%	-0.1%	0.3%	0.2%	2.1%	0.0%	0.1%	-0.2%	-0.5%	0.2%	-0.4%	0.0%	2.5%	0.0%		0.9%	0.3%	0.1%	1.0%
Ltd Service Meals & Snacks (NSA)		0.6%	0.1%	0.3%	0.4%	0.2%	0.2%	0.3%	0.3%	0.2%	0.2%	0.3%	0.4%	0.3%	0.3%		0.4%	0.3%	0.3%	0.0%
Full Service Meals & Snacks (SA)		0.4%	0.1%	0.2%	0.3%	0.4%	0.7%	0.1%	0.2%	0.4%	0.2%	0.3%	0.2%	0.1%	0.4%		0.3%	0.3%	0.3%	0.0%
New Trucks (SA)		-0.1%	-0.1%	-0.2%	-0.3%	-0.4%	-0.1%	-0.1%	0.0%	0.1%	0.0%	0.4%	0.4%	0.0%	-0.1%		0.1%	0.1%	0.0%	0.2%
Urban Consumers Motor Vehicle Maintenance & Repair (SA)		0.8%	0.4%	1.7%	0.0%	0.3%	0.2%	-0.3%	0.6%	1.0%	1.1%	0.2%	0.2%	0.5%	0.3%		0.3%	0.5%	0.5%	-0.7%
Womens & Girls Apparel (SA)		-1.3%	0.2%	1.5%	1.2%	-0.7%	0.3%	-0.3%	0.9%	0.8%	-2.3%	0.0%	0.3%	-2.0%	0.4%		-0.4%	-0.5%	0.1%	-0.5%
Used Cars & Trucks (SA)		-3.7%	1.2%	-0.5%	-1.5%	-0.8%	-1.6%	-1.4%	-0.2%	0.5%	1.2%	1.3%	0.8%	2.2%	0.9%		1.3%	1.1%	-0.4%	2.3%
Computer Software & Accessories (NSA)		2.0%	3.6%	1.0%	0.0%	-3.9%	1.2%	0.9%	0.1%	-0.4%	-0.4%	0.4%	-3.0%	1.0%	3.3%		0.4%	0.2%	0.1%	-1.8%
Mens & Boys Apparel (SA)		1.0%	0.6%	-0.6%	1.1%	0.7%	-1.1%	-0.1%	0.0%	0.6%	0.1%	0.3%	0.1%	-0.5%	0.7%		0.1%	0.2%	0.2%	-0.3%
New Cars (SA)		0.2%	-0.2%	-0.3%	-0.5%	-0.3%	-0.3%	-0.3%	0.0%	0.0%	0.1%	0.6%	0.3%	0.2%	0.1%		0.2%	0.2%	-0.1%	0.3%

*3M Avg Momentum = Current 3M Avg Minus Q1-24 3M Avg

Source: Bloomberg and MUFG US Macro Strategy

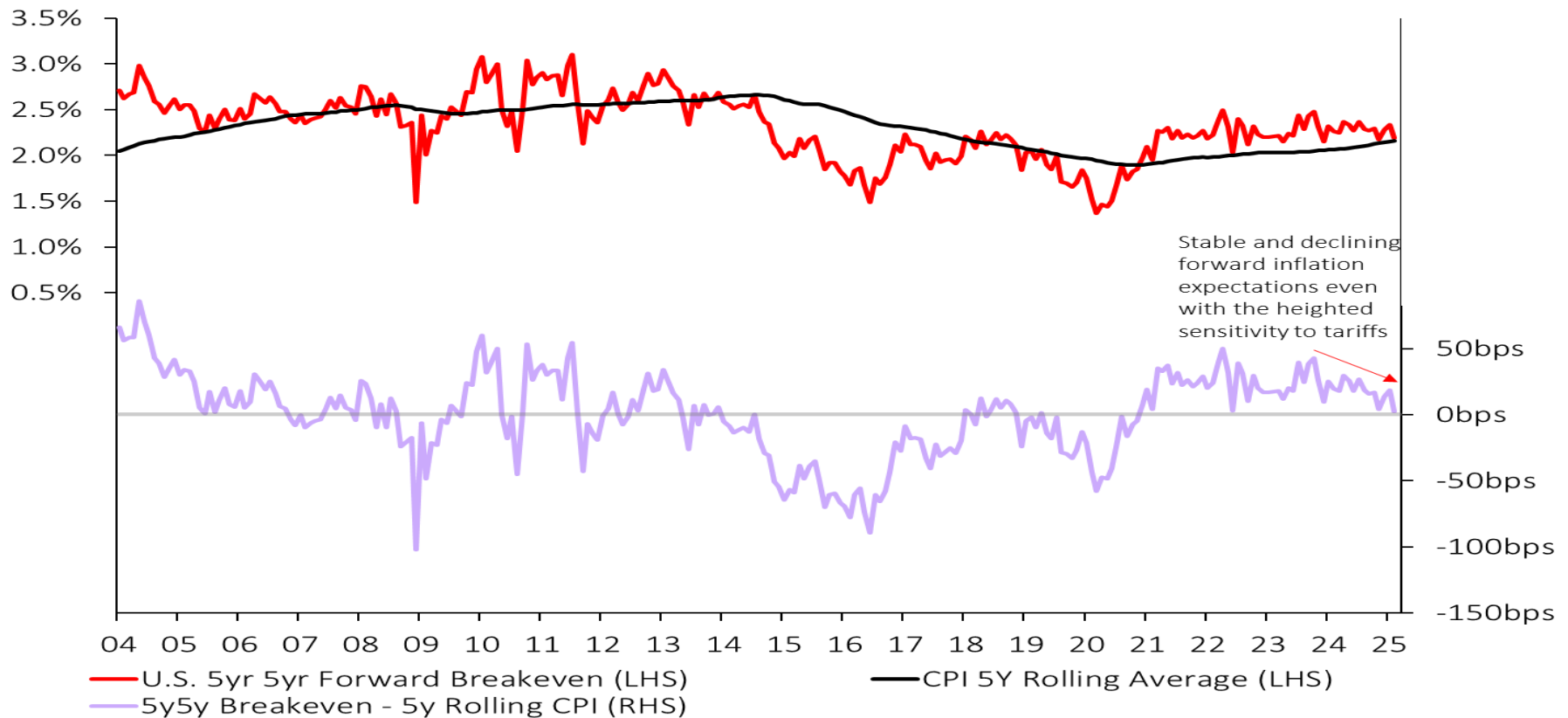
Markets

The issue is US rates markets rallied and priced-in a lot of the uncertainty ahead of the Fed

Rates | Markets are not anticipating a lasting inflation scare

Based on 5y5y market-based forward inflation expectations, the bond market is not discounting an inflation scare and instead is pivoting from concern over long term inflation to worries over growth and trade policy.

5y5y Forward Inflation Expectations (i.e. Breakevens) vs the 5y Rolling Average of Annual CPI vs Spread

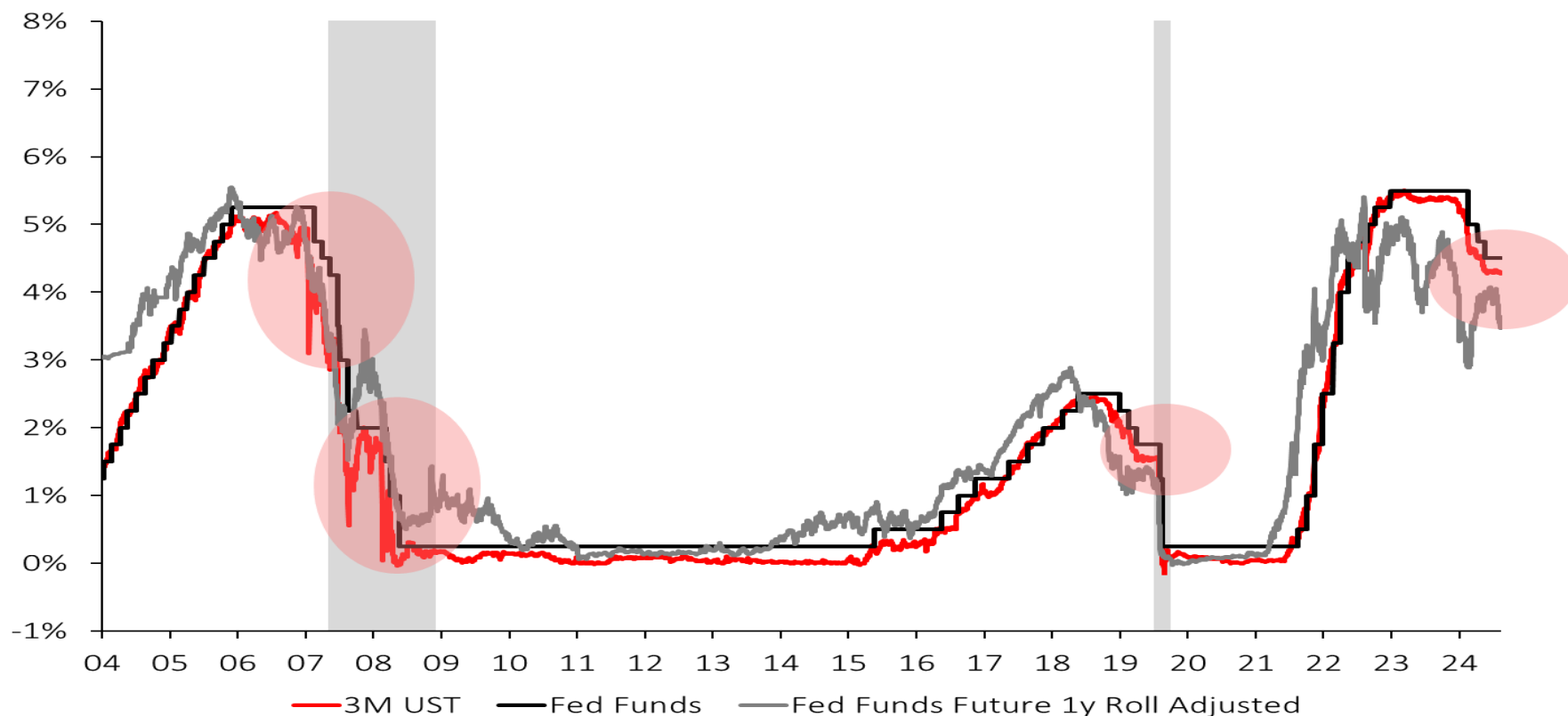


Source: Bloomberg and MUFG US Macro Strategy

Rates | Watch the 3M T-Bill to get a sense of imminent cuts

As seen in the chart (red circle areas), only when 3M T-Bills start to drop is the Fed close to start cutting... Until then, broader markets are just trading rate cut expectations that may or may not get delivered...

3m T-Bill Rate vs Fed Funds Target Spot Rate vs 1yr Constant Maturity (Roll Adj.) Fed Funds Future Rate



Source: Bloomberg and MUFG US Macro Strategy

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