

Fed: The Problem with Partial Assumptions

- **Insofar** that the Fed's **hawkish pivot** *accompanying (and essentially overwhelming!) the 25bp cut only partially incorporates Trump 2.0 risks*, it **may be problematic**.
- Point being, *halving of 2025 'Dot Plot' rate reduction to 50bp* was presumably premised on **hawkish economic upgrades**; comprising *inflation projections bumped up* and *unemployment nudged lower*.
- Inflation (PCE): **Bumped up 2025 projection by 40bp to 2.5%**. Full reversion to 2% inflation target pushed out to 2027 (from 2026), although 2026 is a mere 0.1%-pt higher (at 2.1%).
- Core Inflation (core PCE): **Lifted 2025 projection by 30bp to 2.5% inflation/core inflation**. Full reversion to 2% core inflation also deferred to 2027 (from 2026), although 2026 overshoot is just 0.2%-pt (at 2.2%).
- Unemployment: **unemployment is now nudged lower (by 10bp)** to 4.3% in 2025 (from 4.4%).
- Growth: Growth is hardly changed over 2022-2027, only fractionally tweaked (up 10bp for 2025 to 2.1%), with that 0.1%-pt coming out of 2027 (at 1.9% from 2.0%).
- At face value, the proportionate 50bp inflation-jobs (PCE up 40bp and unemployment down 10bp) hawkish upgrade appears to square with the hawkish 50bp 'Dot Plot' shift.
- But the trouble is, the **assumptions of "Trump-flation" risk are at best incomplete**. *At worst, outright biased*.
- To be sure, it is revealed that **uncertainty around inflation forecasts** have **increased materially**.
- Nonetheless, despite the uncertainty, the emphasis appears to be on the **upside bias in Trump 2.0 for inflation**.
- Specifically, **less uncertain** (and coincidentally **reflationary**) **outcomes** such as *tax cuts* and *deregulation* are ostensibly being **incorporated by some**.
- *In contrast*, **more uncertain** outcomes related to trade tariffs (and consequent retaliation), with **distinctly adverse economic effects**, are **omitted from economic forecasts**.
- It is understandable to preclude the complexities of uncertainty.
- But it is **mistake to confuse the uncertain for the improbable***.
- The **precise outcomes from trade antagonism may be highly uncertain**.
- **But** there are **significant probabilities of global trade friction, to the detriment of US (onshore) demand** (after higher import prices are borne**).
- Moreover, **dis-inflation from money-multiplier suppression** resulting from *Bessent's fiscal deficit reduction plans* alongside *cost slashing ambitions of minted DOGE^* also appear to be out of the Fed's calculus.
- So, what's **potentially problematic** is that **Trump 2.0** appears to be *framed with the bias reflation* whilst *under-accounting for adverse demand risks* as well as *unfamiliar dis-inflation dynamics*.
- In turn, this suggests that the Fed's hawkish flex may be inadvertently overdone.

- The **resultant curve ball** for markets from this may be [UST yields unexpectedly turning sharply lower](#) heading into 2025.

* “Knightian uncertainty” (derived from Frank Knight’s characterization of uncertainty) refers to the inability to predict (ascribe probabilities to outcomes), hence quantify due to unknowns that cannot be modelled. But these are not necessarily proportionately improbable.

** The US does not have the luxury of benefitting from import substitution for a large swathe of goods.

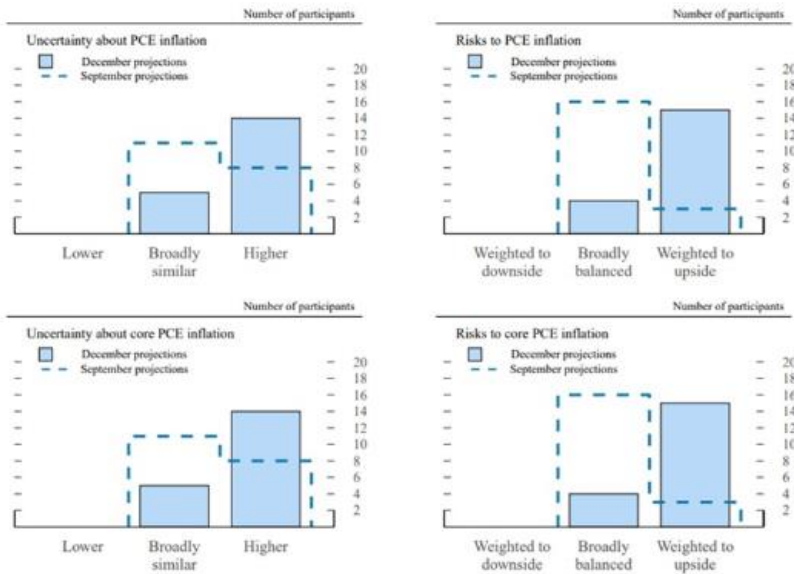
^ DOGE refers to the newly formed Department of Government Efficiency led by Elon Musk and Republican Vivek Ramaswamy to slash government spending.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2024

Percent

Variable	Median ¹					Central Tendency ²					Range ³				
	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run
Change in real GDP	2.5	2.1	2.0	1.9	1.8	2.4-2.5	1.8-2.2	1.9-2.1	1.8-2.0	1.7-2.0	2.3-2.7	1.6-2.5	1.4-2.5	1.5-2.5	1.7-2.5
September projection	2.0	2.0	2.0	2.0	1.8	1.9-2.1	1.8-2.2	1.9-2.3	1.8-2.1	1.7-2.0	1.8-2.6	1.3-2.5	1.7-2.5	1.7-2.5	1.7-2.5
Unemployment rate	4.2	4.3	4.3	4.3	4.2	4.2	4.2-4.5	4.1-4.4	4.0-4.4	3.9-4.3	4.2	4.2-4.5	3.9-4.6	3.8-4.5	3.5-4.5
September projection	4.4	4.4	4.3	4.2	4.2	4.3-4.4	4.2-4.5	4.0-4.4	4.0-4.4	3.9-4.3	4.2-4.5	4.2-4.7	3.9-4.5	3.8-4.5	3.5-4.5
PCE inflation	2.4	2.5	2.1	2.0	2.0	2.4-2.5	2.3-2.6	2.0-2.2	2.0	2.0	2.4-2.7	2.1-2.9	2.0-2.6	2.0-2.4	2.0
September projection	2.3	2.1	2.0	2.0	2.0	2.2-2.4	2.1-2.2	2.0	2.0	2.0	2.1-2.7	2.1-2.4	2.0-2.2	2.0-2.1	2.0
Core PCE inflation ⁴	2.8	2.5	2.2	2.0		2.8-2.9	2.5-2.7	2.0-2.3	2.0		2.8-2.9	2.1-3.2	2.0-2.7	2.0-2.6	
September projection	2.6	2.2	2.0	2.0		2.6-2.7	2.1-2.3	2.0	2.0		2.4-2.9	2.1-2.5	2.0-2.2	2.0-2.2	
Memo: Projected appropriate policy path															
Federal funds rate	4.4	3.9	3.4	3.1	3.0	4.4-4.6	3.6-4.1	3.1-3.6	2.9-3.6	2.8-3.6	4.4-4.6	3.1-4.4	2.4-3.9	2.4-3.9	2.4-3.9
September projection	4.4	3.4	2.9	2.9	2.9	4.4-4.6	3.1-3.6	2.6-3.6	2.6-3.6	2.5-3.5	4.1-4.9	2.9-4.1	2.4-3.9	2.4-3.9	2.4-3.8

FOMC participants’ assessments of uncertainty and risks around their economic projections



Source: Charts and Table from the Fed’s Summary of Economic Projections released with the FOMC.

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