



March FOMC preview: The fog of war and the credibility of policy

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KEY MESSAGES

- We expect the FOMC to acknowledge that risks to inflation have increased on account of the Iran war, and to underscore the importance of maintaining stable long-term inflation expectations.
- We see a significant, underappreciated tail risk that the FOMC moves toward a “symmetric policy bias”, i.e. either a rate hike or a cut is roughly equally likely to follow. However, our base case is that policymakers delay this change for now, as the US labor market does not seem to be overheating and the war’s length, severity and economic impact are uncertain.
- We still expect the FOMC to remain on hold this year, owing to economic resilience and high, sticky inflation. The oil price rise increases our short-run conviction in this view, but leaves us with greater, bidirectional risk over the medium term.

The FOMC is entering a sixth year of well-above-target inflation, something it has consistently argued to be transitory and likely to return to target before long. The FOMC has also now spent several years arguing that monetary policy is restrictive and that the US economy is likely to slow notably over coming quarters; in fact, growth has been resilient. Since [summer 2024](#), the FOMC has also argued that the labor market faces pronounced risk – that it is “flashing red” – but instead, jobless claims have stayed low and prime-age employment has remained close to its highest level since 2001.

Even the best economists have good calls and bad calls. But this context – this question of the Fed’s credibility – is central to the outcome of the March FOMC meeting. The US economy is now confronted by an unknown but potentially significant energy price shock owing to the Iran war, which may sharply push up inflation while also creating downside risks to growth and employment. The textbook response to this type of shock is to dismiss the energy-driven inflation as acyclical, “transitory” noise and to focus instead on any lasting, cyclical impacts to economic activity. Critically, though, a central bank can set the inflation aside only if it can be assured that inflation will naturally return to target on its own, as a result of well-anchored long-term inflation expectations (LTIE). Given all the events of recent years, can the Fed sell another period of “transitory” inflation to the American public (and to itself)? Or will officials judge this as too risky to try?

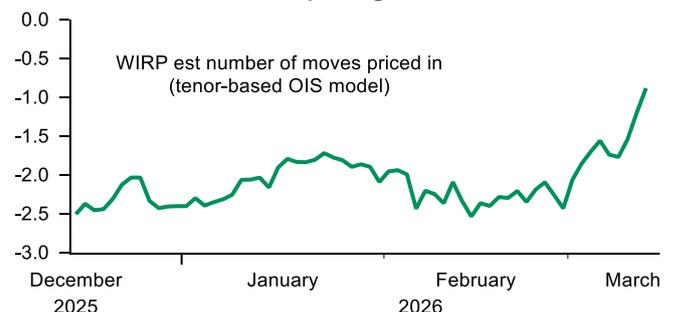
For now, we expect the FOMC to try to keep its options open. We expect it to keep rates on hold on 18 March, and to note in the meeting statement that inflationary risks and uncertainty about the economic outlook have increased. In his press conference, we think Chair Powell will emphasize the importance of maintaining credibility on the FOMC’s 2% inflation target. As a base case, we also expect the FOMC to retain an easing bias, with the statement still referring to “additional adjustments” and the SEP maintaining one 2026 rate cut. We think the FOMC will continue to argue that “the unemployment rate has shown some signs of stabilization” despite weak jobs data, although we think that that weak data, combined with uncertainty about the war’s length, severity and economic impact, will temper how far Powell is willing to go in his press conference in opening the door to eventual rate hikes.

BNP Paribas estimate of FOMC’s March SEP

Variable	2026	2027	2028	Longer run
Change in real GDP	2.3	2.0	1.9	1.8
December projection	2.3	2.0	1.9	1.8
Unemployment rate	4.4	4.2	4.2	4.2
December projection	4.4	4.2	4.2	4.2
PCE inflation	2.9	2.1	2.0	2.0
December projection	2.4	2.1	2.0	2.0
Core PCE inflation	2.9	2.1	2.0	
December projection	2.5	2.1	2.0	
Federal funds rate	3.4	3.1	3.1	3.0
December projection	3.4	3.1	3.1	3.0

Sources: Federal Reserve, BNP Paribas

Markets are pricing out rate cuts



Note: Negative indicates rate cuts
 Sources: Bloomberg, Macrobond, BNP Paribas

We see a significant, underappreciated tail risk that the FOMC goes further than this and moves to a fully symmetric policy bias now. Concerns have escalated within the FOMC in recent months about its credibility, and, in the January minutes, continued high inflation was a trigger among “several” participants for potential rate hikes. The range of economic outcomes that could ensue from the war is very wide, meaning that there may be demand among policymakers for greater room to maneuver. Some may also believe that retaining an easing bias would send an unwanted dovish signal to a bond market that has now largely priced out rate cuts over the next several months. In any event, we think the FOMC will be closely divided on this issue, as it was in January.

Outlook: We continue to expect no rate cuts from the Fed this year, owing to US economic resilience, a stable unemployment rate and sticky, elevated inflation. We think recent economic data has been broadly consistent with this outlook. Growth data has been solid, and employment data – while clearly disappointing for February – has on average over recent months proved consistent with what we would expect for a stable jobs market with tight immigration policy constraining labor supply growth. Inflation has also (as expected) showed continued pass-through of tariffs into goods prices, continued heat in non-shelter services, and continued moderate softening in rent price growth.

It is difficult to anticipate the course of the war. That said, we expect a considerable near-term rise in inflation, with significant core pass-through, ensuing from high energy prices. A straight read of oil futures prices into our inflation forecast would lead to headline PCE inflation in the mid-3% range over the course of 2026. Although we believe the FOMC is pursuing an imbalanced reaction function favoring employment and willing to endure moderately elevated, entrenched inflation, there are likely limits to policymakers’ tolerance.

In the short term, we believe the war’s impact on growth and employment will be modest, leaving a robust outlook in place. This is principally because of the resilience of equity and other financial markets, as well as apparently widespread expectations that the war will not be prolonged and will not lead to disorderly economic or financial conditions. Longer term, uncertainty around the war opens up tails of the distribution: it is easier to envision rate hikes to address inflationary entrenchment, as occurred in extremis under the Volcker Fed, but it is also possible that energy-price volatility and uncertainty could eventually lead to recessionary conditions and rate cuts, as occurred in 2008 prior to the GFC.

We believe the Fed is faced with a persistent inflation problem. It has relied on anchored LTIE to deflate the US economy over time, but with consumers and businesses having faced repeated periods of high and volatile inflation in recent years, we see LTIE as likely to continue responding to economic news, possibly including the war if it persists, and in any event for LTIE to put limited downward force on inflation. The Fed has also formulated monetary policy according to a neutral rate estimate that we think is too low, meaning that the Fed often expects growth to slow or the labor market to stall and is surprised when they do not. Finally, the Fed assumes that fiscal and geopolitical surprises are likely to have no effect on inflation on average, but the trend since the pandemic has been for these policy shocks to be inflationary on average. We believe that this persistent inflation problem, and debate about how to manage it, will have significant influence over the FOMC’s choices going forward.

Policy bias: The [FOMC statement](#) includes the words “additional adjustments,” which is widely understood to mean that while the Fed is on a policy hold of uncertain duration, the next move (whenever it comes) is likely to be another rate cut. This is known as an “easing bias.” In the past, the FOMC has used different language to signal greater balance in the policy outlook: a “symmetric bias.” For example, in [July 2019](#), the FOMC statement said that as it “contemplates the future path of the target range for the federal funds rate” it would look at various factors; this language was hashed out in a torturous [back-and-forth debate](#) to “regain optionality.”

The current easing bias was originally a consensus view on the FOMC. At the [January](#) meeting, however, things changed, with only “several participants” thinking that rate cuts would “likely be appropriate” if inflation declined over time as they expected. On the other hand, “several participants” – a group of apparently similar size to the first – “indicated that they would have supported a [two-sided description](#) of the Committee’s future interest rate decisions, reflecting the possibility that [upward adjustments to the target range for the federal funds rate could be appropriate if inflation remains at above-target levels.](#)”

Moving to a symmetric bias could take the form of replacing the words “the extent and timing of additional adjustments to ... the federal funds rate” with “the path of the federal funds rate,” “the stance of monetary policy,” “[future policy adjustments](#),” or a similar phrase that does not include the word “additional.” A related change would be to say that risks to inflation have risen relative to those for employment or are in greater balance, similar to the [June 2008](#) and [September 2025](#) FOMC statements.

We tend to think that at the March meeting, the FOMC will not be quite ready to make a shift to a symmetric bias and will instead defer this issue to the April meeting. The unemployment rate appears to be broadly stable but not declining, suggesting little imminent need to slam on the brakes. Moreover, the Iran war has only recently begun, and the FOMC will probably hesitate to make a lasting change to the policy statement based on a geopolitical shock that could prove to be fleeting. Interest rate futures also now incorporate very little easing from the Fed in 2026, reducing the need for a hawkish FOMC to deliver a shock to expectations. Finally, we think this FOMC has historically reacted to bad inflation news with a multi-meeting lag (such as during the pandemic reopening), as it has required a high level of conviction before taking actions that could put the labor market at risk.

The most compelling argument to changing the bias now, in our view, is not that a hike is genuinely seen as a near-term possibility, but that it signals policymaker commitment to the inflation target and reduces risk of de-anchoring if cuts are eventually needed. However, this is not a risk-free endeavor. In June 2008, the FOMC similarly tried to balance risks to inflationary entrenchment associated with very high oil prices with slowing growth and a labor market of questionable vigor. A [9 June 2008](#) speech underscoring commitment to low and stable inflation produced one of the largest Treasury market sell-offs in history, only three months ahead of the failure of Lehman Brothers, and is in hindsight regarded at the Fed as a mistake. We think the burden of proof to take this type of step is surmountable, but that it will probably take a bit more time and a bit more evidence that high oil prices will be sustained.

Dots: We expect the FOMC to move up its inflation forecasts sharply in the Summary of Economic Projections, both due to upside surprises to PCE inflation in early 2026 and to incorporate a higher oil baseline. We expect the FOMC to only partially incorporate higher oil futures prices into the projections, in the hope that these market prices include a transitory geopolitical risk premium; a full incorporation would be worth a further 0.3pp increase in headline PCE and 0.15pp in core PCE. We expect steady projections for growth, employment, and policy.

We expect rate projections will be broadly stable. We think most FOMC participants will revise their policy views slowly in response to the war, in part due to the high level of uncertainty but largely because policy battle lines within the committee had become so dug-in and strongly held, but this is a close call for us. The bar to move to a zero-cut median SEP dot is likely lower than to change the statement language because non-voting reserve bank presidents contribute to the SEP, some of whom have changed views rapidly in the past.

For the median 2026 rate projection to shift to no cuts, three policymakers would need to change their views. The most likely way for this to happen is that some combination of non-leadership FOMC participants like Governors Barr and Cook, Boston Fed President Collins, Chicago Fed President Goolsbee and Minneapolis Fed President Kashkari move their dots to zero for 2026. While we think that some of this group may shift views – Kashkari, for example, appeared uncomfortable with further cuts and the easing bias in a Wall Street Journal interview – our guess is that there is not enough movement to shift the median.

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In addition, there is a mitigation measure to manage conflicts of interest for each transaction with controls put in place to restrict the information flow, involvement of personnel and handling of client relations between each transaction in such a way that the different interests are appropriately protected. Gifts and Entertainment policy is to monitor physical gifts, benefits and invitation to events that is in line with the firm policy and Anti-Bribery regulations. BNPP maintains several policies with respect to conflicts of interest including our Personal Account Dealing and Outside Business Interests policies which sit alongside our general Conflicts of Interest Policy, along with several policies that the firm has in place to prevent and avoid conflicts of interest.

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