US Daily: April FOMC Preview: On Hold Ahead of the Leadership Transition

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- The FOMC is likely to reiterate its wait-and-see message at its April meeting this week because the war with Iran continues to cloud the economic outlook and to present risks to both inflation and activity. The Committee's post-meeting statement is likely to acknowledge the better labor market news and higher inflation numbers but to leave the standing policy guidance unchanged. We expect a strong consensus to stay on hold for now, with only one dissent, as in March.
- The announcement that the Department of Justice is dropping its investigation of Chair Powell has cleared the way for Kevin Warsh to be confirmed as the new chair. While the bond market's reaction to the news implied it sees the switch from Powell to Warsh as having mildly dovish implications for policy later this year, we are less confident in this because Warsh and Powell have actually had similar views on inflation and interest rate policy, at least prior to the war.
- Our probability-weighted Fed forecast remains more dovish than market pricing because we continue to expect two 25bp rate cuts in September and December, and we think that rate hikes are quite unlikely. To monitor the risk that inflation sparked by the war could become more persistent and rate hikes more likely, we introduced a composite indicator that includes wage pressures, inflation expectations, and the breadth of inflation. So far, it remains subdued.

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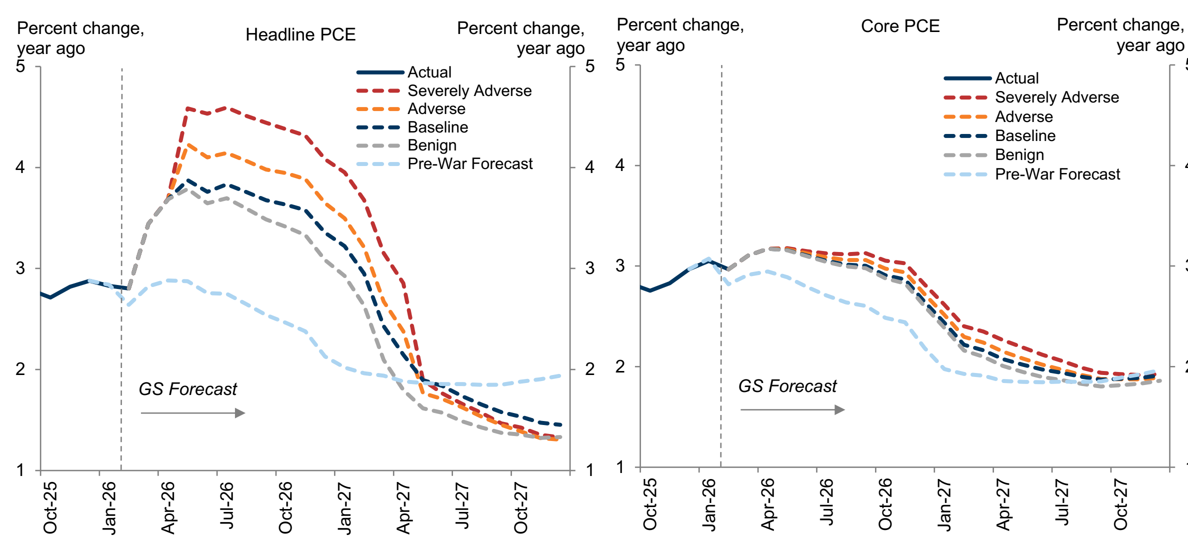
Our April Fed Chatterbox noted that most participants see the current policy stance as leaving the FOMC in a good place to remain on hold while it evaluates news about the war and its impact on the economy. We expect a strong consensus to stay on hold, with only one dissent from Governor Miran, as in March.

The FOMC's post-meeting statement is likely to leave the policy guidance unchanged. While the minutes to the March meeting noted that "some" participants saw "a strong case for a two-sided description of the Committee's future interest rate decisions," recent comments from participants indicated that most still expect the next move to be a cut, and there is little additional reason to make a change now that the FOMC chose not to in March.

We expect small changes to the statement to note the better labor market news and higher inflation numbers. The FOMC could drop "job gains have remained low" and leave only "the unemployment rate has been little changed in recent months," or it could note that job gains have picked up and have been roughly in line with slower labor force growth on average. The FOMC is also likely to say that "inflation remains elevated," dropping "somewhat." Both headline and core PCE inflation are likely to exceed 3% when March data are released on Thursday, and we have recently raised our own inflation forecasts (Exhibit 1) on the back of further increases in our commodities strategists' oil price forecast.

Exhibit 1: Our Commodities Strategists Have Just Raised Their Oil Price Forecast, and We Now Expect Year-over-year Headline PCE Inflation to Stand at 3.4% and Core PCE Inflation at 2.6% in December 2026



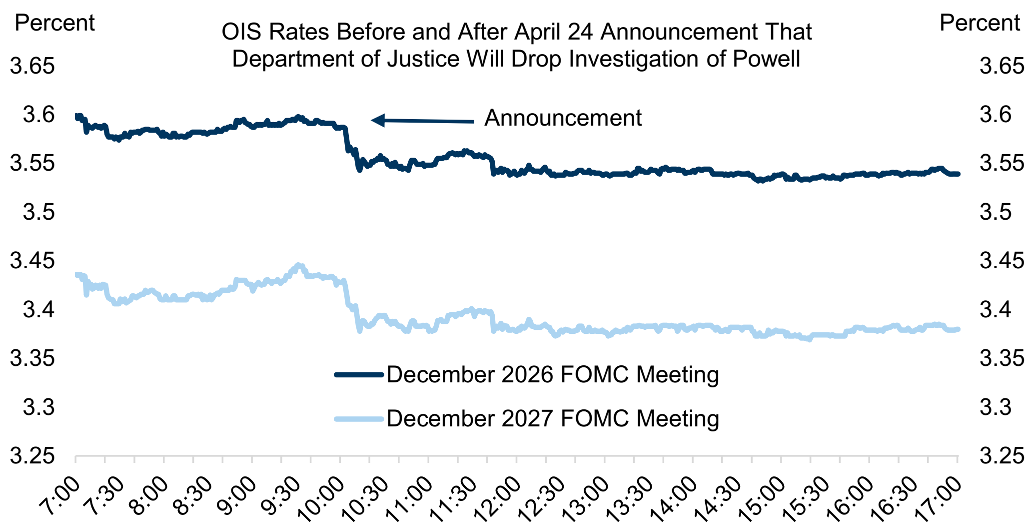
Note: Baseline assumes oil prices average $100 in April and May before declining to $90 by 2026Q4. Benign scenario assumes oil prices average $100 in April and May before declining to $80 by 2026Q4. Adverse scenario assumes oil prices average $100 in April and $125 in May before declining to $100 by 2026Q4. Severely adverse scenario assumes oil prices average $100 in April and $145 in May before declining to $120 by 2026Q4.

Source: Goldman Sachs Global Investment Research

The announcement last week that the Department of Justice is dropping its investigation of Chair Powell led Senator Tillis to say on Sunday that he is prepared to move forward with the confirmation of Kevin Warsh as the new chair. We discussed Warsh's views in an earlier note and discussed his proposal to pair rate cuts and balance sheet reduction last month. Powell said he had not decided whether to remain on the FOMC as a governor at the March meeting.

The leadership transition is unlikely to affect policy decisions while uncertainty around the war remains high. But the bond market's reaction to the news that the investigation is ending (Exhibit 2) suggests that most investors see the switch from Powell to Warsh as having mildly dovish implications for policy later this year. We are less confident in this, both because a new chair might not have as much influence as Powell had in pressing for cuts when the FOMC is divided, and because Warsh and Powell have actually had similar views on inflation and interest rate policy, at least prior to the war. In his Senate testimony last week, Warsh highlighted the trimmed mean measure of inflation, which has run lower than the core recently. But that is partly because it is trimming out tariff-affected categories, which is similar in effect to Powell's preference for citing core PCE inflation net of estimated tariff effects.

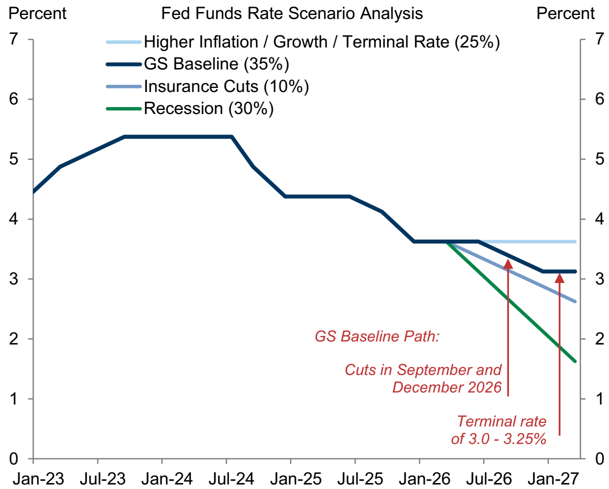
Exhibit 2: The Bond Market Took the Announcement That the Department of Justice Will Drop Its Investigation of Chair Powell, Paving the Way for Warsh to Be Confirmed, as Modestly Dovish News

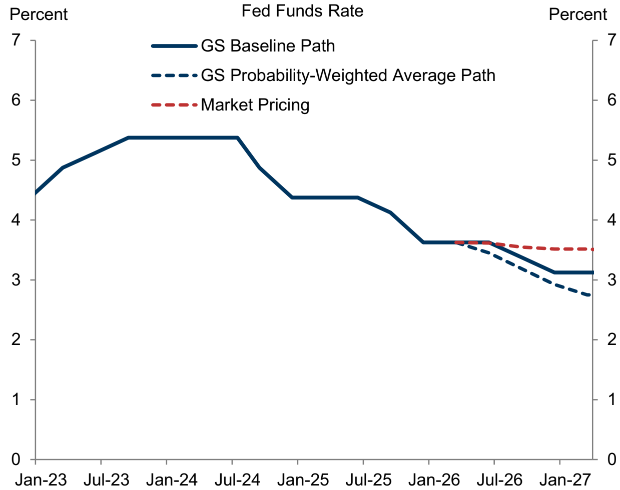


Source: Goldman Sachs Global Investment Research, Bloomberg

Our probability-weighted Fed forecast remains more dovish than market pricing (Exhibit 3) because we continue to expect two 25bp rate cuts in September and December, because we think that if cuts do not occur this year they would likely come next year, and because we think that rate hikes are quite unlikely.

Exhibit 3: Our Probability-Weighted Fed Forecast Is Much More Dovish Than Market Pricing Because We Expect Two More Cuts This Year and Because We Think That Rate Hikes Are Quite Unlikely

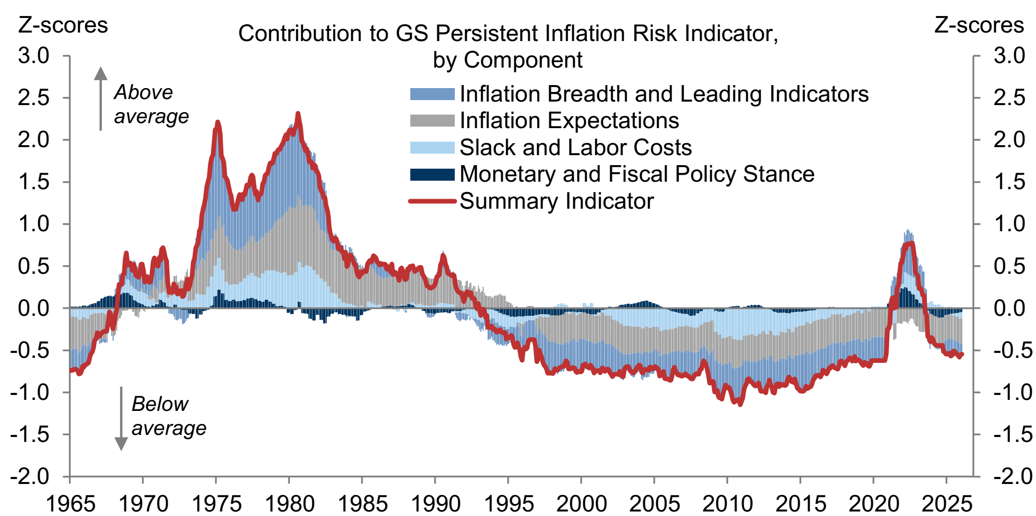




Source: Goldman Sachs Global Investment Research

To monitor the risk that inflation sparked by the war could become more persistent and rate hikes more likely, we recently introduced a new indicator that combines key signals including slack and wage pressures, inflation expectations, and the breadth of inflation. The indicator should capture the more concerning aspects of the 2022 experience if they reappear—wage growth accelerating beyond a point compatible with 2% price inflation and threatening to create a wage-price feedback loop, signs that larger-than-usual price increases are becoming normalized, and the broadening of large price increases beyond products directly affected by rising input costs. So far, our measure remains subdued (Exhibit 4).

Exhibit 4: We Would Worry More About the War Sparking Persistent Inflation and Possible Rate Hikes If Wage Growth Accelerated, Inflation Breath Increased, and Inflation Expectations Beyond This Year Rose



Source: Goldman Sachs Global Investment Research

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