Yardeni Research

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Morning Briefing

The Fed's Economic Forecast Versus The Consensus & Ours

Check out the accompanying chart collection.

Executive Summary: Investors clearly fear a recession is coming—that's what the recent stock market correction suggests. The consensus of economists probably puts the prospect of a recession at 35% (as we now do). Fed officials likely expect to avert a recession by lowering interest rates; FOMC meeting participants dropped their GDP projections last week to 1.7% this year. As for us, we see a fork in the road. One way leads to stagflation, which includes the possibility of a recession (35% odds). But our base case remains the Roaring 2020s (65%), in which a tech-led productivity boom lifts profit margins, propels GDP, suppresses inflation, and fuels wage growth and consumers' buying power. ... Also: Dr Ed reviews "I'm Still Here" (+ +).

YRI Weekly Webcast. Join our live webcast with Q&A on Mondays at 11 a.m., EST, with Ed and Eric. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Forecasts I: The Consensus. Trump Turmoil 2.0 has caused a correction in the stock market. The S&P 500 fell 10.1% from its record high on February 19 through March 13 (*Fig. 1*). It was down 7.8% on Friday from its peak. The Nasdaq is down 11.8% from its peak on December 16 through Friday's close (*Fig. 2*). The Magnificent-7 stocks led the recent rout. The Roundhill Magnificent Seven ETF (MAGS) is down 18.8% from its record high on December 17, while the Defiance Large Cap ex-Mag 7 ETF is down 6.0% since February 19 (*Fig. 3*). The latter is essentially the S&P 500 minus the Mag-7, i.e., the "S&P 493."

As we've previously noted, S&P 500 corrections (10%-20% declines) typically occur when investors fear a recession is imminent. The decline is attributable to a drop in the forward P/E of the S&P 500. The forward earnings of the index continues to rise because industry analysts tend not to share the recession concerns of investors. That's because such fears don't plug well into the analysts' earnings models; the analysts are more attuned to what managements are saying about the companies they cover. Bear markets (declines of 20% or more) occur when investors' recession fears are realized, forcing industry analysts to scramble to cut their earnings estimates.

So the forward P/E is a leading indicator of the economy that isn't very accurate, while forward earnings is highly correlated with the Index of Coincident Economic Indicators, which is the most accurate monthly indicator of the business cycle (*Fig. 4*).

Currently, investors fear a recession, while forward earnings continues to rise to record-high territory. On March 5, Debbie, Eric, and I raised our subjective probability of a recession from 20% to 35% because of the Trump administration's increasing tariff turmoil and shotgun approach to reducing federal government payrolls.

Polymarket.com, an online betting platform, showed that the odds of a recession stood at 22% in mid-February (*Fig. 5*). It rose to about 40% during the first half of March and is now at 35%. Polymarket also allows traders to place a bet on "How high will inflation get in 2025?" However, the choices are limited to inflation rising above 3%, above 4%, and up to "above 10%." The latest betting shows 48% odds on inflation rising above 3%.

Meanwhile, the March Consumer Sentiment Index (CSI) survey showed that respondents expect a median inflation rate of 4.9% over the next 12 months, while a similar February survey conducted by the Federal Reserve Bank of New York showed 3.1% over the same period (*Fig. 6*).

It's hard to pin down a precise consensus outlook for inflation. The same can be said about an outlook for the economy. That's partly because consensus forecasts change over time. Also, the consensus of the general public is bound to be different than that of economists, which is bound to differ from investors' consensus. Different strokes for different folks, depending on their personal experiences and biases. Indeed, the CSI survey has become very partisan lately, with Democrats much more pessimistic than Republicans about the outlook for inflation and the economy.

The Wall Street Journal conducts a quarterly survey of economists. The latest survey was covered in a January 19 *article*. Here are the salient points:

(1) *GDP & recession odds.* The odds of a recession over the next 12 months in the January poll was down to 22%, the lowest since January 2022 and down from the most recent peak of 63% during October 2022. The economists collectively forecast that real GDP will increase 2.0% in 2025.

If we may be allowed to forecast the forecasters, we reckon that the survey in early April will show that their subjective odds of a recession has increased to 35%, the same as ours. We guess that their 2.0% real GDP forecast for this year will remain unchanged. Ours remains unchanged at 2.5%-3.0%.

(2) *Inflation.* Economists had already begun modeling the effects of President Trump's plans to raise tariffs, cut taxes, and restrict immigration at the time of the article: "The upshot: Inflation and interest rates are likely to be higher for at least the next two years than forecasters anticipated before the election."

The consensus of 73 economists showed the CPI inflation rate at 2.7% y/y through December 2025, up from 2.3% in the October survey. Their forecast for inflation this year is likely to be closer to 3.0% in the April survey on concerns that Trump's tariffs are bound to boost prices at least on a one-shot basis. In late November, Trump said he would impose tariffs of 25% on Mexico and Canada and 10% on China on day one of his presidency. He started talking about more widespread "reciprocal tariffs" about a month ago. They are scheduled to be announced on April 2, which is likely to influence the next *WSJ* survey results.

(3) *Interest rates.* Here is what the *WSJ* article reported about the consensus outlook for interest rates: "Faced with stickier inflation, economists expect the Fed to keep interest rates higher through 2027 than previously forecast. The midpoint of the range of the federal funds rate [FFR], currently 4.375%, is now seen ending the year at 3.89%, up from the October average projection of 3.3%. Economists now expect the 10-year Treasury bond yield to end 2025 at 4.4%, up from an October projection of 3.7%."

We reckon the consensus FFR forecast will remain about the same, calling for two 25bps cuts this year. The year-end bond yield forecast might drop a bit from the *WSJ* survey's 4.4% to the current level of 4.2%.

We are still in the none-and-done camp on Fed rate cutting this year. If we are wrong, the current consensus of economists and the FFR futures market—two rate cuts—will likely be right (*Fig. 7*). We still expect the 10-year Treasury bond yield to range mostly between 4.25% and 4.75% this year.

Forecasts II: The Fed. The latest *Summary of Economic Projections* (SEP), released by the Federal Open Market Committee (FOMC) after its meeting last Wednesday, showed that the meeting participants collectively expect to lower the FFR from 4.25%-4.50%

currently. In terms of their new economic forecasts, their "dot plot" continues to have two 25bps cuts this year, two next year, and one in 2027, with the "longer-run" FFR still seen at 3% (*Fig. 8*). The latter implies that the current level of the FFR is restrictive.

Presumably, most FOMC participants are anticipating that they will have to lower the FFR closer to its longer-run level to avert a recession. Indeed, they lowered their real GDP growth forecasts to 1.7% from 2.1% for 2025, to 1.8% from 2.0% for 2026, and to 1.8% from 1.9% for 2027 (*Fig. 9*). This likely reflects the growth drags from government spending cuts and the prospect of significant tariffs squeezing profit margins and household spending power.

That's a relatively pessimistic forecast considering that the labor force is growing between 0.5% and 1.0% y/y currently and productivity is growing around 2.0% y/y (*Fig. 10* and *Fig. 11*). Those numbers add up to real GDP growth rates of 2.5%-3.0% y/y, consistent with our more upbeat outlook (*Fig. 12*).

In the SEP, the median unemployment rate projection for the end of this year was raised from 4.3% to 4.4% (*Fig. 13*). It remained at 4.3% for the ends of both 2026 and 2027.

So why are Fed officials saying that they are in no hurry to lower interest rates if they are anticipating they will have to do so to avert a recession later this year? Indeed, just a few hours after the FOMC voted to leave the FFR unchanged, in a post Wednesday night on Truth Social, President Trump encouraged Chair Jerome Powell and his colleagues to ease policy as the administration enters the next phase of its aggressive trade policy.

"The Fed would be MUCH better off CUTTING RATES as U.S.Tariffs start to transition (ease!) their way into the economy," Trump wrote. "Do the right thing. April 2nd is Liberation Day in America!!!"

The Fed is in no hurry to do so because the latest economic indicators suggest that the economy remains resilient. Furthermore, Fed officials have raised their inflation expectations since the December SEP, with core PCED now expected to end the year at 2.8% versus 2.5% in December, presumably reflecting upside pressure on prices from tariffs, but their 2026 forecast remains 2.2% (*Fig. 14*). In other words, the FOMC expects tariffs to have a transitory impact on inflation.

In his *press conference* on Wednesday, Fed Chair Jerome Powell confirmed all the above:

(1) *Transitory uncertainty.* Powell mentioned the words "uncertain" or "uncertainty" 16 times. He attributed the abnormal amount of uncertainty to Trump 2.0. For example, he said, "So in the current situation, there's probably some elevated uncertainty because of … significant policy shifts in those four areas that I mentioned: tariffs, immigration, fiscal policy, and regulatory policy. So there's probably some additional uncertainty, but that should be passing; we should go through that. And then we'll be back to the regular amount of uncertainty."

(2) *Tariffs are the known unknown*. The main source of uncertainty is clearly tariffs, according to Powell: "We don't know what's going to be tariffed. We don't know for how long or how much [or] what countries. We don't know about retaliation. We don't know how it's going to transmit through the economy to consumers. That really does remain to be seen. [T]here are lots of places where … that price increase from the tariff can show up between the manufacturer and a consumer. Just so many variables. So we're just going to have to wait and see."

(3) *Inflation closer to target*. Powell noted that inflation has moderated significantly over the past two years. He acknowledged that it "remains somewhat elevated relative to our 2 percent longer-run goal." He also said, "Estimates based on the consumer price index and other data indicate that total PCE prices rose 2.6% over the 12 months ending in December and that, excluding the volatile food and energy categories, core PCE prices rose 2.8%." He did not mention the recent spike in the CSI survey's one-year-ahead expected inflation rate. Instead, he said that long-term inflation expectations "remain well anchored."

It's not clear why Powell estimated December's PCED inflation rates. January's numbers came out at the end of last month showing headline and core inflation rates of 2.5% and 2.6% (*Fig. 15*). He might have misspoken and was actually referring to February's PCED, which will be released on March 28.

February's headline and core CPI inflation rates were 2.8% and 3.1% (*Fig. 16*). More encouraging were the 2.0% and 2.2% readings excluding shelter (*Fig. 17*). The CPI rent of shelter inflation rate remains elevated at 4.3% y/y, but it remains on a moderating trend (*Fig. 18*).

(4) *Transitory tariff inflation.* Powell mentioned the word "transitory" twice when he discussed the likely impact of tariffs on inflation. For example: "As I've mentioned, it can be the case that it's appropriate sometimes to look through inflation if it's going to go away quickly without action by us, if it's transitory. And that can be the case [with] tariff inflation. I

think that would depend on the tariff inflation moving through fairly quickly and critically as well [as] on longer-term inflation expectations being well anchored."

Describing inflation as "transitory" didn't work out so well for Powell last time, in 2021, just before inflation turned into a persistent problem during 2022 and 2023. Powell noted that Trump 1.0's tariffs didn't move the needle on inflation. But he didn't mention that the Smoot-Hawley Tariff of June 1930 had an extremely deflationary impact, causing the global economy to fall into a depression.

(5) *Good place*. On balance, Powell came across as relatively optimistic: "And right now, we feel like we're in a very good place. Policy's well positioned. The economy's in … quite a good place …[W] hat we do expect is to see further progress on inflation, and …as we see that—or if we were to see weakening in the labor market that could foster—we could then be in a position … of making further adjustments. But right now … we don't see that, and we see things as in a really good place for policy and for the economy. … [S]o we feel like we don't need to be in a hurry …to make any adjustments."

Powell did not respond to Trump's post Wednesday evening.

Forecasts III: Our Two Scenarios. We've decided to fold our 1990s meltup/meltdown scenario into our Roaring 2020s scenario. The current correction in the stock market suggests that the former has played out already, as the bull market's highflyers have been hit hardest by the current correction. That leaves us with two scenarios: the Roaring 2020s, to which we assign a 65% subjective probability, and a mostly stagflation scenario, with a 35% probability. The former includes the possibility of a rebound in the former highflyers, while the latter includes the possibility of a recession.

So our base case continues to be more upbeat than both the consensus expectations of economists and the projections of Fed officials. In this Roaring 2020s scenario, productivity growth continues to be boosted by technological innovations. That boosts the growth rate of real GDP, keeps a lid on inflation, fuels the growth of real wages (i.e., consumers' purchasing power), and lifts profit margins.

Movie. "I'm Still Here" (+ +) is a 2024 Brazilian docudrama about the Paiva family's strength during the 1970s military dictatorship in Brazil. Fernanda Torres nails it as Eunice Paiva, a mom thrust into chaos after her husband, a former politician, gets snatched by the regime. Dictatorships are deadly. They kill their opponents and terrorize their citizens. Here in the US, partisanship has reached the point where Democrats and Republicans are accusing each other of being existential threats to our democracy. Fortunately, our constitutional system of checks and balances continues to work against extremists on both sides. (See our movie reviews *archive*.)

Calendars

US: Mon: S&P Global M-PMI & NM-PMI Flash Estimates 51.9 & 51.2; Bostic; Barr. **Tues:** Consumer Confidence Index 94; New Home Sales 680,000 Units; Richmond Manufacturing Index 8; Williams; Kugler. (FXStreet estimates)

Global: Mon: Eurozone, Germany & France M-PMI Flash Estimates 48.0, 47.7 & 46.2; Eurozone, Germany & France NM-PMI Flash Estimates 51.0, 51.4 & 46.3; UK M-PMI & NM-PMI Flash Estimates 48.0 & 51.0; Bailey; BoJ Policy Meeting Minutes. **Tues:** Ifo Business Climate Index 87. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 0.6% last week, behind the 0.9% rise for the AC World ex-US index, which it has trailed in eight of the past nine weeks. The US MSCI has risen 2.8% from March 13's six-month low to 8.0% below its January 23 record high. The AC World ex-US has lagged since March 13 with a gain of 2.0%, but is just 2.4% below its June 15, 2021 record high. EM Asia was the best performing region last week, with a gain of 1.3%, followed by EM Latin America (1.2%), EM (1.1) and the AC World ex-US. EMEA was the worst regional performer, with a decline of 0.6%, followed by EMU (-0.3), Europe (0.0) and EAFE (0.7). The India MSCI index performed the best among country indexes last week, with a gain of 6.4%, followed by Korea (3.9), Japan (3.1), Spain (2.3), and South Africa (2.3). The China MSCI index was the week's worst country performer, falling 1.7%, followed by the Mexico (-1.2), Hong Kong (-1.0), Sweden (-0.9), and Germany (-0.9). On a ytd basis, the US MSCI index is down 3.8% and trails the 7.8% gain for the AC World ex-US. Among regional indexes, EMU is ahead of the pack ytd, leading with a gain of 15.6%, followed by EM Latin America (14.5), Europe (13.2), EAFE (9.9), and the AC World ex-US. The worst performing regions so far in 2025: EM Asia (4.2), EM (5.2), and EMEA (6.7). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 24.1%, followed by Germany (19.3), China (17.6), Sweden (17.4), and Brazil (15.8). The worst performing countries ytd:

Taiwan (-6.3), India (-4.0), the US (-3.8), Australia (-2.5), and Canada (1.1).

US Stock Indexes (*link*): Forty-six of the 48 major US stock indexes that we follow rose for the week, compared to just one rising in the prior week and none the week before that. The Russell MidCap Growth index was the best performer, with a gain of 2.0%, ahead of S&P 500 LargeCap Pure Growth (1.6%), S&P 600 SmallCap Pure Value (1.4), S&P 600 SmallCap Pure Growth (1.3), Dow Jones Industrials (1.2), and S&P 500 LargeCap Pure Value (1.2). The Dow Jones 20 Transports, with a decline of 0.2%, was the worst performer, followed by Dow Jones 15 Utilities (-0.1), S&P 500 LargeCap Growth (0.1), and Nasdaq Composite (0.2). Just six of the 48 indexes are still positive so far in 2025, down from 47 of 48 rising ytd in mid-February and 46 rising in 2024. The Dow Jones 15 Utilities is in the top spot as the best performer so far in 2025, with a gain of 2.7%, ahead of Russell 1000 Value (1.3), S&P 500 LargeCap Pure Value (1.3), S&P 100 Equal Weighted (1.0), and Russell 3000 Value (0.9). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-10.4), Nasdaq Industrials (-9.5), S&P 600 SmallCap Value (-9.0), Russell 1000 Growth (-8.7), Russell 3000 Growth (-8.7), and S&P 600 SmallCap Equal Weighted (-8.7).

S&P 500 Sectors Performance (*link*): Four of the 11 S&P 500 sectors rose during the week ending March 21, and the same four sectors beat the S&P 500’s 0.5% gain. Although seven of the 11 sectors underperformed for the week, their declines were relatively minor. The outperformers last week: Energy (3.2%), Financials (1.9), Health Care (1.1), and Industrials (0.8). The underperformers last week: Consumer Staples (-0.3), Materials (-0.3), Utilities (-0.2), Communication Services (-0.1), Information Technology (-0.1), Real Estate (-0.1), and Consumer Discretionary (0.0). The S&P 500 is now down 3.6% ytd, yet a whopping nine of the 11 sectors are ahead of the index and six are in positive territory. Energy now wears the crown as the best ytd performer, with a gain of 7.3%, ahead of Health Care (6.2), Utilities (3.2), Financials (2.0), Materials (1.6), Real Estate (1.4), Consumer Staples (1.2), Industrials (0.1), and Communication Services (-3.5). These two sectors are lagging the S&P 500 so far in 2025: Consumer Discretionary (-13.9) and Information Technology (-9.5).

US Economic Indicators

Leading Indicators (*link*): “The US LEI fell again in February and continues to point to headwinds ahead,” noted Justyna Zabinska-La Monica, senior manager of business cycle indicators at the Conference Board. *Leading economic indicators (LEI)* fell for the third successive month in February, by 0.3% m/m and 0.6% over the period, to its lowest level since December 2016. The *LEI* has plunged 15.9% since December 2021's record high. The LEI dropped 1.0% during the six-month period ended February 2025, less than half its 2.1% decrease over the prior six-month period. *On a positive note*, according to the report, "the LEI's six-month and annual growth rates, while still negative, have remained on an upward trend since the end of 2023, suggesting that headwinds in the economy as of February may have moderated compared to last year." During February, five of the 10 components of the LEI contributed negatively, while four contributed positively, with nondefense capital goods orders excluding aircraft unchanged. The *biggest drags on the LEI* were consumer expectations for business conditions (-0.19ppts) and the ISM new orders index (-0.15), followed by initial claims (-0.05), building permits (-0.03), and the leading credit index (-0.01). *Partially offsetting these declines* were gains in the manufacturing hours worked (+0.12ppts), followed by stock prices (+0.04), while the measures for both the interest-rate spread and manufacturers' new orders for consumer goods & materials contributed +0.01ppt to the LEI.

Coincident Indicators (*link*): The Coincident Economic Indicators (CEI) index rose for the fourth straight month to a new record high, climbing 0.3% in February and 1.1% over the period. The CEI expanded 1.2% during the six-month period ended February 2025, twice its 0.6% growth over the prior six-month period. All four components of February's CEI—payroll employment, personal income less transfer payments, manufacturing & trade sales, and industrial production—once again contributed positively to the CEI, with industrial production leading the pack for the third successive month, followed by personal income less transfer payments, manufacturing and trade sales, and payroll employment.

Regional M-PMIs (*link*): The Philadelphia Fed is the second regional Fed bank to report on manufacturing activity for March, New York being the first. New York showed a sharp deterioration in business activity and an acceleration in prices, with its *headline general business conditions* measure tumbling 25.7 points (to -20.0 from 5.7), while the *prices-paid and prices-received* measures saw the former accelerating at the fastest pace in over two years, while the latter continued to pick up. Looking at the *Philadelphia survey*, it showed manufacturing activity in the region expanded overall but was less widespread. The *general business activity index* fell 5.6 points (to 12.5 from 18.1) in March, with both the *new orders* (8.7 from 21.9) and *shipments* (2.0 from 26.3) measures showing a dramatic slowing in activity during the month. Meanwhile, firms continued to report overall gains in *employment*, with this measure jumping 14.4 points (19.7 from 5.3) this month to its highest reading since October 2022, while the *average workweek* expanded 5.8 points (8.7 from 2.9). Turning to prices, the *prices-paid* (48.3 from 40.5) index showed an acceleration for the fourth successive month—to its highest reading since July 2022—while the *prices-received* (29.8 from 32.9) measure showed a slight slowing in inflationary pressures. The *future general activity index* sank 22.2 points (to 5.6 from 27.8) to its lowest reading since January 2024. The *future new orders* (2.3 from 33.1) measure dropped 30.8 points to its lowest level since May 2023, with shipments (11.3 from 36.5) sinking 25.2 points to its lowest reading since June. The *future employment* (17.3 from 23.7) measure showed only a slight slowing of jobs growth. Both the *future prices-paid* (44.6 from 58.6) and *future prices-received* (39.7 from 46.1) gauges showed a slowing of inflationary pressures.

Existing Home Sales (*link*): "Home buyers are slowly entering the market," noted Lawrence Yun, chief economist of NAR. "Mortgage rates have not changed much, but more inventory and choices are releasing pent-up housing demand." Existing home sales in February rebounded from January's slump, jumping 4.2% to 4.26mu (saar) but down 1.2% from a year ago. Single-family units jumped 5.7% in February to 3.89mu, though were basically even with a year ago, ticking down 0.3%, while existing condominium and co-op sales sank 9.8% on both a monthly and yearly basis to 370,000 units. *Regionally*, existing home sales on a monthly and yearly basis were a mixed bag: Sales in the West (13.3% m/m & 0.0% y/y) posted the strongest monthly gain and the Northeast (-2.0 & 4.2) the largest yearly gain, while the South (4.4 & -4.0) saw sales rise during February but fall from year-ago levels; sales in the Midwest (0.0 & 1.0) were flat during February and only slightly above year-ago levels. The inventory of unsold existing homes increased to 1.24mu in February–up 5.1% from January and 17.0% from a year ago (1.06mu); February's unsold inventory represented 3.5 months' supply at the current sales pace, identical to January's supply and up from 3.0 months last February.

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