US Interest Rate Projections & the Gulf in Global Trade Balances

The Federal Open Market Committee is the main committee that oversees and determines monetary policy, including the buying and selling of US Treasuries. For the Federal Reserve to make any changes to monetary policy, it first requires a majority of FOMC members to vote in favour of any action. The committee comprises the Board of Governors of the Central Bank, including Chair Jerome Powell, along with the Presidents of certain Reserve Banks.

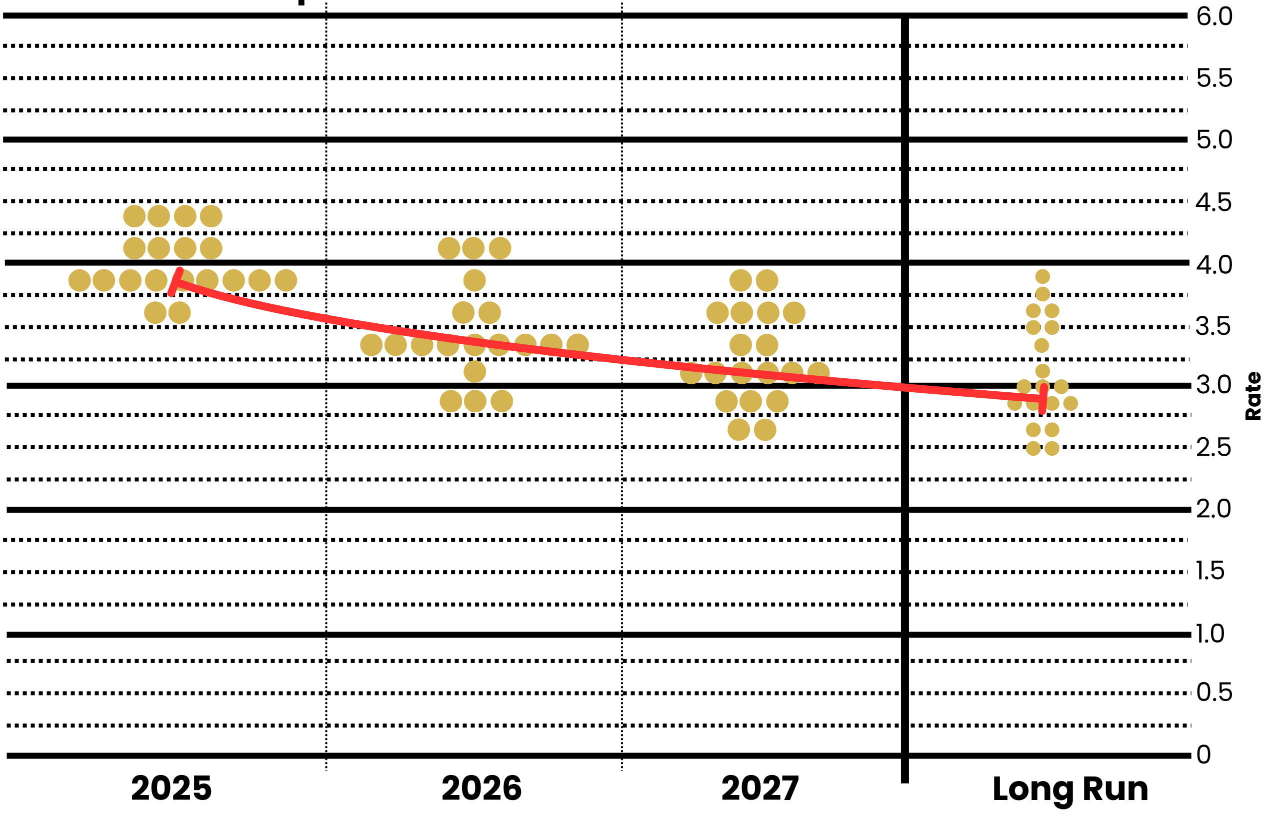
As part of the Fed's decision-making process, it also produces a summary of economic projections, outlining its view on key economic indicators such as inflation and GDP growth. Another key projection is the Dot Plot, which reflects FOMC participants' assessments of appropriate interest rate levels over several distinct time frames. In the Dot Plot, each golden dot represents one FOMC member, allowing us to observe where the Federal Reserve expects rates to be from 2025 to 2027. Below is the current Dot Plot, released on the 19th of March.

For 2025, nine FOMC members project that rates will be in the range of 3.75%–4%, compared to the current level of 4.25%–4.50%. This indicates that most Fed members expect a 50bps reduction, or two rate cuts, in 2025. More importantly, if we observe the red line that divides the majority opinions in 2026 and 2027, we can see a gradual decline between 2025 and 2027.

From this, we can infer that members do not currently anticipate a scenario in which rates would need to be cut rapidly, such as in a recession. Rather, the FOMC currently predicts a steady decline in interest rates, which aligns with the committee's inflation forecasts for 2025–2027 and emphasises that the committee expects the US economy to perform well over the next two years.

While markets are currently volatile and recession concerns are heightened, it is important to bear in mind that the key decision-makers on US monetary policy do not currently anticipate a major economic downturn in the short term.

Federal Open Market Committee Dot Plot - March 2025



Source - Seaspray Private

The main reason for such recessionary talk has been the potential impact of tariffs and a broader trade war between the US and its key trading partners. While the tariffs themselves are unlikely to have a major impact, the consequences of a trade war could slow overall economic growth.

The primary driver behind these US tariffs is, of course, the country's trade deficit. Since 1970, the United States has run a trade deficit, posting a deficit of $2.59 billion that year. Since then, however, it has only deepened, and when compared to other key markets, the contrast is quite stark. Below, we see the Net Trade Balance in Goods for major economies worldwide in 2023, based on the latest available data from the World Bank. China had the world's largest goods surplus in 2023, posting a net trade balance of $593 billion. The rapid expansion of China's export market has propelled its merchandise exports to $1 trillion since 2020. Over the past two decades, its trade balance has surged from $33 billion to half a trillion based on current data, and it has likely increased further in 2024.

Germany recorded the second-largest net trade balance in 2023 at $249 billion. As Europe's largest economy, Germany has faced domestic GDP growth challenges, yet its strong export market—particularly in automobiles, which totalled $174 billion—reinforces its status as an export powerhouse. Remarkably, Ireland had the third-largest net trade balance in the world in 2023, totalling $168 billion, despite having the smallest population among the countries listed below. Ireland's thriving pharmaceutical export industry, the largest of its kind globally, has significantly benefited the country, enabling it to compete on the international stage against much larger economies while also contributing to GDP growth.

At the other end of the spectrum is the US, which ran a net trade deficit of just over $1 trillion in 2023—the largest of any nation. Strong consumer demand in the US, combined with a limited capacity for domestic manufacturing, has led to this substantial trade deficit, which the current US administration aims to reduce.

Source - Seaspray Private