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Fed Rate Cuts Would Risk Repeating the Mistakes of the 1970s

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On Wednesday, March 18th, the Federal Open Market Committee (FOMC), the Federal Reserve's policymaking body, announced its decision to hold short-term rates steady, ending the series of three straight rate cuts that closed out 2025.

Markets sold off in the afternoon, as the move increased inflation concerns and the Fed's Summary of Economic Projections signaled fewer than expected rate cuts the rest of this year. The S&P 500 fell to its lowest level since last November (now down more than 3% year to date). U.S. Treasuries sold off for the same reasons, causing yields to rise—the 2-year Treasury yield increased 7.5 basis points to 3.746% and the 10-year Treasury yield increased 5.5 basis points to end the day at 4.257%. **The Fed's dot plot now forecasts only one 25 basis point rate cut in 2026 and another in 2027.** Interestingly, one FOMC participant forecasted a 25 basis point rate *increase* next year, highlighting the extreme level of uncertainty about the appropriate direction of monetary policy. With the 2-year Treasury priced above the Federal Funds Rate, the bond market also appears to be pricing in the possibility of near-term rate increases.

USA Federal Funds Target Rate

Recession Periods - United States

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Current target range

3.75

6% 5% 4% 3% 2% 1% 0%

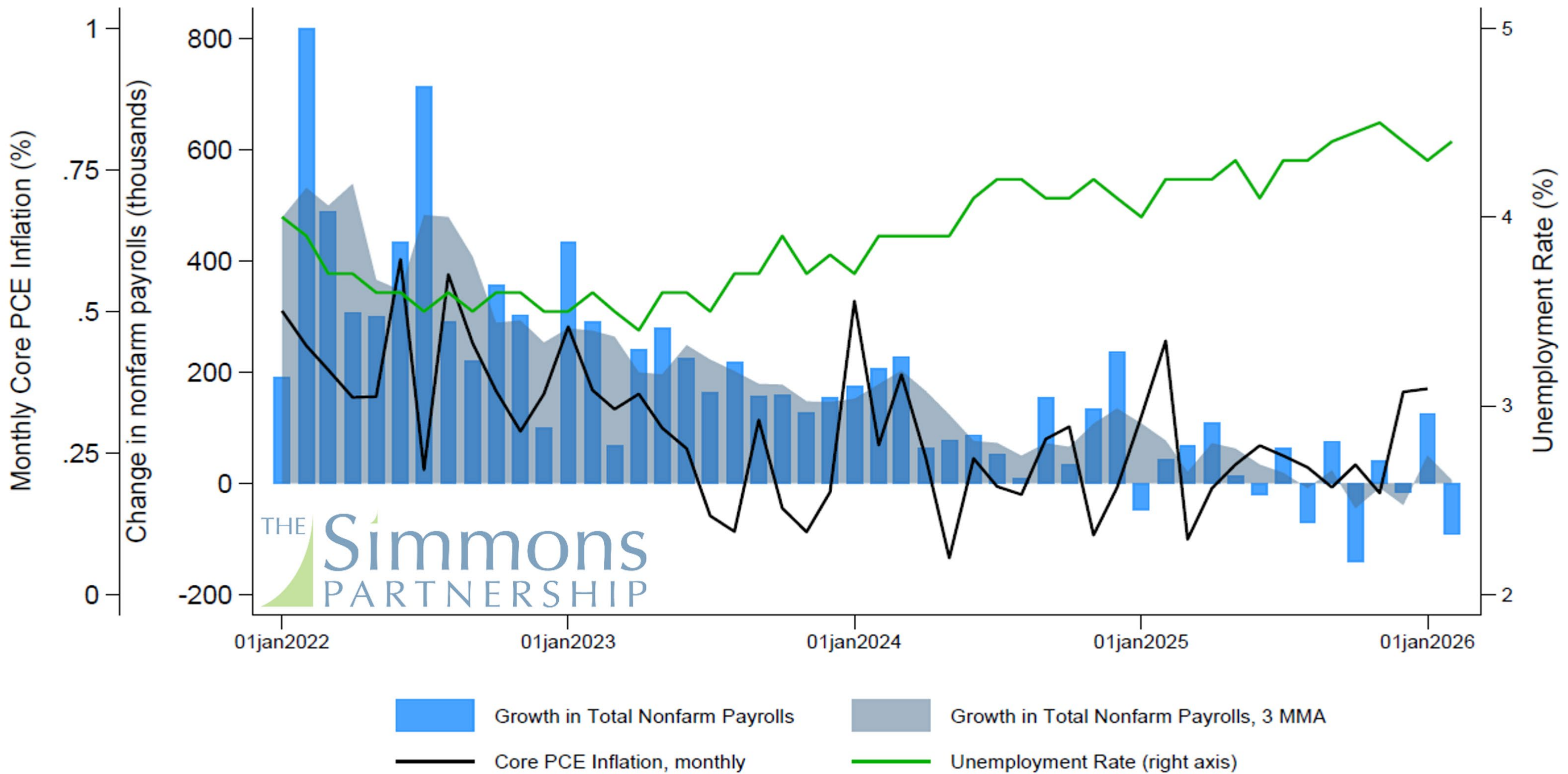
'22 '23 '24 '25 '26 '27 '28 '29

The Fed's dot plot—each dot representing a FOMC participant's assessment of the appropriate target level of the Fed Funds Rate—indicates at most one 25 basis point rate cut this year, with the majority favoring another 25 basis point cut in 2027. Cutting rates amid the current economic backdrop risks a policy misstep reminiscent of the Fed's response to the 1973 oil crisis.

Source: FactSet and Federal Reserve Board of Governors

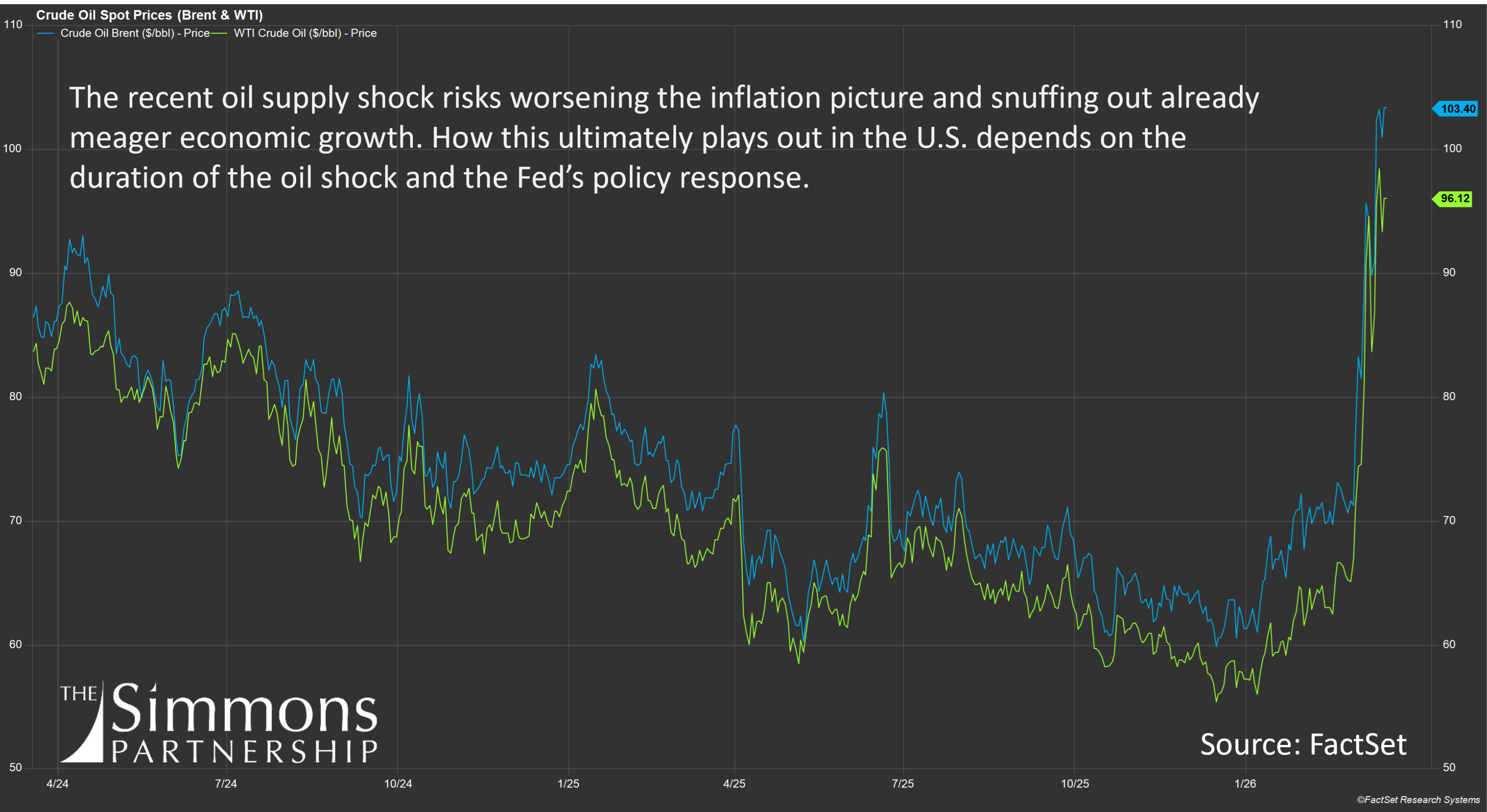
The Fed is in a tough spot. Their decision, which I believe is correct, reflects the uncertainty of the current macroeconomic environment. U.S. economic growth over the past year has been consistently revised down and much weaker than initially estimated. The latest revision for Q4 2025 showed the economy grew at an annualized rate of 0.7%—half the 1.4% growth rate initially released by the BEA in February's advance estimate. The labor market is the weakest it has been in decades, shedding 92,000 jobs in the month of February with the unemployment rate ticking up to 4.4%. PCE inflation (currently at an annualized rate 3.1%) remains persistently above the Fed's target. Additionally, the onset of the conflict in Iran has increased geopolitical uncertainty and sent a shock through oil markets. Meanwhile, Chairman Powell has faced significant criticism for not cutting rates fast enough, particularly from the White House. President Trump has all but demanded lower rates and Kevin Warsh, the nominee to replace Powell in May, seems primed to deliver.

The current oil supply shock risks worsening the inflation picture and snuffing out what meager growth we have. Oil is an input to virtually everything, so a negative supply shock is inflationary for input costs. Additionally, higher oil prices drive up the cost of gasoline and diesel—some estimates suggest that consumers can expect an increase of 30 cents for a gallon of gasoline for every $10 per barrel increase in the price oil. Oil prices are up about $40 per barrel since the beginning of the year. Perhaps more insidiously, higher prices at the pump tend to dampen sentiment (which is already weak) and increase inflation expectations. In turn, higher gas prices tend to crowd out consumer spending in other areas as consumers cut back—a vicious cycle of low growth and high inflation (stagflation) that is particularly difficult for policymakers to remedy with conventional tools.



Data courtesy of the U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Analysis (retrieved from Federal Reserve Bank of St. Louis FRED Database).

We've been here before. In an eerily-familiar setup to today, the Fed under Arthur Burns had been cutting rates throughout the early 1970s (reportedly also under heavy pressure from the Nixon White House). An OPEC oil embargo in the fall of 1973 caused a sharp spike in oil prices. With unemployment and inflation very similar to today, the Fed chose to remain accommodative and cut rates in the face of the oil supply shock. The Fed's misstep effectively institutionalized the inflationary impact of the supply shock, with rising input costs and loose monetary policy fueling rising inflation and further cementing higher inflation expectations.



How this ultimately plays out in the U.S. depends on two things: the duration of the oil shock and the Fed's policy response. If the war in Iran is resolved quickly, the recent disruption to oil markets could prove to be temporary—as a rule, policymakers should ignore short-term shocks that result in one-time price shifts. **However, if the Fed cuts rates amid the current economic backdrop, they risk a policy misstep reminiscent of their response to the 1973 oil crisis.**

At least for now, the Powell Fed seems loathe to let history repeat itself. Time will tell if his successors will have the same fortitude.

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