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The Presidential Race and Next Week's FOMC Meeting

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The presidential nomination process is reaching a critical moment with the important Florida and Ohio primaries next Tuesday. On the prediction markets, Trump is now up to 71% to 74% to be the GOP nominee, and a win in both those states would virtually clinch his nomination. Right now Kasich is given a slight edge in Ohio, but Trump has a double digit lead over Rubio and Cruz in Florida. However, we know from what happened in Michigan that surprises can occur. Despite her Michigan defeat, Clinton is still an 82% to 88% favorite to be the Democratic nominee.

Draghi worked his magic on the European markets yesterday … for about 45 minutes. Markets were pleased with the drop in the policy rates and the increase in the QE, but when he noted in the subsequent news conference that he does not anticipate any more actions, the markets quickly reversed, and then some. Nevertheless, European stocks have rallied today, noting that Draghi did not foreclose further measures if the economy did not respond to the increased stimulus.

Next Wednesday we have the important quarterly FOMC meeting which includes forecasts of key economic variables and the path of future Fed Funds rates. To predict that there will not be any change in current policy rate of 25 to 50 bps is a "slam dunk." Yet, the language that is used in the statement will be very important to the markets. Fears of recession have been reduced significantly in recent weeks; yesterday's near record low for jobless claims, a very sensitive labor market indicator, shows the economy is moving forward. To be sure, projections for Q1 GDP growth are not extraordinary – 2% to 2.5%, but they certainly indicate that the economy is in a stall.

The critical issue for the Fed are the firm readings on inflation. And with oil now in the high $30s (Brent today is near $41), energy prices may begin to rise. We have already seen national gasoline prices rise 19 cents from the mid- February low and further increases seem inevitable (gas jumped 4 cents yesterday, one of the largest one-day increases in more than a year). If job growth continues at its current rate of 250k to 250k a month and the participation rate does not rise, the unemployment rate will continue to fall. No one knows for sure when the labor market will become "tight" enough to spur wage increases that exceed productivity growth, but if that happens in the context of rising commodity prices, it will difficult for the Fed to stay at current rates for long.
