

2026 Citadel FI&M Central Bank Challenge

April 2026 FOMC Policy Recommendation



Hold FFR at 3.50–3.75%

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Team 5

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Hold Rationale



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Executive Summary: Hold FFR at 3.50–3.75%

Holding Best Balances Inflation and Growth Risks

The Market Default – Hold at 3.50-3.75%

Target Rate (BPS)	Now	1 Month Ago
300-325	0.0%	0.1%
325-350	0.0%	5.8%
350-375 (current)	99.5%	94.1%
375-400	0.5%	0.0%

- Interest rate traders have priced in 99.5% probability of a hold per CME FedWatch
- Powell in March FOMC Press Conference advocated for a hold in the plausible estimates of neutral to help stabilize labor market and allow inflation to resume downward trend to 2%
- Fed's March dot plot shows 19 submissions with a meaningful amount of movement toward fewer cuts in 2026

Our Agreeing View – HOLD

Three thesis pillars supported by a semi-structural model:

Inflation Progress Remains Incomplete

Core inflation is easing, but underlying price pressures remain above target. Holding preserves restraint and reduces the risk of easing before disinflation is secured.

Labor Is Cooling, Not Breaking

Hiring and vacancies are moderating, but employment conditions remain sufficiently resilient. Current weakness does not yet justify pre-emptive easing.

Growth Can Absorb Continued Restraint

Financial conditions and private demand remain supportive enough to sustain activity. Holding maintains inflation pressure without imposing the excess cost of another hike.

Inflation: Core PCE inflation Path

Trend is Toward Target, but with Roadblocks

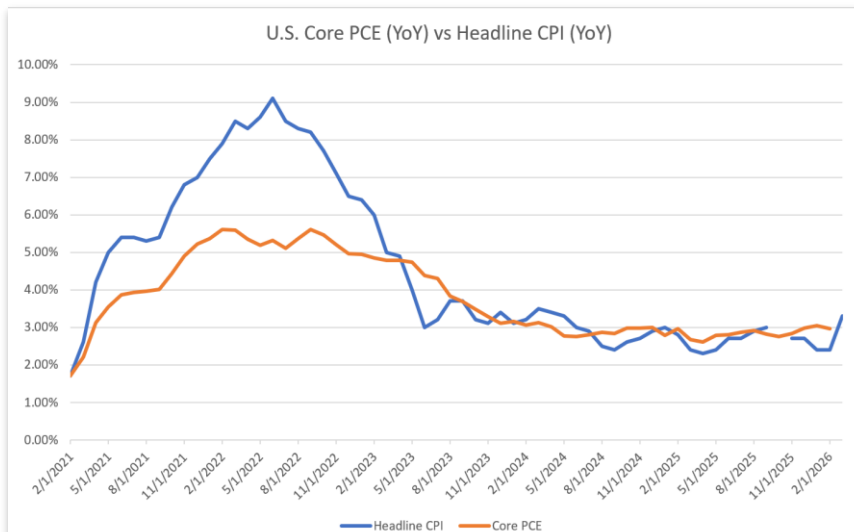
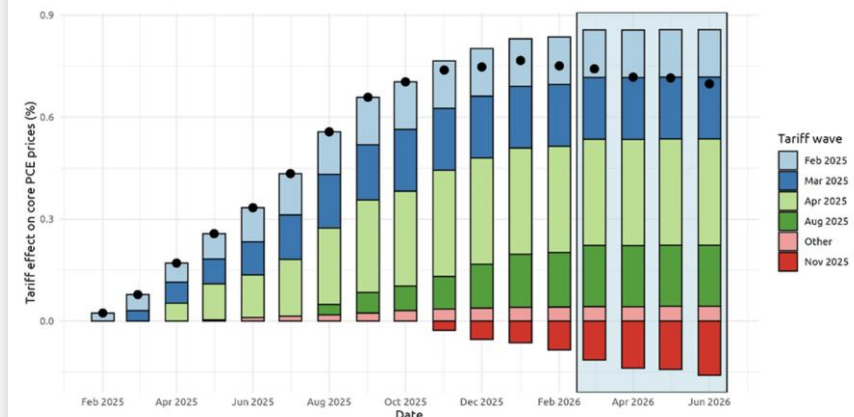


Figure 4. Tariff effects on core PCE prices



Forward view:

Shelter's OER lag will mechanically compress headline PCE through Q3 2026. Services in core already deflating from peak. Goods in core currently suffering for tariff/reshoring effects will normalize. PCE & CPI less oil/energy signal disinflation.

Tariffs & Oil:

Passthrough effects from 2025 Tariffs is effectively complete. Goods inflation from Tariffs peaked in February 2026 (Figure 4).

Black dots represent total tariff effect on core PCE.

Core PCE in Feb '26

+2.97%

Down from +3.05% in Jan '26, converging to target

Core CPI in Mar '26

+2.6%

Gained slightly from 2.5% in Feb '26

Headline CPI in Mar '26

+3.3%

Energy (fuel oil) is largest contributor

Shelter CPI in Mar '26

+3.0%

0.2% increase from Feb '26, still sticky

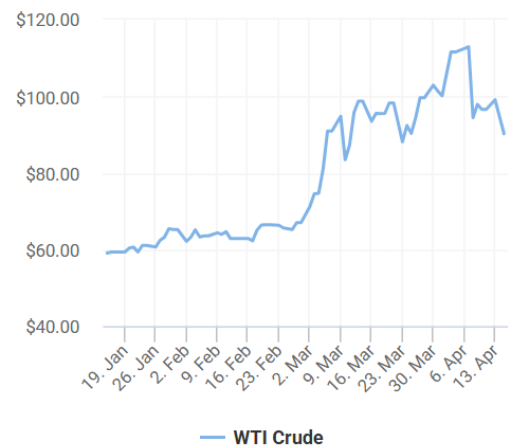
Δ MoM	Oct '25	Nov '25	Dec '25	Jan '26	Feb '26
PCE	0.2	0.2	0.3	0.3	0.4
Goods	-0.1	0.1	0.4	0.0	0.7
Services	0.3	0.3	0.3	0.4	0.2
PCE less food & energy	0.2	0.2	0.3	0.4	0.4
Energy	-0.3	1.7	0.3	-1.7	0.8
Housing	0.1	0.1	0.3	0.2	0.2

Oil Shock – Supply-Side Disruption

Fed Should Parse the Geopolitical Oil Shock Historically

What Happened

WTI Crude Oil – Recent Spike



- Iran conflict drives S&P GSCI commodity index up 33% YoY, 27% YTD
- FOMC March statement explicitly flagged Iran conflict as upside inflation risk in 2026
- BOE and ECB consider hikes — indicative of global caution
- Short-run UMich inflation expectations spiked

1979 Parallel – Key Differences

Factor	1979	2026
US Energy Position	Net importer (~7-9M barrels/day)	Net exporter (petroleum flat to slight)
Fed Credibility	Weak (Great Inflation era)	Strong (post-Volcker disinflation framework)
Inflation Expectations	Unanchored	Well-anchored
Domestic Production	Constrained	Record highs (produces record ~13M barrels/day)
Strategic Petroleum Reserve Buffer	Depleted (~100-200M barrels)	Available (~400M barrels)

- US is now a net exporter of oil and LNG to Western allies facing supply shortages
- BOJ/ECB import exposure is different

Fed's Policy Framework

*"[Are Oil Shocks Inflationary? Asymmetric and Nonlinear Specifications versus Changes in Regime] finds that since around 1980, **oil price changes** seem to affect inflation only through their direct share in a price index, with **little or no pass-through into core measures**.*

– Mark A. Hooker

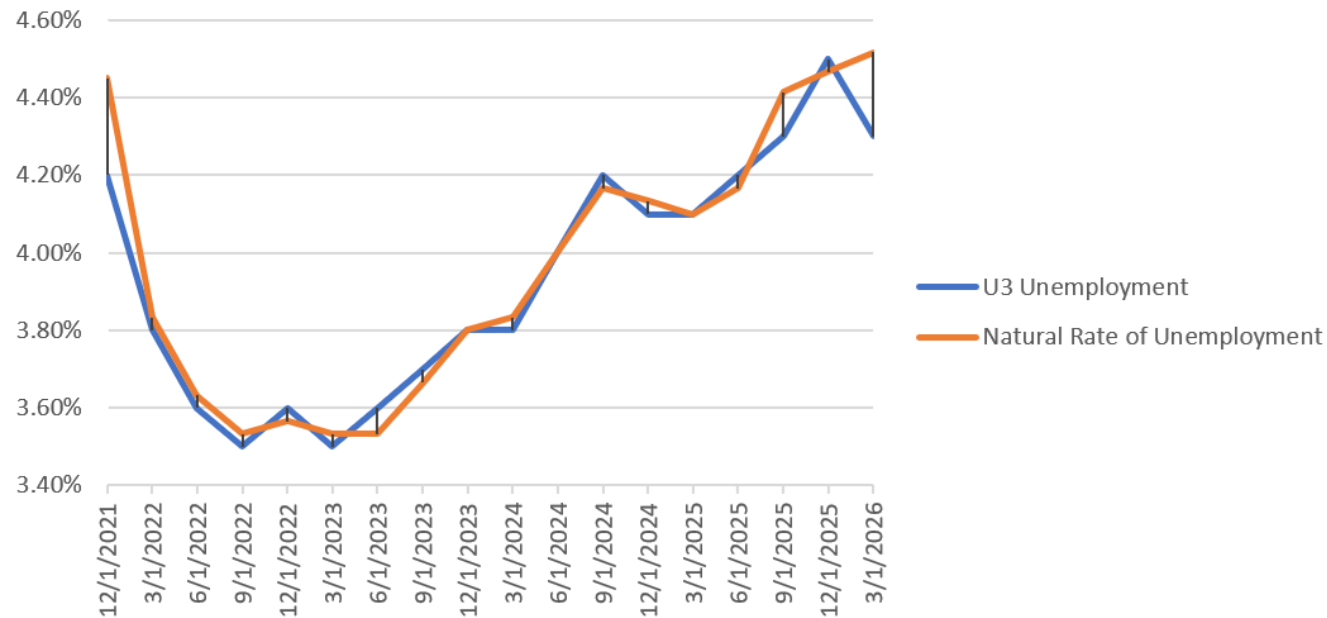
- Long-run expectations anchored (TIPS 5y5y, UMich 5-10yr both stable)
- Oil/energy is a supply-side shock, the Fed's demand-side tool cannot fix price level
- Fed should discount temporary energy vol

Bottom line: Fed should look through this shock just as it did post-2022 Russia-Ukraine War energy spike

Labor Market: Headline Strengths Masks Softening

Delta Exists Between Reported Strength and Underlying Fragility

U.S. U-3 Unemployment vs CBO Natural Rate of Unemployment



Outlook:

- Unemployment gap = $U3 - NAIRU$, $U3 < NAIRU$ means negative unemployment gap
- Standard textbook interpretation: labor market is tight, demand > supply
- Our interpretation: unemployment gap is lagged and overestimated, structural labor changes (immigration, DOGE, participation shifts, AI)

Wage Growth (YoY)

3.5%

Lowest since Covid, disinflationary signal

Long-term unemployed

1.8M

25.4% of all unemployed, with % rising MoM

Unemployment Rate Mar '26

4.3%

Down 0.1 pp, labor force contraction

Nonfarm Payrolls Mar '26

+178K

Beat consensus of +57K, Feb '26 revised to -133K

- Headline labor strength masks underlying deterioration, with unemployment near 4.3% due to labor force contraction
- Wage growth decelerating to 3.5% YoY, consistent with easing labor market tightness and reduce inflationary pressure
- No-hire/No-fire industry dynamic with hiring rate at 3.1% matching Covid & GFC-level lows Federal employment - 355K (-12%) since Oct 2024 is a DOGE caused shift
- Traditional Phillips Curve relationships may be breaking down as productivity outpaces labor demand

AI – Productivity Jumps & Worker Displacement

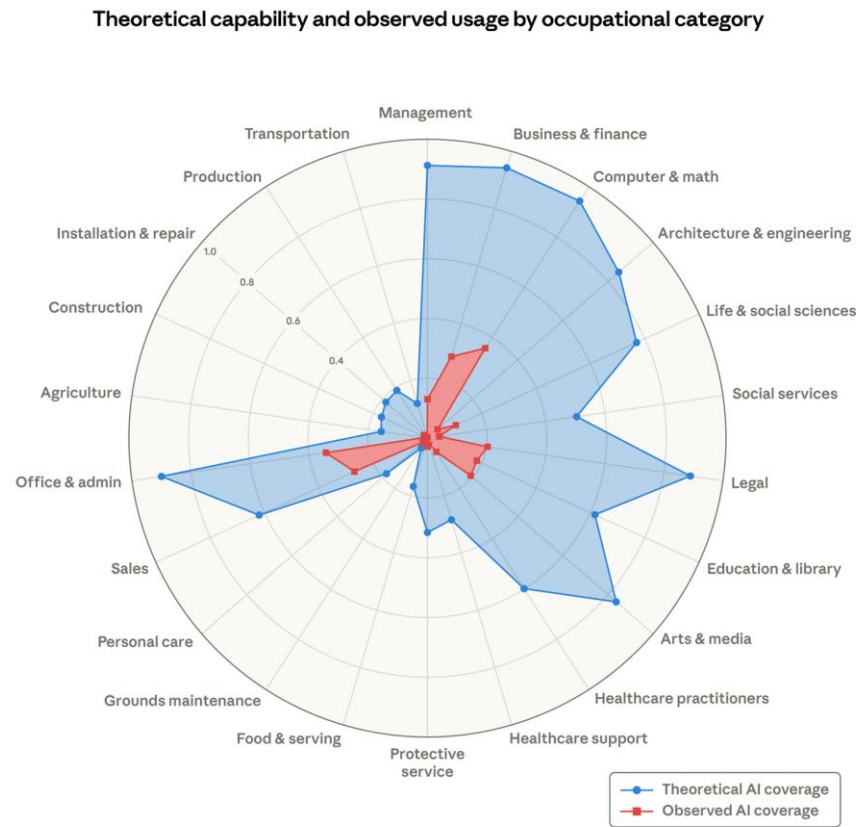
A Structural Break in the Labor Market, Not a Cyclical Phenomenon

Real Wage Growth



- Real wage growth shows deceleration from post-COVID highs
- Workers feel stagflationary pressure even though real wages are positive
- This artificial consumer perception shapes expectations as well as the inflation and wage bargaining dynamics

AI-Driven Labor Disruption by Sector

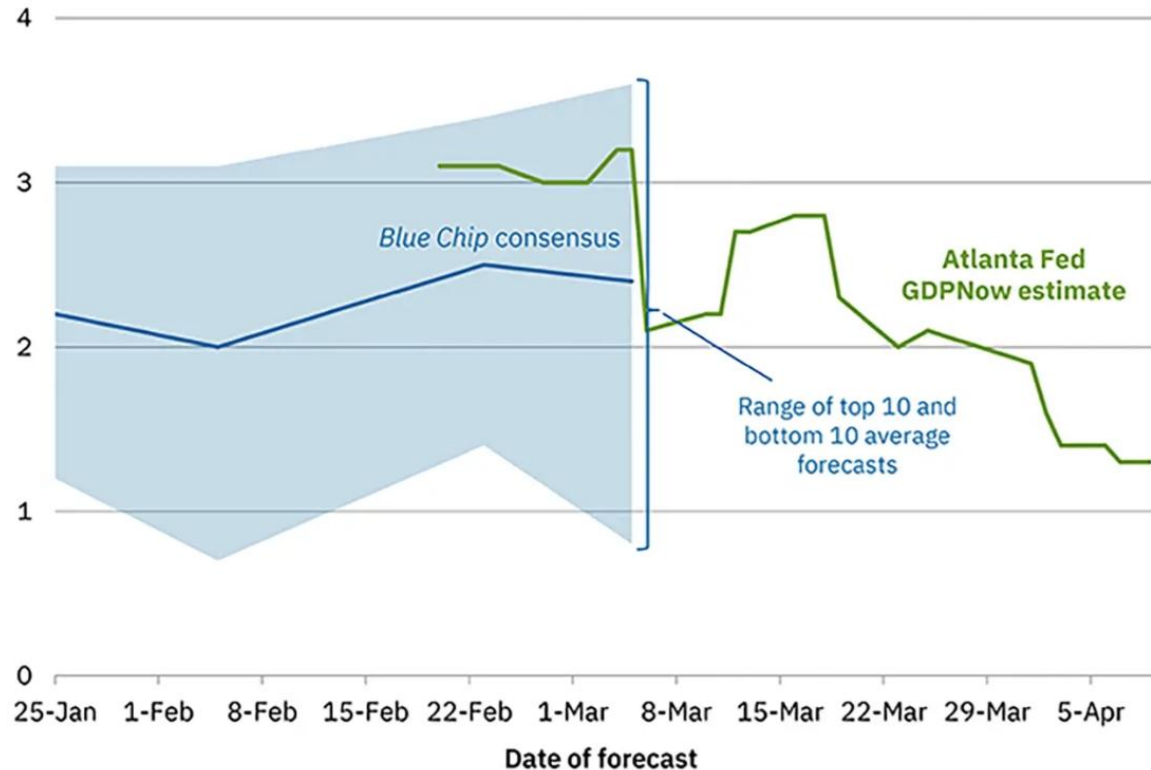


- Anthropic Economic Research: AI exposure is still far below theoretical capability so no yet realized high displacement
- Resume.org business survey finds 58% of companies plan layoffs in 2026, with 35% citing AI adoption as the primary driver
- MIT CSAIL + ORNL Iceberg Index: AI exposure covers ~11.7% of U.S. wage value equivalent to about \$1.2T in annual wages across ~151M workers and 923 occupations
- 1990s computers boom: similar high task exposure, no immediate labor displacement, lagging unit labor cost compression

Real Economy: Consensus Growth Softening

Concerning GDP Growth, Consumer Spending & Business Investment

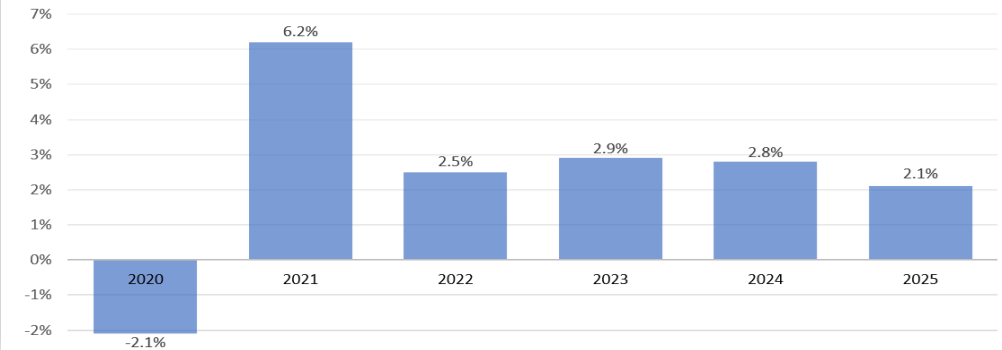
Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

U.S. REAL GDP GROWTH



Growth Drivers

- Consumer spending remains resilient, supported by positive real income growth
- AI-related CapEx continues business investment
- Carryover momentum from 2025 supports full year growth expectations ~2.2-2.4%

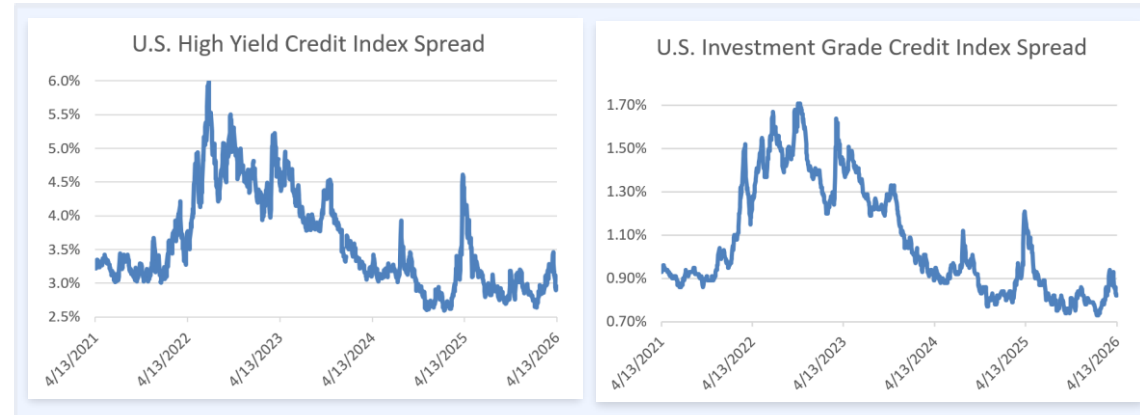
Headwinds Building

- Consumption increasingly credit driven, with savings rate declining and buffers eroding
- Growth momentum slowing with real time GDP tracking closer to ~1.3%
- Political and geopolitical uncertainty dampening consumer and business confidence

Financial Conditions: Tightening at the Margin

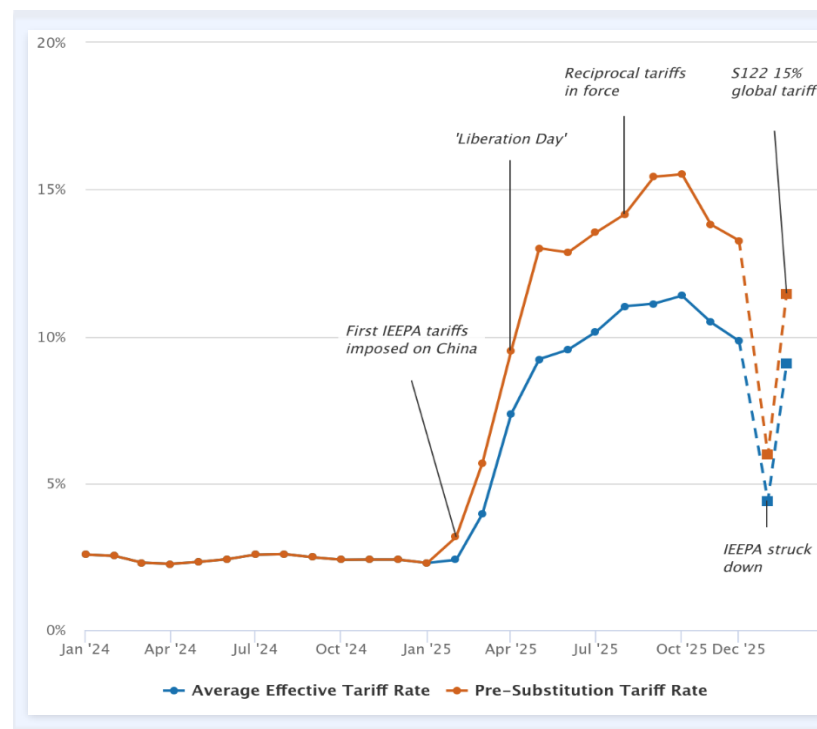
Markets Pricing Adds to Our Conviction

Domestic Financial Conditions



- Equity markets off highs, reflecting higher discount rates and weaker sentiment
- Financial conditions tightening gradually, reflecting early stage repricing in credit markets
- Spreads remain below prior stress levels (HY ~3-3.5%, IG ~0.9-1.0%) indicating tightening remains orderly

Trade & Tariffs



- Effective tariff rates have increased sharply, marking a clear shift to a higher trade barrier regime
- Tariffs are acting as a persistent drag on growth, with estimated impacts of ~0.2-0.8% on GDP
- Elevated trade policy uncertainty continues to weigh on business investment and planning
- Tariffs function as a supply-side shock, putting upward pressure on import prices and inflation

Dollar & Intl.

DXY



- DXY down ~1% in recent weeks, but remains ~5-7% above mid 2024 levels
- Prior USD strength tightened global conditions, with EM currencies down ~5-10% vs USD at peak
- Rate differentials remain elevated, with US 10Y yields ~4.3-4.4% vs ~3-3.5% in Europe
- Dollar strength historically associated with ~0.2-0.4pp drag on global growth via trade channel
- FX volatility elevated, with DXY swings of ~3-4% over recent months reflecting policy uncertainty

Key Risks & Exogenous Shocks

Inflation Risk Persists, but Downside Risks to Growth Are Building

Risk Factor	Direction	Our Assessment
Iran/Oil Escalation	↑ Inflation	Raises headline inflation while acting as a drag on real income and consumption
AI-Driven Labor Disruption	↓ Employment	Gradually weakens labor demand, increasing downside risks to employment and wage growth
OBBA Fiscal Expansion	↑ Growth	Supports near term growth but risks sustaining inflation pressures
Dollar Depreciation	↑ Import Pricing	Increases import prices, adding modest upward pressure to inflation
Financial Stability	↓ Growth	Early tightening in financial conditions may amplify downside risks to growth if sustained
Global Risk-Off	↑ USD, ↓ Growth	Strengthens the dollar and tightens global conditions, weighing on external demand
Long Lags	↓ Growth	Lagged effects of restrictive policy are likely to weight more heavily on growth ahead

Semi-Structural Model: Overview & Block A

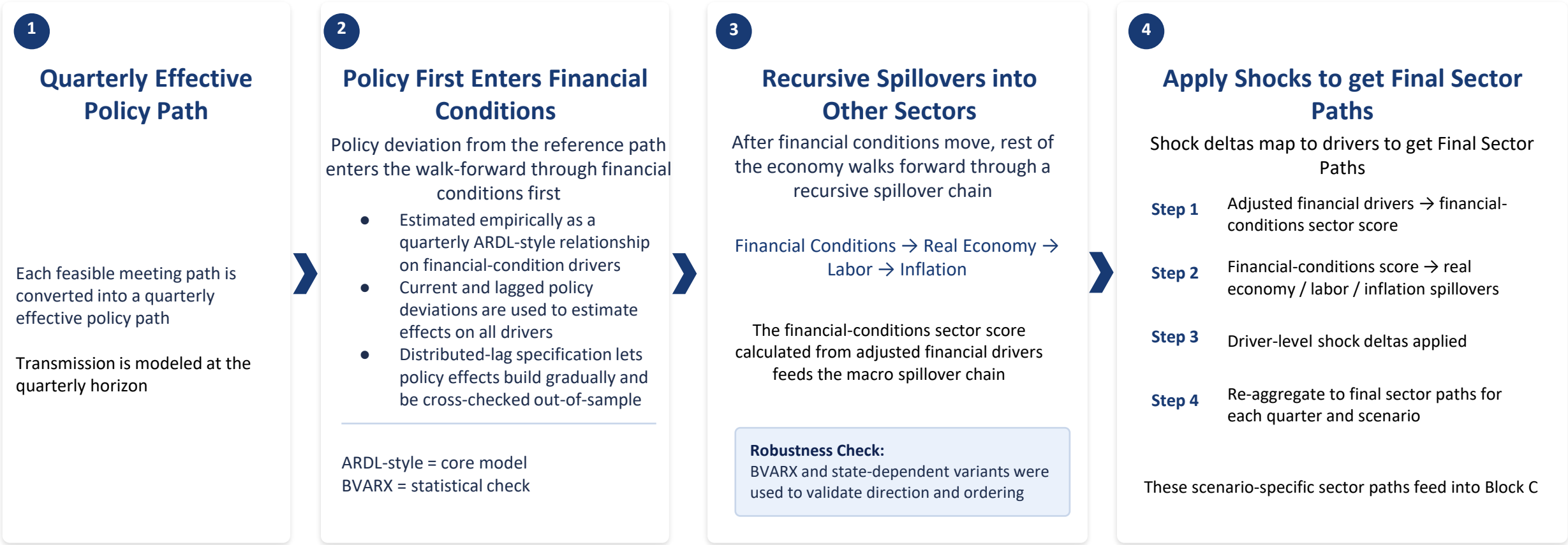
Block A: Lock the Common Information Set



Fed-style process: sector intelligence + baseline forecasting + participant judgment + risk discussion + model-based comparison

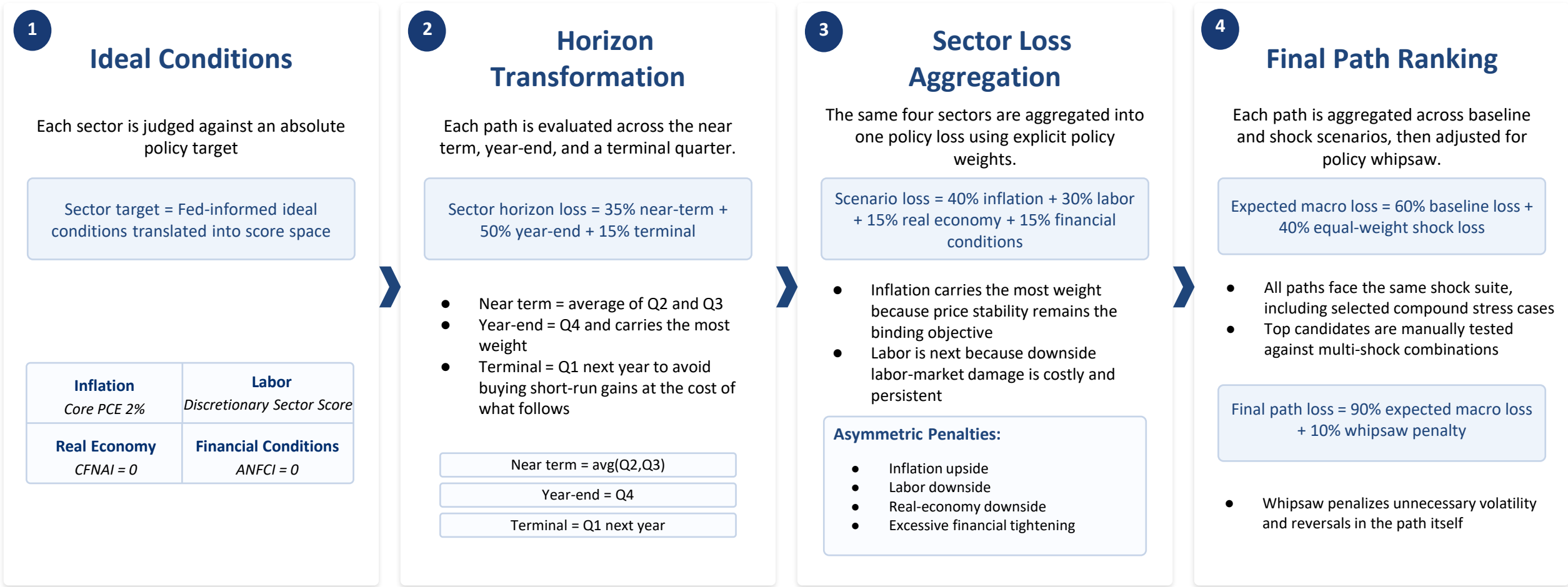
Semi-Structural Model: Overview & Block B

Block B: Walk Feasible Policy Paths Through the Economy



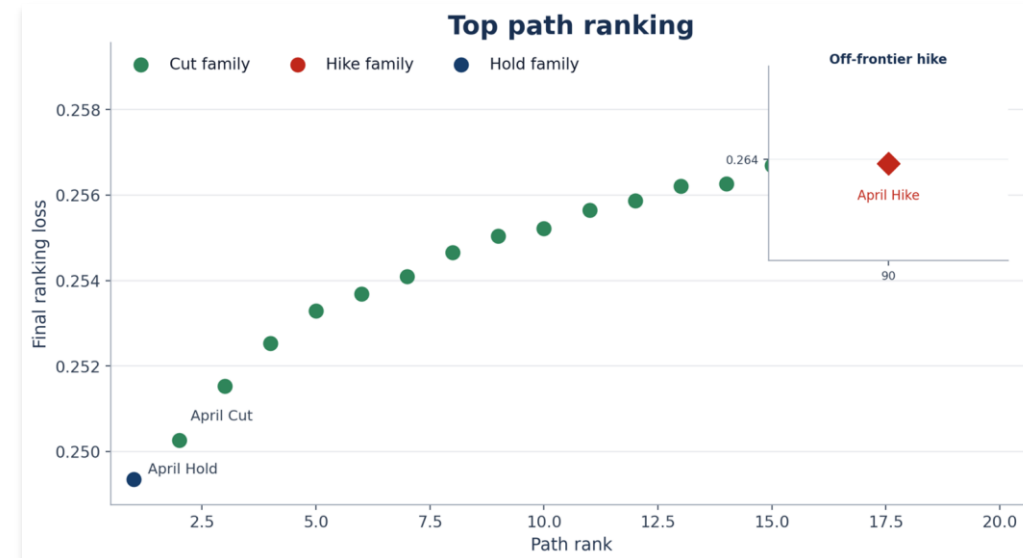
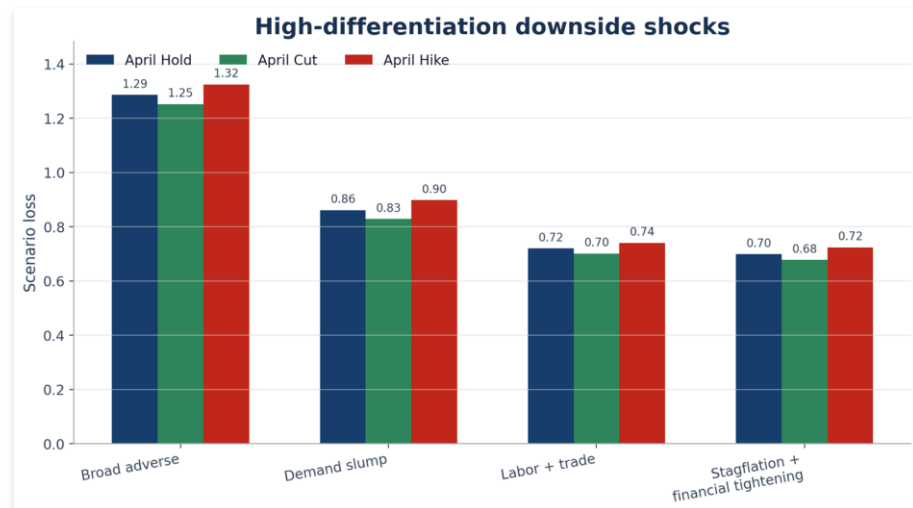
Semi-Structural Model: Overview & Block C

Block C: Score Feasible Policy Paths Against the Policy Objective



Model Result

Recommends Hold



Cut vs. Hold vs. Hike

- Hold wins the full objective
- Cut introduces unnecessary easing risk
- Hike is too costly to defend as an alternative

Holding best balances both risks: it preserves progress on inflation while avoiding unnecessary damage to growth and employment. The current backdrop favors patience over either premature easing or additional tightening.

Our Final Recommendation

April FOMC – Dual Mandate Balance in a Dynamic Environment

Inflation

Iran Conflict

- Passthrough effects
- Reigniting negotiations
 - S&P rally, Crude prices down 20% from peak

Shelter

- OER lags will continue deflation

Services

- Deflationary trend in past 4 months

Tariff effects

- Peaked in Feb 2026
- Estimated that effects are largely over
 - Source: Minton, Ray, Somale (2026)

Unemployment

Asymmetric downside risk

- Supply-side
 - Labor force participation rate contraction
 - Immigration, DOGE
- Demand-side
 - AI-displacement, productivity

Stalling/disinflationary wage growth outlook

- Stagflation perception
- Lack of employee confidence
- Lack of wage negotiating power

JOLTS hiring rate slips

- No-fire no-hire environment
- Slacking job openings

Final Judgement: Hold FFR at 3.50-3.75%

