Another Fed cut, but there is growing dissent

The Fed cut rates 25bp. Two members voted for no change, but individual forecasts suggested six FOMC members felt that a cut wasn't "appropriate". Current Fed members suggest just one further cut is their 2026 central projection, but with changes coming and the jobs market cooling the risks are skewed towards them cutting by more

At the press conference following the Federal Reserve's rate decision, Chair Powell is not likely to talk about the things we want to know

Fed cuts with forecast pointing to a hawkish tilt within the Fed

The Federal Reserve has cut the Fed funds target rate range 25bp to 3.5-3.75% as widely expected. This is the third consecutive cut and brings the cumulative easing to 175bp since September last year. The decision wasn't unanimous, with Jeffrey Schmid again voting for a no-change outcome, this time joined by Austan Goolsbee. At the opposite end of the spectrum, Stephen Miran again voted for a 50bp cut. In terms of the dot plot of individual forecasts, the median prediction is just one further rate cut in 2026, just as was the case in the previous forecasts from September. The thrust of the accompanying statement is unchanged from October.

Looking at the forecasts, there is clearly a hawkish tilt. While two members voted for no change today, six members felt the "appropriate" rate should be 3.875% – not the 3.625% central range we are now at. Moreover, they have revised up their fourth quarter 2026 year-on-year GDP growth forecast to 2.3% from 1.8%, which Chair Powell attributed to a rebound following the end of the government shutdown and ongoing rapid data centre spending. This is above the 2% Bloomberg consensus forecast of the private forecasters (ourselves included). Core inflation projections have been revised down 0.1 percentage point for 2025 and 2026, but they continue to forecast one further 25bp cut in 2027 with the longer run rate remaining at 3% for Fed funds.

Federal Reserve central projections

	2025	2026	2027	2028	Longer run
Change in real GDP (4Q YoY%)	**1.7**	**2.3**	**2.0**	**1.9**	**1.8**
Previous Fed projection (Sep)	1.6	1.8	1.9	1.8	1.8
Unemployment rate (% year end)	**4.5**	**4.4**	**4.2**	**4.2**	**4.2**
Previous Fed projection (Sep)	4.5	4.4	4.3	4.2	4.2
Core PCE inflation (4Q YoY%)	**3.0**	**2.5**	**2.1**	**2.0**	-
Previous Fed projection (Sep)	3.1	2.6	2.1	2.0	-
Federal funds rate (year end)	**3.6**	**3.4**	**3.1**	**3.1**	**3.0**
Previous Fed projection (Sep)	3.6	3.4	3.1	3.1	3.0

Source: Federal Reserve, ING

The Fed is changing in 2026

But does this matter, given that we know the Federal Reserve's structure is changing? In our view, not really. From May, the Fed will have a new Chair. Kevin Hassett, the current Director of the National Economic Council, is the hotly tipped favourite. He is an advocate for lower rates, and if President Trump is successful in forcing out Governor Lisa Cook, we could see the appointment of a replacement who is equally inclined to lower borrowing costs. This would mean that five of the seven members of the Board of Governors are Trump appointees. Furthermore, in February, all 12 regional Fed presidents are up for reappointment – candidates are nominated by regional Fed banks' management, but can be vetoed by the Board of Governors. This creates the possibility of a revamped Fed that thinks very differently from the current committee. In any case, current Chair, Jerome Powell, reiterated that the Fed will decide policy on a meeting-by-meeting basis.

We continue to look for two further cuts in 2026

In terms of market pricing, the WIRP function on Bloomberg suggests the market is looking for 50bp of additional cuts in 2026. Right now there appears little need for much more easing from the Fed given the economy is growing, unemployment is low, equity markets are close to all-time highs and inflation is closer to 3% than the Fed's 2% target.

Nonetheless, we suspect the inflation backdrop will become more conducive for interest rate cuts in the coming months, thus giving the doves the justification for further action. While the tariff threat lingers, it is coming through more slowly and less forcibly than feared. This allows more time for disinflationary forces from lower energy prices, slowing housing rents and weaker wage growth to mitigate and, we believe, push inflation closer to 2% more quickly than the Fed is forecasting. With the jobs part of the Fed's mandate looking more troubling – note Chair Powell suggesting the Fed thinks job gains have been overstated by 60,000 in recent months – we see the Fed cutting rates twice in 2026 with 25bp cuts forecast for March and June.

Finally, we have the funds rate below 10yr SOFR – now that's more normal

The theme from this FOMC meeting and the last, for rates, is a compression towards what looks like a landing area on a couple of fronts, even if temporary. The balance sheet is now on freeze (there is a floor set for bank reserves), and the funds rate is now super close to where it is looking more normal, or at least close to it. Let's expand on both.

First, the level of the funds rate and floating rates in general. The 3mth SOFR rate is finally below the 10yr SOFR rate (just this week). Which means, at long last, it's cheaper to fund floating than to fund fixed. This is as 10yr SOFR has been under rising pressure in the past weeks, but also as 3mth SOFR has been tamed by the rate-cutting narrative. It's the first time since the second half of 2022 (and briefly in January 2025) that the 10yr SOFR rate has been above most floating rates, and that will be copper-fastened as soon as the Fed cuts by 25bp in a bit. For players that have balked at the idea of swapping to floating on account of negative impact carry, that has now gone away (at least for as long as 10yr SOFR remains elevated).

Second, liquidity conditions. Repo has been tending tight in the past few months, and things reached a point of no return when the effective funds rate began to de-anchor and trek towards the rate on excess reserves (now just 1bp below). The Fed reacted at the previous FOMC meeting by reverse engineering this into a rationale for freezing the balance sheet, where further MBS roll-offs would be matched by T-bills buying. But as we've noted, the Fed will ultimately have to re-expand the balance sheet at the same pace as the nominal economy is growing at. So, if nominal GDP is growing at 3-5%, bank reserves too should expand at that rate. The Fed has reacted to this reality by implicating flexibility to buy T- bills in excess of the MBS roll-off, to ensure ample reserves.

Reserve management purchases is the term the Fed is using to describe its T-bill buying agenda, as in fact they can go out as far as 3 years in Treasuries if needed. That's quite deviant from a pure T- bills buying programme, and bordering in fact on QE. They'll start with $40bn of buying, and suggest it will wane in later months due to seasonal liquidity circumstances. Good for the front end!

Dollar softens after a not so hawkish cut

The initial FX reaction to the 25bp rate cut was a marginally weaker dollar. Perhaps it was the fact that there were only two hawkish dissenters against the cut or the fact that the single 2026 rate cut was left in. In other words, it could have been worse for dollar bears.

The modest bullish steepening of the curve – on the view that the Fed will keep cutting even though GDP forecasts have been revised slightly up – is usually a bit of a tailwind for the activity/commodity currencies and the commodity complex as a whole. In terms of those commodity currencies, we think AUD/USD would have more upside than USD/CAD has downside. Today's Bank of Canada meeting showed that policymakers did not want to get sucked into validating market positioning that the next move would be a rate hike.

It may well be as well that the dollar is also reacting to this relatively large T-bill buying programme from the Fed, as well as the Kevin Hassett effect too.

However, we doubt the dollar needs to fall much further immediately. The next big cue will be the

November nonfarm payrolls release on 16 December and whether a soft number can keep market pricing of two further rate cuts in 2026 intact. We also have a raft of G10 central bank meetings over the next ten days, where the BoJ should hike, the BoE should cut and some emerging optimism from the ECB could support recent euro strength.

Seasonally, the dollar tends to weaken into year-end and with Fed event risk now out of the way, EUR/USD could have that run-up to 1.1800 after all.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com