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Fed cuts 25bp and signals just three more will be enough

The Fed cut the policy rate 25bp as expected. They think three more cuts will be enough to boost growth and prompt a revival in the jobs market, but the market is sceptical. We look for four more 25bp cuts before trade clarity, a weaker dollar and lower borrowing costs start to stabilise the situation

The Federal Reserve cut interest rates by 25 basis points and signalled there will be more later this year and into next

Fed delivers the 25bp that was expected

As widely expected, the Fed has resumed cutting interest rates with a 25bp move today. There was only one dissenter – the recently appointed (temporary) Governor Stephen Miran – who voted for a 50bp cut. Ahead of time, there had been suspicion it could have been a three-way split, with Governors Michelle Bowman and Chris Waller potentially voting for 50bp (playing catch-up after they voted 25bp in July) with the possibility of one or two hawkish regional Fed bank chiefs voting for no change. In the end, there was relative unity amongst the officials.

Chair Powell described the move as a “risk management cut” since, on the face of it, the US appears in pretty decent shape. The economy grew more than 3% in the second quarter, inflation is above target at 3%, unemployment is low at 4.3% and equity markets are at all-

time highs. But dig under the surface and things are shifting, most notably in the jobs market.

Downside risks to the jobs market the focus

In the press release they have dropped "solid" with regard to the jobs market description, which is unsurprising after the recent soft run and major downward revisions to employment data – a point highlighted by Chair Powell in the press conference. It was this that was the main justification for the move, with the FOMC acknowledging that “downside risks to employment have risen… and in light of the shift in the balance of risks” decided to act.

Looking at the “dot plot”, the consensus amongst officials is two more cuts this year, which is in line with our own forecast and market pricing. Their June forecasts only had two cuts in total for the year. As for 2026, they continue to project just one further cut.

The fact that they revised growth and inflation forecasts higher and unemployment lower suggests that they think swift, sharp action over coming months will deliver real results for the economy. The market is not convinced by these softest of soft-landing projections and thinks the Federal Reserve will probably need to do more with an additional 2–3 cuts now priced over and above the Fed forecasts. This would get the Fed funds rate below 3% in the second half of 2026.

New Federal Reserve central projections versus June forecasts

	2025	2026	2027	2028	Longer run
Change in real GDP (4Q YoY%)	**1.6**	**1.8**	**1.9**	**1.8**	**1.8**
Previous Fed projection (Jun)	1.4	1.6	1.8		1.8
Unemployment rate (% year end)	**4.5**	**4.4**	**4.3**	**4.2**	**4.2**
Previous Fed projection (Jun)	4.5	4.5	4.4		4.2
Core PCE inflation (4Q YoY%)	**3.1**	**2.6**	**2.1**	**2.0**	**-**
Previous Fed projection (Jun)	3.1	2.4	2.1		-
Federal funds rate (year end)	**3.6**	**3.4**	**3.1**	**3.1**	**3.0**
Previous Fed projection (Jun)	3.9	3.6	3.4		3.0

Source: Federal Reserve, ING

We think the Fed will end up cutting rates more than they suggest

Our view is somewhere between the two. We look for 25bp cuts in October and December with additional cuts in January and March, at which point we think the Fed will take stock of the situation.

Inflation does remain above target and tariffs are likely to keep it elevated in the near term, but evidence of cooling consumer demand and a weakening jobs market is becoming more obvious. Moreover, factors that contributed to inflation hitting 9% in 2022 – oil prices tripling, housing rents soaring and wages jumping – are clearly absent and, if anything, will act as a

disinflationary influence over coming quarters. A cooling economy with gradually rising unemployment will further contribute to inflation heading back towards 2% by the end of 2026. Meanwhile, lower borrowing costs, a weaker dollar and greater clarity on trade may be enough to stabilise business sentiment and gradually deliver stronger growth through 2026.

The US 10yr Treasury yield looking to get below 4% and stay below at least for a bit, driven by a lower real yield

The 10yr Treasury yield was teetering on the precipice of a sustained break below 4% post the Fed decision to cut rates by 25bp. The bias for market rates was down ahead of Powell speaking, but reverted higher thereafter. The US 2/10yr curve is a tad steeper overall. It had snapped dramatically steeper from the front end to begin with, but the back end then did some catch up (fall in rates), manifesting in a much tamer net steepening. Similar to the 10/30yr spread – overall, a tad steeper, just about.

Once Chair Powell spoke, there was a more material backup higher in market yields, and a re-steepening of the curve, especially as the reference to inflation risks began to feature some more. The curve has more steepening to do ahead (our view), as the steepening so far is being muted by longer tenor rates wanting to share in the lower rates tendency. That novelty will wear off should inflation rates edge higher in the coming months. That is not something this bond market wants to think too much about right now. That can change. See more here.

In terms of liquidity management, there was no change in the Fed's policy of allowing a roll-off of MBS bonds (this tends to be nowhere near the stated cap) and capping the Treasury roll-off at $5bn. This fits with our relaxed attitude with respect to the fall in bank reserves seen of late (mostly through the re-build in the Treasury cash balance). Even though repo has been trading in an elevated fashion of late, that is not a reflection of a lack of bank reserves in our opinion (and the Fed seems to agree with a lack of action). See more here. It's more likely a reflection of market positioning into the Fed decision, and to some extent a combination between that and the management of the quarterly turn (and September turns have historically spooked markets).

Fed suitably dovish, positioning limits dollar downside

Dollar bears went into this meeting a little nervous that the Fed wouldn't deliver for them. In the end, the Fed delivered on expectations of three cuts this year and the first reaction for the dollar was to fall across the board by around 0.5%.

Within about 30 minutes, however, the dollar had more than recouped its losses as US yields reversed higher. We suspect this reversal had more to do with positioning rather than a less dovish re-assessment of today's communication from the Fed. A trader's market.

A Fed formally shifting the risk on its dual mandate to the downside because of a softer jobs

market and the expectation of two further rate cuts this year and a path to 3.00-3.25% for the policy rate do not look particularly dollar positive for us. And when the dust settles over coming days, we suspect the dollar could drift back to the lows of the year and now will prove hyper-sensitive to US labour market data.

We certainly don't see today's Fed communication as a major threat to the risk environment either, where a Fed cutting rates back from restrictive to neutral in a still-growing economy is consistent with our baseline of a benign decline in the dollar into year-end.

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