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FX RATES UNITED STATES

Fed holds rates steady at the top of the neutral range

The Fed left monetary policy unchanged in a range between 3.5% and 3.75%, but the accompanying statement and press conference suggested the Fed is more confident that the policy easing cycle is close to a conclusion. Treasury yields and the dollar have received some support from this, but there will be more tests to come



Fed Chair Powell at the press conference after keeping interest rates unchanged

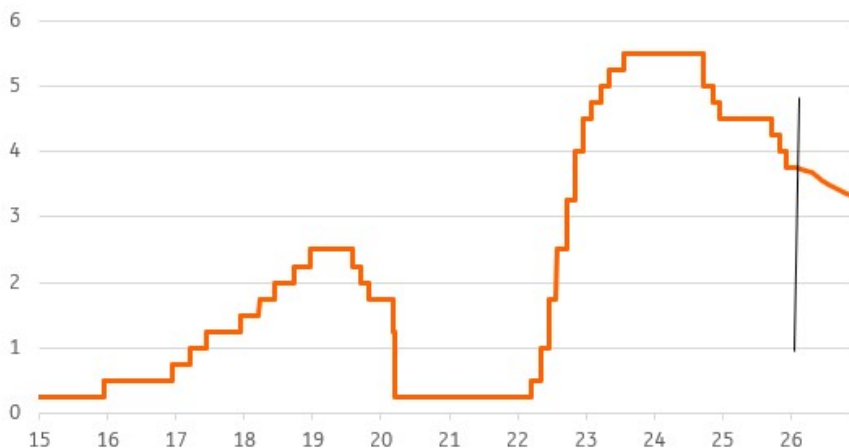
No interest rate change in 10-2 vote

The Federal Reserve held policy rates steady in a 10-2 vote as widely expected. Both Governors Stephen Miran and Chris Waller voted for 25bp cuts as we suspected. Remember, this is Stephen Miran's last meeting with his term ending on Saturday. Chris Waller's name continues to be mentioned in connection with the Fed Chair position, but he is now seen in a distant third place behind both Rick Rieder and Kevin Warsh by prediction markets.

The key takeaway is a slightly hawkish twist to the accompanying statement and press conference. At the December FOMC meeting, officials stated that "downside risks to employment rose in recent months," but chose to remove that line today. Other than that, growth is described as "solid" while they acknowledge "some signs of stabilisation" in the

unemployment rate. At the press conference, Chair Jerome Powell acknowledged data distortions related to the pandemic, but did suggest the growth outlook has improved in recent months.

Fed funds ceiling rate (%) with implied market pricing for 2026



Source: Macrobond, ING

A more upbeat growth assessment

No new forecasts were published at this meeting, but if they were to have released an update, Chair Powell suggests they would have been firmer than what was published in December. Back then, they revised up the fourth quarter year-on-year 2026 GDP growth to 2.3% from 1.8% and suggested unemployment would end this year at 4.4% with the core PCE deflator at 2.5%. Given this backdrop, they projected that just one further rate cut this year would be the most appropriate policy path.

The latest Bloomberg consensus survey suggests GDP growth of 2.1%, unemployment at 4.4% and the core PCE deflator at 2.5%, so the Fed is pretty much in line with the market. Nonetheless, the consensus among economists, including ING, is for two rate cuts, with the market pricing 46bp.

We still look for two more rate cuts

In terms of our Fed view, we see monetary policy as still being slightly restrictive – Powell suggested that we are currently at the higher end of the plausible range of what could be described as neutral. Although the growth story is firm, we expect the Fed to be able to move policy closer to the middle of a neutral range given the weakening jobs market – remember Chair Powell’s comment from December that the Bureau of Labor Statistics may be overestimating job creation by 60,000 per month, which implies employment is effectively flat.

At the same time, the latest inflation numbers confirm that tariffs are not having the immediate impact on prices that most feared. That is not to say we can't rule out that it may lead to higher prices eventually. But the fact it is coming through so slowly gives more opportunity for falling energy costs, slowing housing rents and weaker wage growth to mitigate and allow inflation to continue trending down towards 2%. Powell again repeated today that he thinks most of the tariff impact has already passed through. Therefore, from a risk management perspective, we believe the Fed has scope to cut rates twice more.

Regarding questions about his own future, Chair Powell indicated he hadn't made any plans. While his Chair position ends on 15 May, he could stay on as a voting member of the FOMC, given that position doesn't expire until 31 January 2028. President Trump has already acknowledged that prospect, cautioning last week, that "if that happens, his life won't be very, very happy, I don't think".

Market rates smell some more upside, while the plumbing gets the thumbs up (just)

The curve edged higher on the smidgen of reduced negative commentary from the FOMC statement, and the commentary from Chair Powell subsequently copper-fastened the market notion that rate cuts are off the agenda, at least for now. This week, the 10yr yield edged up from the 4.2% area on Monday to 4.25% post the FOMC (and is higher today, pre and post the FOMC). It's been quite the week for dollar products, given the FX intervention talk out of Japan, and then the dollar weakness push from President Trump. Add that vulnerability to a Fed that's standing pat on less macro negatives, likely facilitates an upside test for market rates as a lasting reaction.

In terms of the plumbing, no change to the policy action of buying bills, and out to 3yr Treasuries where required. That *has* been required, as the latest data show renewed net buying in the bond space (in fact, dwarfing the roll-off of MBS paper). Repo volatility circumstances have in turn calmed, but the effective funds rate remains elevated. It remains at just a basis point below the rate paid on excess reserves, versus a prior 7bp spread. It's not a drama. But still, the optics aren't great. And those optics were, in fact, the genesis of the decision to re-ignite bills buying in the first place. But, not a lot of additional commentary on this from Chair Powell.

Dollar's wild ride continues

This week's wild ride in the dollar continues as a steady Fed policy announcement sees the dollar recover a little more ground. Most of the reversal to the recent dollar bear trend had been done earlier in the day, however, when US Treasury Secretary Bessent said that the US 'absolutely' had not been involved in any USD/JPY FX intervention. That has drawn the sting out of the view that the Administration is favouring a weaker dollar a la Mar-a-Lago.

Earlier this week, investors had concluded that the dollar was ready for another leg lower and had paid up for downside protection. We had felt that today's FOMC could provide a mildly hawkish event risk for the dollar but were worried that the event might be swamped by the prevailing bearish mood.

In the end, the dollar does seem to have reacted to the steady story from the Fed and no signs of any imminent rate cuts. To completely unwind the newfound pessimism in the dollar, something like the DXY dollar index would need to start closing above Monday's gap at 97.43 and EUR/USD below 1.1834.

The next couple of days will show whether investors have concluded that the dollar needs to go lower and that today's bounce is a selling opportunity. To be clear, dollar fundamentals have not deteriorated substantially over the last week. But let's see if investors and corporates feel the need to increase their dollar hedge ratios – consistent with the big moves in the FX options market.

Fresh drivers here will be the incoming US data, President Trump's pick for the Fed Chair and whether the Japanese snap election on 8 February triggers fresh pressure on the yen and Japanese government bonds.

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THINK economic and financial analysis

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