

FX Viewpoint Flash

Currencies
Global

Fed hold hits USD

- ◆ The Fed held rates steady, saying the FOMC's confidence on inflation has not improved; QT to slow from June onwards
- ◆ Our economists now expect just one 25bp cut in 2024 (75bp previously) and 75bp of cuts in 2025 (unchanged)
- ◆ The USD is likely to be on the backfoot over the very near term, before showing more resilience in the months ahead

At its 30 April-1 May policy meeting, the Federal Open Market Committee (FOMC) **voted unanimously to hold the federal funds target range unchanged at 5.25-5.50%**, as widely expected. This was the sixth consecutive meeting in which the target rate was kept unchanged; the most recent policy rate change was a 25bp hike back in July 2023.

As for the statement, the changes to the text were broadly minimal, while the FOMC added a new sentence which states: *"In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective."* However, this should hardly be a surprise, as US core PCE inflation has been little changed over the past four months, falling only marginally from 2.9% in December and January to 2.8% in February and March (*Bloomberg*, 26 April 2024). In the press conference, the Federal Reserve (Fed) Chair Jerome Powell noted that **inflation was proving "more persistent than expected"**. When asked specifically about the risk that rates might even have to be increased, Fed Chair Powell said that **it was "unlikely" that the next policy rate move would be a hike**. This fed into some USD softness.

Given the accumulation of data this year showing resilient economic growth and sticky core inflation in the US, **our economists now expect only one 25bp rate cut in 2024 (75bp previously) and 75bp of rate cuts in 2025 (unchanged)**. Markets currently price in 33bp of rate cuts by the Fed in 2024 (*Bloomberg*, 2 May 2024).

The FOMC announced that the cap on redemptions of US Treasury securities on the Fed's balance sheet will fall to USD25bn per month as of 1 June 2024, down from USD60bn per month currently. As a result, our economists estimate that **overall quantitative tightening (QT)**, including ongoing reductions in the Fed's holdings of mortgage-backed securities, **will fall to cUSD45bn per month** from cUSD80bn per month. **The Fed has made it clear that the primary tool to achieve its dual mandate is the policy rate**. The slower QT pace is mostly just a technical decision, rather than a clear signal in itself, and **one that should not be seen as USD negative**.

The US Dollar Index (DXY) fell below 106 after the FOMC decision and comments, and **the USD is likely to be on the backfoot over the very near term**, in our view. Beyond the FOMC decision, the USD's broad direction is more likely to be determined by the interplay of risk appetite and relative rates, with any positive momentum on the former to undermine the USD. **Relative rates should offer some support to the USD** if other central banks, most notably in Europe, show more dovish momentum in the weeks and months ahead. That remains our central case.

The Fed kept rates unchanged for a sixth straight meeting, as widely expected

The Fed said there is a lack of inflation progress, but signalled rate hikes are unlikely

Our economists now see only one 25bp cut in 2024

The Fed announced that it will slow its pace of QT, starting from 1 June

We expect the USD to strengthen modestly in the weeks and months ahead

Disclosure appendix

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