INDOSUEZ WEALTH MANAGEMENT

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Fed (In)Dependence: Our Analysis Following the December FOMC

A Moderately Hawkish Cut

As widely anticipated, the Federal Reserve (Fed) cut interest rates for the third consecutive time, bringing the Fed Funds rate to 3.5-3.75%. We view this as a "moderately hawkish cut"—the Fed maintained a cautious stance, which was less hawkish than some market participants had feared. Our key takeaways from the meeting are:

1. **Rising Dissent**: The number of dissenting votes was the highest since 2019, though the outcome could have been more divided.
2. **Wide Dispersion in Rate Expectations**: The 2026 dot plot reveals a 200 basis points (bps) spread among FOMC members, highlighting significant uncertainty and polarisation over the balance between labour market support and inflation control. Notably, one member projects six 25 bps cuts, while three anticipate higher rates by end-2026.
3. **High Bar for Further Cuts**: Chair Powell emphasised the need for more data, particularly on employment, before considering additional cuts. The frequent reference to "neutral" (a dozen times) underscores the Fed's cautious approach, especially given recent data delays following the government shutdown.

Bottom Line: One More Cut Under Jerome Powell—Then What?

- FOMC members expect only one additional cut in 2026, consistent with our own outlook for a gradual normalisation. The market currently prices in two cuts, down from nearly three just weeks ago.
- We have consistently cautioned against expectations for aggressive easing, given our view of a resilient economy and labour market.
- However, speculation around the next Fed Governor—particularly if aligned with a more dovish administration—could influence market pricing and policy direction. Political considerations could lead to further cuts, resulting in curve steepening and a weaker dollar. We remain cautious on duration and USD exposure.
- Our stance could be reassessed as new inflation and employment data become available.

Balance Sheet Management vs. Quantitative easing (QE)

The Fed announced it will resume US Treasury purchases for balance sheet management, beginning with 40 billion dollars in Treasury Bills at least until April—just 12 days after the end of Quantitative Tightening. While the Fed distinguishes this from quantitative easing (QE), the market reaction—softer USD and stronger gold—suggests otherwise: "It looks like QE, it smells like QE, it must be QE". Regardless of semantics, this move increases liquidity.

Fed Independence: A Medium-Term Perspective

We do not believe the Fed's independence is at risk over the medium-term. In the short-term, however, markets may remain cautious until the new Chair's policy stance is clear. We are confident that the broader FOMC will uphold its mandate, regardless of leadership changes. While political pressures exist, history suggests that any new Chair will be mindful of their legacy and the risks of policy missteps—particularly in the context of large fiscal deficits.

A Final Thought: The Fed's "Social" Mandate

The dual mandate—maximising employment and maintaining stable inflation—remains a source of internal debate. The question of whether the Fed should cut rates increasingly depends on one's economic perspective: higher-income Americans may see little need, while lower-income groups may benefit more directly. While not explicit in its mandate, the Fed's awareness of social inequality may become a more prominent topic in future policy discussions.

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