

Research US

Fed review: Balanced and optimistic

- The Federal Reserve maintained its policy rate target, administered rates and balance sheet policy all unchanged in the January meeting, as widely expected.
- Powell struck a balanced but positive tone, and avoided firm forward guidance on possible timing of the next rate move. Economic outlook has improved in early 2026, which has both reduced downside risks to labour market and upside risks to inflation.
- Market reaction remained very muted. The next rate cut is fully priced in by July. We see risks tilted towards faster easing and expect cuts in March and June.

The Fed kicked off 2026 policy meetings with a balanced, yet positive tone. The updated statement saw economic activity expanding at a 'solid' pace (prev. 'moderate') and said that the unemployment rate has 'shown some signs of stabilization' (instead of 'edged up through September'). It also completely removed the sentence stating that 'downside risks to employment rose in recent months'.

Outgoing governor Miran and Fed chair candidate Waller dissented in favour of a 25bp cut, but Powell clarified that there was 'broad support' for holding rates steady. He added that for now, no one's base case entails the next move being a rate hike.

Powell repeated the statement's optimistic message, saying that the labour market 'may be stabilizing' and that 'incoming data shows clear improvement in outlook for growth'. To balance the tone, he also emphasized that upside risks to inflation have eased and appeared more confident that tariff-driven inflation would subside over the course of 2026. Powell refrained from commenting on the recent USD weakness, and whether the move could fuel additional inflation. He also avoided a question regarding the very latest uptick in markets' breakeven inflation expectations.

The more positive growth outlook did not have much impact on financial markets, because it mirrors upward revisions to consensus forecasts seen already since December. In relative terms, we remain more bearish on growth and predict 1.8% real GDP growth for 2026 in comparable Q4/Q4 basis (Reuters consensus: 2.2%, the Fed's median December projection: 2.3%). We think that drawdown of frontloaded inventories has still shielded private consumption from the full tariff impact, and that cooling labour market balance will continue to weigh on wage growth (chart 2).

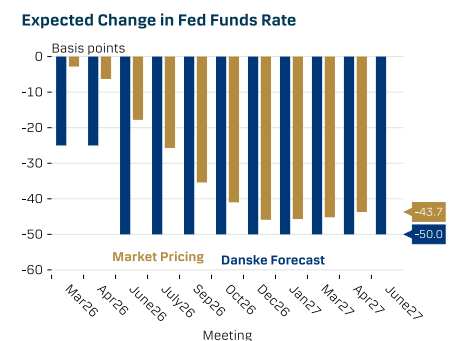
As such, we believe the Fed could end up cutting rates already in the next March meeting and follow up with a final cut to neutral in June. Markets continue to price in the next cut for July, with around 60% likelihood of a second cut during H2.

Powell refrained from commenting on Lisa Cook's situation, the probes against himself and the possibility of continuing as Fed governor post-May – all as expected. He also did not comment on the outlook for the Fed's balance sheet or the reserve management purchases initiated in December. We expect net T-bill purchases to hover around USD40-50bn/month until April tax-date, before slowing substantially.

Our Fed call (unchanged)

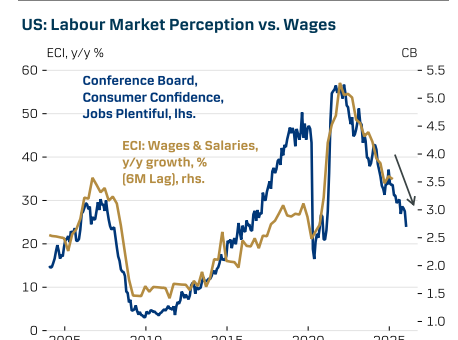
- Two more 25bp rate cuts in March and June. Terminal rate forecast 3.00 -3.25%.

Chart 1: We think the Fed could cut faster than markets anticipate



Sources: Macrobond, LSEG, Danske Bank

Chart 2: We don't think downside risks to labour markets have fully dissipated yet.



Sources: Macrobond, Conference Board, U. S. Bureau of Labor Statistics, Danske Bank

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Ad hoc

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