FX Viewpoint

Currencies
Global

USD: Dip post FOMC but strength ahead

- The FOMC kept policy rates unchanged for a fifth straight meeting, but three dissenters voted for a 25bp rate hike
- Policymakers are likely to continue debating possible rate hikes through the remainder of this year
- We expect the USD to grind higher supported by widening interest rate differentials and robust US economic activity

The Fed left rates unchanged prompting the USD to dip

The Federal Open Market Committee (FOMC) kept the **policy rate unchanged** at 3.50-3.75% at its 28-29 July meeting. While this was in line with the near-unanimous economist consensus, markets had priced a 35% chance of a 25bp hike, leading to immediate USD weakness as rate expectations were modestly repriced lower.

Warsh reframed from providing near-term guidance

Federal Reserve (Fed) Chair Warsh avoided explicit guidance on the likelihood of a near-term hike, which **the market interpreted as dovish and USD-negative**. He also provided limited insight into the committee's internal debate, instead reiterating the shared commitment to return inflation to the 2% target and referencing a discussion centred on four questions – including the impact of recent economic shocks and supply-chain strains – without disclosing the committee's conclusions.

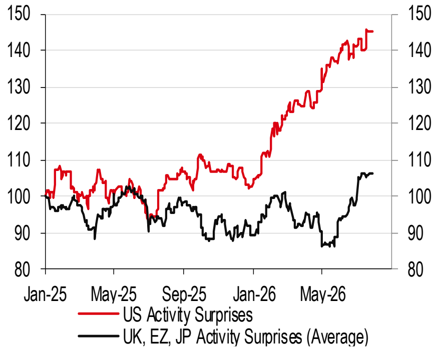
For now, the doves seem to represent the majority view

The debate likely echoed **recent Fed rhetoric**. Hawkish members have argued for higher rates given persistently above-target inflation, a resilient US labor market and easy financial conditions, while the dovish contingent favours patience to allow more time to assess conditions and decide on next steps. Although the press conference did not deliver a "hawkish hold" tone, the emphasis on achieving 2% inflation suggests **the door remains open to tightening** if needed.

We still favour modest USD strength ahead

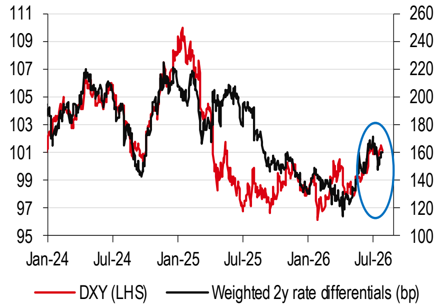
Overall, we do not expect this meeting to derail our generally **constructive USD outlook**. The Fed's narrative has shifted from an easing bias to a willingness to hike, a transition that has come alongside resilient economic activity, upside inflation risks and widening interest rate differentials (see charts). Geopolitical risk may also provide sporadic USD support although FX sensitivity to the US-Iran conflict is waning. We continue to expect modest USD strength ahead despite this setback.

The upward trend in US activity surprises



Source: HSBC, Bloomberg

The US Dollar Index (DXY) is trading more in line with rate differentials



Source: HSBC, Bloomberg

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