DBS Flash

US: Unanimous FOMC rate rise sets up one more hike this year

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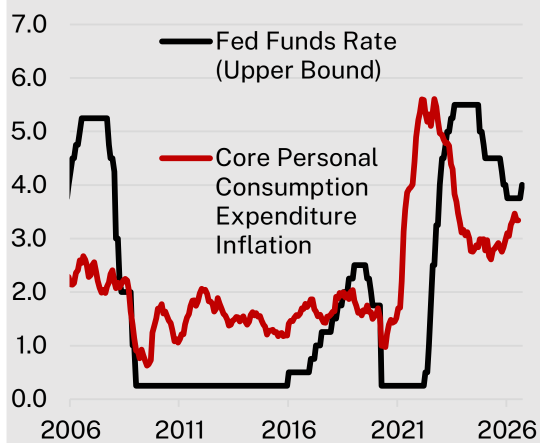
- *The Fed unanimously raised the policy rate by 25bps to 4% amid persistent inflation.*
- *AI investment, oil shock, and tariffs are adding demand, supply and policy pressures.*
- *Two further hikes are expected, taking the terminal rate to 4.5% by early next year.*
- *Solid growth, consumption, jobs and productivity allow the Fed to focus on inflation.*
- *Market, AI, debt, labour or geopolitical shocks could force a shift toward stabilisation.*

FOMC REVIEW

The US Federal Reserve delivered a widely anticipated rate hike at the conclusion of the September 15/16 Federal Open Market Committee meeting. We had expected a contentious outcome that could result in no change, but in the event the entire committee came together in voting for a rate hike. Persistent inflation, compounded by an array of demand (AI build-out), supply (oil shock), and policy (tariffs) factors have pushed the Fed into a corner that was not anticipated at all just six months ago. A 25bps hike to 4% of the Fed Funds Rate sets the ground for more hikes ahead, as reflected in the vast majority of the FOMC members' projections.

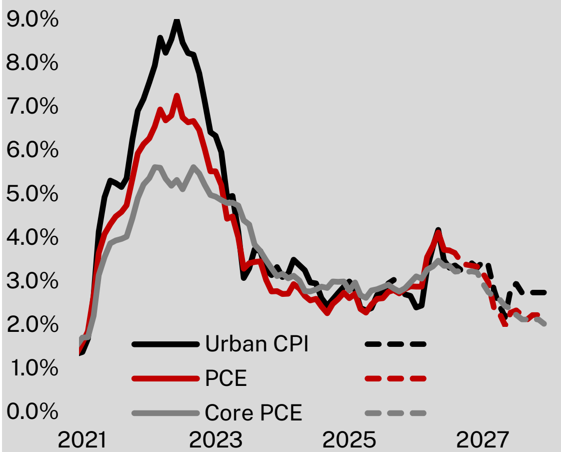
FFR and Core PCE



Source: CEIC, Bloomberg, DBS

We will pencil in one more rate hike this year and one more early next year, taking the terminal rate of this short cycle to 4.5%. In making this call, we take note of the points by Fed Chair Warsh last month, that monetary conditions are not tight, the pace of inflation heading back toward the 2% target is yet to be satisfactory, and short-term interest rates remain the key tool to deal with the Fed's mandate. Today's statement also reflects sufficient comfort with GDP growth, consumption, labour market, and productivity to retain the focus on inflation for the time being.

US inflation, actual and forecast, various measures

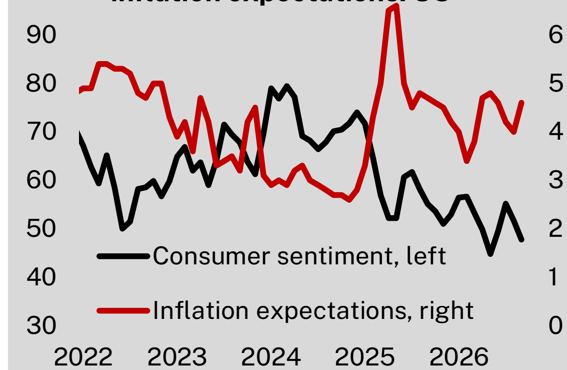


Source: CEIC, DBS

Much can cause this path of the rate hike to get undone. A large market selloff, a public debt crisis, an AI-related cataclysmic event, slippage in the labour market, or a major worsening of the geopolitical environment could force the Fed to shift its focus from inflation to economic stablisation. At the other end of the risk spectrum, continued fiscal slippage, and greater pressure from price and wages due to the AI boom could leave the market unsatisfied even with the policy rate at 4.5%.

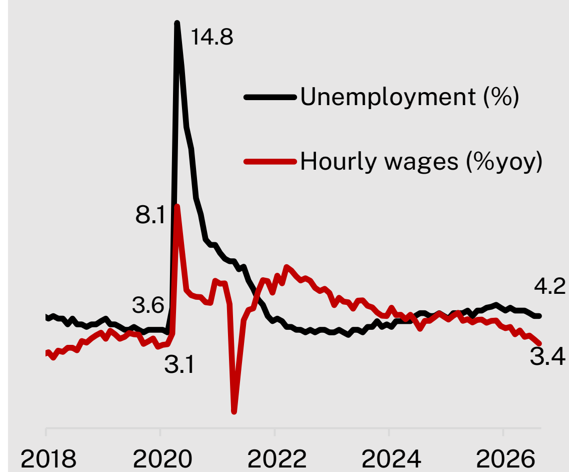
Bottomline, the about-turn by what had seemed like a dovish Fed Chair just a few months ago underscores the challenges embedded in this cycle. While inflation may be largely supply-side driven, there are enough risks to the inflation outlook to warrant more action in the coming months. This is particularly the case as the Fed's leadership appears keen to stamp credibility in a vigorous manner.

Consumer sentiments and inflation expectations: US



Source: University of Michigan, DBS.
Sentiment index set to 100 for 1966 reading.
12-month ahead inflation expectations is survey median reading.

US Labour market



Source: CEIC, DBS. Data through August 2026

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