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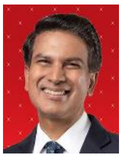
Fed's options

27 July 2026



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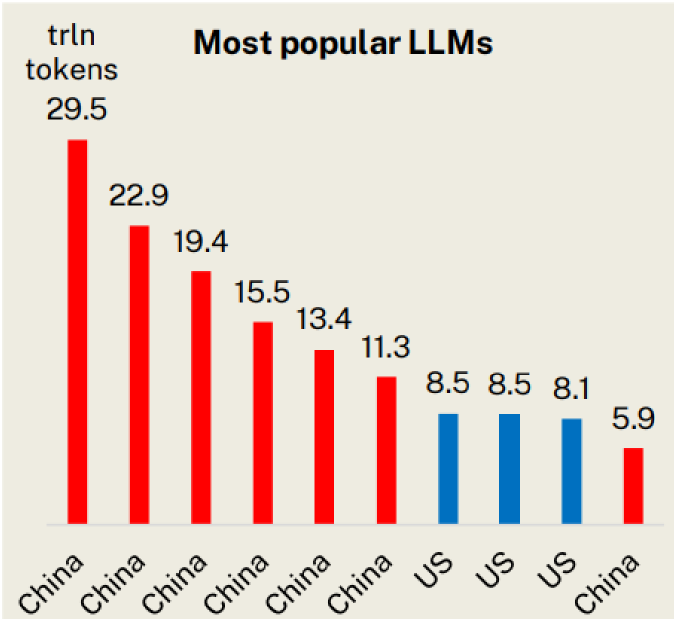
- *The Fed faces a tough call: sticky inflation argues for hikes, but soft demand, weak investment, muted wage growth, and heavy debt issuance support holding rates steady for now.*
- *Sticky core inflation keeps pressure on the Fed to hike the FFR rate.*
- *Mixed macro data gives support to both hawks and advocates of patience.*
- *Consumption and investment softness weaken the case for immediate tightening.*
- *Labour market resilience is fading, with job creation lagging prior cycles.*
- *Despite higher hike odds, our call remains a near-term Fed hold.*

CHART OF THE WEEK: LLM RANKINGS

A front in the China-US tech rivalry relates to AI models. While Silicon Valley-based AI companies have captured global attention with their large language models, China's companies have kept pace with innovation. Latest data show that by token usage, the top-10 ranking of most popular models feature 7 Chinese models, with the top-5 consists entirely of them. Unsurprisingly, this has raised alarm in US circles; risk of sanctions over chip usage and model training is rising.



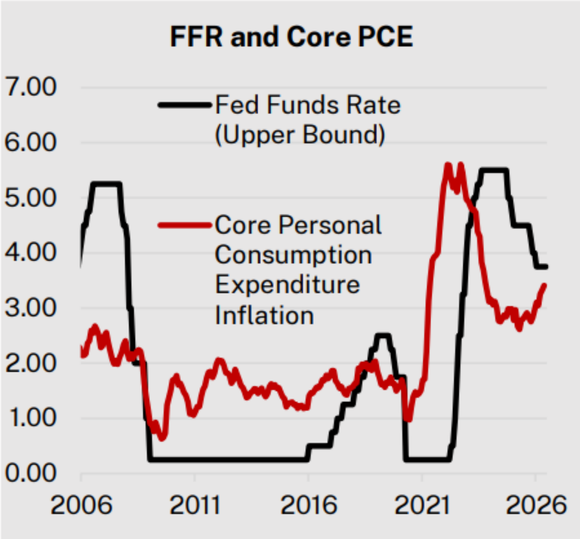
COMMENTARY: Fed's options

Taimur Baig

Should the US Federal Open Market Committee (FOMC), begin raising the Fed Funds rate? Are US economic conditions characterised by risks that need to be mitigated by higher borrowing costs? These questions will be confronting the FOMC members as they meet later this week (July 28-29). The year has turned out to be quite different from where things were at its beginning, when expectations were very much tilted toward monetary accommodation. But sticky core inflation, fuelled by electronics, immigration, tariff, and services prices, has become concerning, compounded by the Iran war-induced headline fuel inflation.

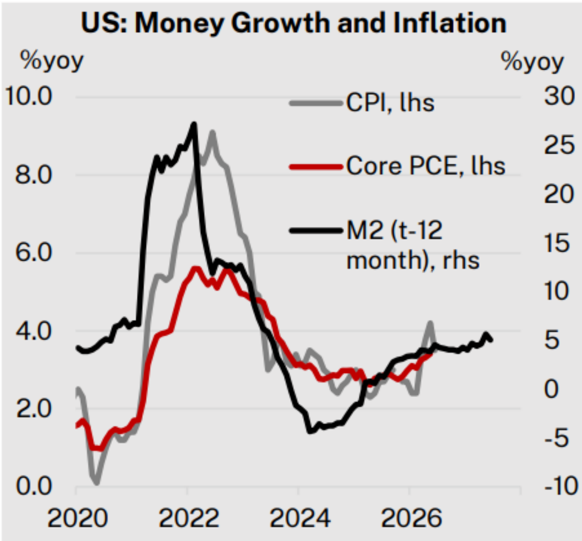
For a central bank ostensibly targeting 2% inflation, 3%+ core inflation since December-2025 is problematic to say the least. Some FOMC members ought to be scarred by the memories of the mid-2021 to mid-2022 period, when policy was kept extra-accommodating despite soaring core inflation. That episode alone should inform proactive decision-making this round.

The macro dataflow at the current juncture is however mixed, offering some ammunition to those in favour of a wait-and-see approach. While the AI-adjacent part of the economy is hot, the rest of the economy is somewhat lacklustre. Consumption has cooled a tad, perhaps owing to fuel price surge, dragging down Atlanta Fed's 2Q GDP Nowcast to below 2%. Inflation may be more supply side than demand side.

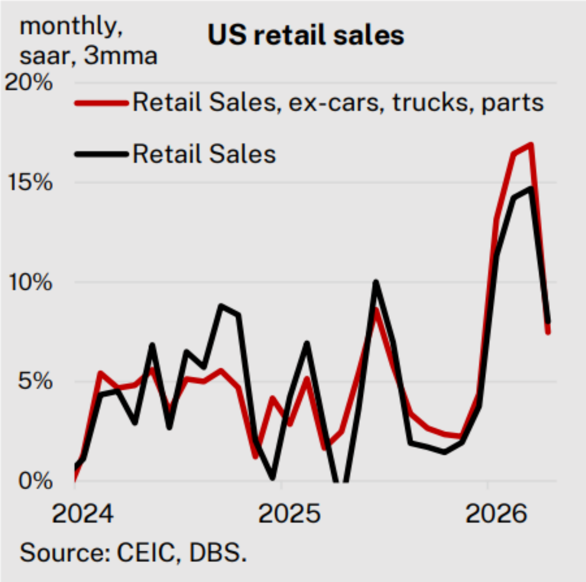


Source: CEIC, Bloomberg, DBS

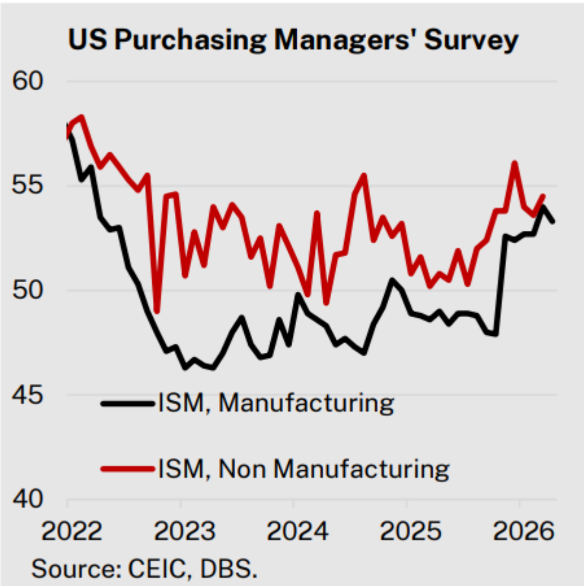
Then there is the relationship between money supply growth and inflation, something that is being argued forcefully by former FOMC member Stephen Miran. M2 growth was substantial before the 2021-22 inflation spike, but it is not presently. Someone critical of the Fed then would not use this data to be critical now. FOMC chair Warsh could well be in such a camp.



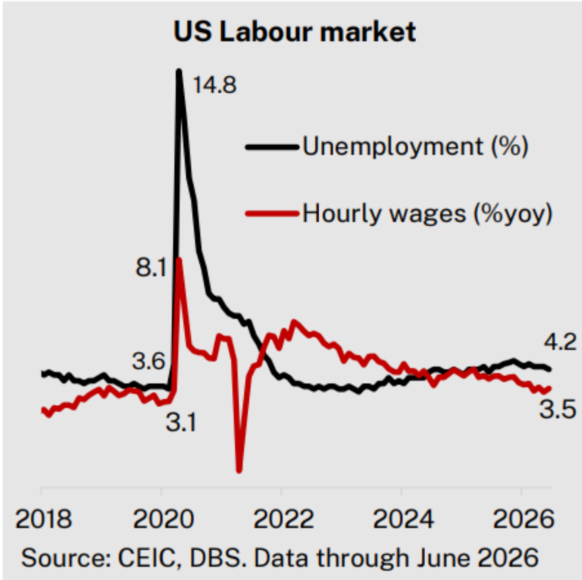
Source: Bloomberg, DBS

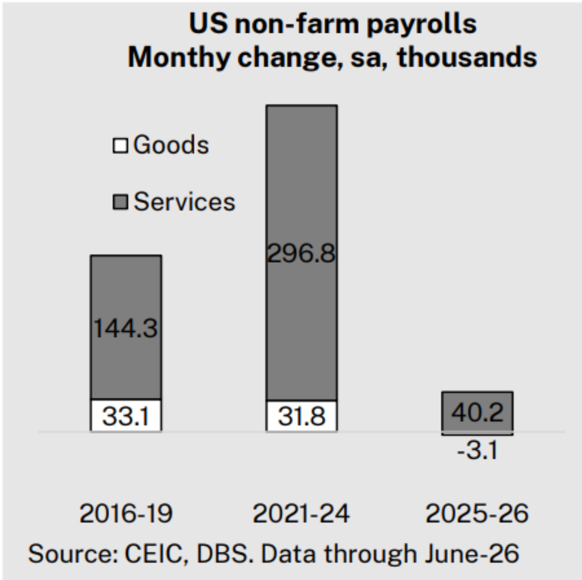


The production side of the economy is strong, but the investment side, despite the AI spending surge, is soft. Total real investment rose by just 0.4% in 2025, and was down 3.3%yoy in 1Q26. Public spending contribution to growth has also been negative lately.



Does the labour market warrant caution? Not quite. While the unemployment rate is low and real wage growth is still positive (but barely), job creation is lagging the Trump 1.0 and Biden years substantially. Add to that the angst around AI, labour market sentiments are hardly constructive overall.





Should the Fed go ahead with a couple of precautionary rate hikes just in case, given the buoyancy in asset markets and the need to maintain credibility? We think some, but not enough, FOMC members think along those lines. Our view is that once wage growth (around zero in real terms), retail sales (on the soft side), and the public debt situation (enormous forthcoming issuances tilted toward short duration) are considered, the case for pause, for the time being, remains. We don't reject the market pricing that the odds of a hike have risen, we just don't think they have risen enough. **Our call remains on the side of a hold**.

FX: A RETICENT FED AMID TRUMP FATIGUE

Philip Wee

Global central banks are entering a pivotal phase, with policy rates expected to remain unchanged across the Federal Reserve, the Bank of England, and the Bank of Japan this week, following the European Central Bank's decision to leave rates on hold last week. While markets broadly expect all four central banks to resume tightening in September if economic conditions warrant, the key distinction lies in their communication.

The ECB, BOE, and BOJ are likely to retain the option of further tightening through their guidance. However, the Fed could chart a different course under Chairman Kevin Warsh. **Rather than reinforcing expectations for a September move, Warsh may signal a broader overhaul of the Fed's communications framework**, including hints at this week's FOMC meeting about the possibility of scrapping the dot plot and Summary of Economic Projections from the September meeting. Such a shift would place greater emphasis on meeting-by-meeting decisions and incoming data.

While Warsh has indicated a lack of tolerance for elevated inflation, this week's PCE headline and core inflation could mirror the declines in CPI and PPI, providing him the cover not to hike before the November 3 midterms. **While the policy path may remain similar to that of its global peers, the Fed's communications style could become the source of market differentiation.**

The bullish USD narrative will become harder to sustain if Brent crude prices settle into a broad $70-100 per barrel range. According to the New York Times, US President Donald Trump may set aside plans to sharply escalate the US military attacks against Iran. With less than 100 days to midterms, the return of oil prices to $100 has coalesced the Democrats' campaign offensive to steer the election into a referendum on the Trump administration's foreign policy and economic management.

The market's muted reaction to Trump's latest tariff announcement on forced labour reflects fatigue. After many escalate-to-de-escalate episodes aimed at forcing trade deals, markets now assign a lower probability to the most disruptive outcome. This week's corporate earnings will show investors expecting earnings to be affected but not derailed. Moreover, oil matters more than tariffs this year amid a US economy that looks closer to Goldilocks than exceptional, and a new Fed leader who keeps rate decisions close to his chest.

Singapore's decision this morning to very slightly increase (less than April's rise) **the SGD NEER policy band's slope** came amid the rebound in global crude prices and the return of tariff uncertainty. Per our model, the new slope should be more consistent with 2026's official inflation forecast range of 1.5-2.5%. MAS's willingness to curb SGD NEER volatility limits USD/SGD to 1.2850.

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