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Macro Insights Weekly

Return of QE?

Group Research

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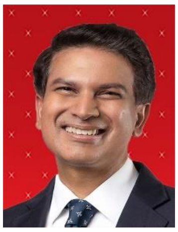

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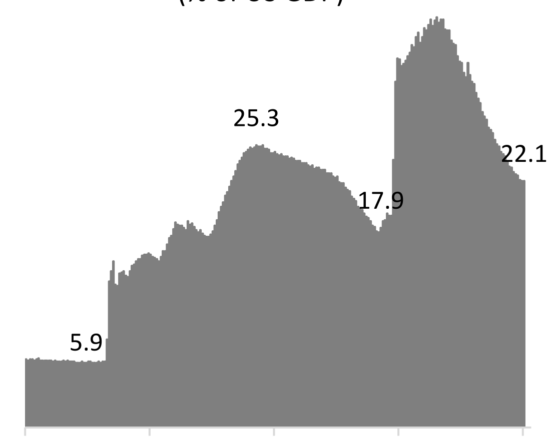
- *The path for the Fed to keep cutting rates, a key demand of the Trump administration, may be getting complicated, but policy accommodation is likely to continue, in our view.*
- *Some Fed officials have argued that further easing is not a deal.*
- *We actually think the bar is rather low, given the pressure coming from the White House.*
- *The Fed will likely cut rates further, and take additional easing steps.*
- *QT will end on December 1.*
- *If repo rates don't ease, QE will follow shortly.*

Chart of the Week: Fed balance sheet

At the onset of the 2008 global financial crisis, the US Federal Reserve embarked on an extraordinary asset purchase program, causing its balance sheet to quadruple in size. Once the economy had recovered, some reduction in balance sheet took place during 2015-19, but then pandemic-response came about, doubling the size again. The balance sheet was shrunk from 2022 onward, but the Fed has made it clearly lately that it is done; pre-pandemic size of the balance sheet won't be re-visited. The financial system demands much more liquidity.

Fed balance sheet
(% of US GDP)



Source: Bloomberg, DBS

Commentary: Return of QE?

The path for the Fed to keep cutting rates, a key demand of the Trump administration, is getting complicated. Fed communication turned more balanced last week after the widely expected rate cut in the October policy meeting. Not only did Chair Powell push back against the idea that another rate cut in December was a done deal, several Fed officials, voting and non-voting members of the FOMC, also stepped forward with arguments for caution. Kansas City President Jeff Schmid, who voted against the rate cut decision, was joined by Dallas Fed President Lorie Logan and her Cleveland counterpart, Beth Hammack, both of whom will be voting next year, in pointing out that the case for continued rate cut is not quite clear cut. The US labour market is largely in balance, the economy shows continued momentum, and inflation remains well above target. Substantial worsening of the labour market and significant easing of inflation is needed to justify further accommodation, along this line of argument.

We find logical alignment with the camp in favour of turning cautious, but we also see the political reality. **In our view, the bar for further accommodation is rather low**. The kind of pressure being exerted by the White House, combined with some large companies announcing job cuts and no sign of a jump in inflation expectations, is sufficient to keep the Fed on course toward further rate cuts. We see the December rate cut taking place with rather high likelihood.

Policy support does not have to come from rate reduction alone. As indicated recently, the Fed is done with quantitative tightening. With the central bank's balance sheet declining to about USD6.6trln, signs of liquidity turning somewhat tight have begun to emerge, with the widely followed SOFR-FFR spread widening.

The market and the Fed have been following such developments closely. Accordingly, the Fed announced last week that it would stop its three-year effort to reduce the size of its balance sheet on December 1. Unlike the rate cut decisions, the rationale behind ending QT was widely shared among Fed officials. Given post-GFC regulations and the evolving structure of the US financial system since the Covid pandemic, a much greater amount of bank reserves seem to be warranted now to maintain market stability. There is no going back to the 2010s, lets alone the 2000s level of Fed balance sheet.

The Fed will continue unwinding its portfolio of mortgage-backed securities, but the proceeds would be reinvested into US treasury bills, which in turn would help the funding of the burgeoning fiscal deficit. The central bank did not announce any additional liquidity measures to help ease funding costs, but we don't think that's too far away. If the recent rise in repo rates is not reversed in the coming months, the Fed could begin buying assets to keep reserves from falling further, which would mark a return to quantitative easing.

What was once considered as emergency measures to stave off a major financial crisis has now become a routine part of liquidity management. QE is now done to keep liquidity at comfortable levels. It may also be done, in our view, in response to political pressure. The Fed's independence is reflected not just in its rates decisions; the QT to QE transition will show its decision-making latitude as well.

Taimur Baig

FX: USD’s October rebound faces balancing tests in November

The DXY Index may face resistance around the significant 100 level after rebounding 2.1% to 99.8 in October. With the US and China de-escalating trade tensions for a year, attention now turns to the US government shutdown, which is entering its second month and inflicting more pain on the US economy. S&P Global estimated that the shutdown would shave 0.1-0.2% off GDP per week. **The November 4 gubernatorial elections in Virginia and New Jersey will serve as an early gauge of voter sentiment** ahead of the 2026 midterms. Markets view a pro-Democrat swing as leading to a swift resolution (risk-positive, USD-negative), while a Republican hold could entrench the standoff.

With the US-China truce easing concerns about another round of tariff-led inflation, Fed officials may turn more defensive on labour market weakness. US President Donald Trump may name Fed Chair Jerome Powell’s successor after Thanksgiving (November 27), which could undermine Powell’s authority and cloud forward policy guidance.

USD/JPY’s rise stalled around 154 on October 31 after Japanese Finance Minister Satsuki **Katayama warned against one-sided JPY weakness with a high sense of urgency**, including moves driven by speculation. During Trump’s visit to Japan last week, US Treasury Secretary Scott Bessent was encouraged by Katayama’s “deep understanding of how Abenomics has moved from a purely reflationary policy to a programme that must balance growth and inflationary concerns for the citizens of Japan.” Despite Prime Minister Sanae Takaichi’s strong start on the international stage – strengthening ties with Trump and projecting a “Japan First” diplomacy – her ambitious fiscal stimulus and reform agenda will face domestic hurdles in a fragmented Diet, fragile LDP coalition politics, and a wary public burdened by high living costs.

AUD/USD remained capped at 0.6630 and supported at 0.6440 through October. Reserve Bank of Australia Governor Michele Bullock will likely highlight three reasons for keeping the cash rate target unchanged at 3.60% at the November 4 meeting. First, CPI inflation was hotter than expected at 3.5% YoY in September, surpassing the 2-3% target range. Second, Bullock will likely affirm the trimmed mean inflation of 1% QoQ in 3Q25 as a “material miss.” Third, Bullock will brush aside the rise in September’s unemployment rate to 4.5% from 4.3% and affirm the labour market as a little bit tight. Hence, expect the RBA to revise its inflation outlook upward in the Statement on Monetary Policy.

GBP/USD is hovering near support at 1.3060-1.3100 after sliding 2.2% to 1.3152 in October. There are two reasons why the Bank of England will keep its bank rate unchanged at 4% at its meeting on November 6. First, September’s CPI (3.8% YoY) and core inflation (3.5%) were well above the 2% target. Second, Chancellor Rachel Reeves faces a difficult balancing act in the November 26 Autumn Budget. Against limited fiscal headroom, Reeves needs to preserve fiscal credibility, fund Labour’s growth agenda, and assure markets scarred by the 2022 mini-budget crisis.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)