Liquid Insight

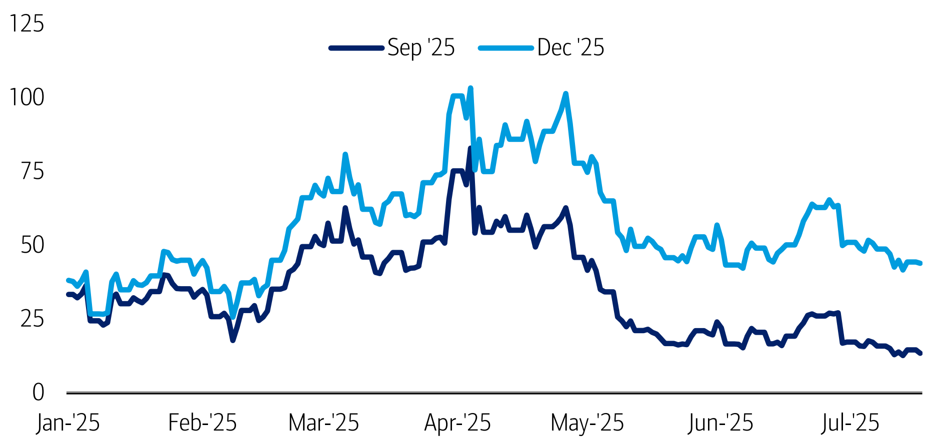
FOMC Preview: Patience is key

Key takeaways

- We anticipate the main theme of the July FOMC meeting to be one on patience and data dependency.
- We are seeing a growing divide within the committee, but we think Chair Powell is in no hurry to cut.
- The market is pricing virtually no expectations for rate moves and we don't expect significant impact on the dollar.

By FOMC: Mark Cabana, Aditya Bhave & Alex Cohen

Exhibit 1: Markets continue to price out Fed cuts
Cumulative cuts priced by Sep 2025 and Dec 2025 (bp)



Source: BofA Global Research, Bloomberg, Tullett Prebon

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July FOMC: Patience is key

We expect the main message from the July FOMC meeting to be that the Fed is patiently on hold and data dependent. We see a growing divide on the committee, but Chair Powell seems to be in no hurry to cut. On the labor market, Powell will likely note that the unemployment rate remains range-bound despite slowing private sector job growth. On inflation, Powell will probably point to signs of tariff pass-through in the June CPI data and the fact that June PCE inflation is likely to come in strong.

The US rates market expects little out of the July FOMC meeting. The market is pricing virtually no chance of a rate move & expects Chair Powell to reiterate data-dependence & patience. Meanwhile, the meeting is unlikely to be pivotal for the US dollar, with the next tariff deadline and US employment report 2 days later shaping up to be bigger market events.

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Timestamp: 22 July 2025 01:03AM EDT

US Econ: a house divided, but Powell still controls the message

We expect the main message from the July FOMC meeting to be that the Fed is patiently on hold and data dependent. We don't expect any substantive changes to the FOMC statement. However, Governor Waller would most likely dissent in favor of a 25bp rate cut. Governor Bowman might also dissent.

More broadly, we see a growing divide on the committee. Williams, Kugler, Bostic adopted a hawkish tone last week, citing evidence of tariff pass-through in the recent inflation data and arguing for the Fed to stay on hold "for some time". Even Goolsbee has been less dovish that before in recent comments. Meanwhile, Waller and Bowman have tilted dovish, and Daly is still making the case for cutting sooner rather than later.

Besides dissents, we won't get much flavor of the disagreements on the committee at the July meeting until we see the minutes. That's because there is no Summary of Economic Projections this time. Instead, Chair Powell would get to control the message via his press conference. And we think Powell is in no hurry to cut.

On the labor market, Powell would likely note that the unemployment rate remains range-bound despite slowing private sector job growth. This suggests supply factors are at play. However, we don't think he would be inclined to take a strong stand on the labor market outlook, given that there are two more jobs reports before the September meeting (with the July jobs data released just two days after the July FOMC meeting).

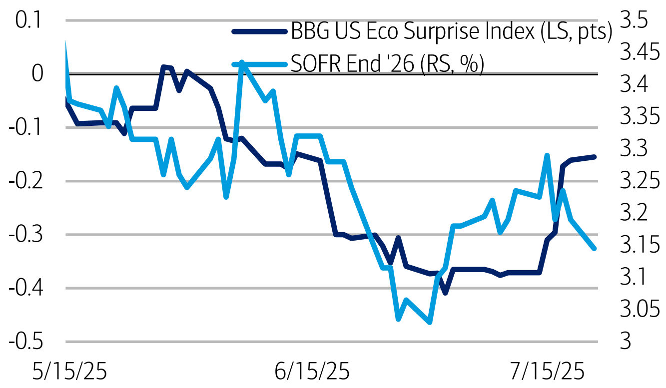
On inflation, Powell would probably point to signs of tariff pass-through in the June CPI data and the fact that June PCE inflation is likely to come in strong. Another reason for Powell to remain non-committal in July is that the Fed has the optionality of signaling its plans for September at the Jackson Hole Symposium (Powell's speech will most likely be the morning of August 22). By that time, the Fed will have another month's worth of data in hand.

US rates: still on hold, Fed independence erosion risk

The US rates market expects little out of the July FOMC meeting. The market is pricing virtually no chance of a rate move & expects Chair Powell to reiterate data-dependence & patience. The market's larger focus will be on any shift in guidance around the future rate path & characterization of dissents from other Governors. We will also be watching for any discussion of policy implementation tools given debt limit passage & upcoming Treasury cash balance rebuild.

Fed rate path: Powell is expected to be non-committal on the near-term Fed path. Labor & inflation data since the June FOMC meeting have both printed at or above expectations, which would justify the Fed decision to remain on hold. Despite the data, rates have declined since the June FOMC partially influenced by dovish Fed speak (esp from Governor Waller) (Exhibit 2, Exhibit 3). Given the tension between US data & Fed speak, we expect limited rate path guidance from Powell. The market is currently pricing ~55% probability of a 25bp rate cut at the September meeting; we might guess these probabilities are pared back after limited Powell guidance on the rate path. We still like being paid Dec '25 FOMC OIS.

Exhibit 2: Since June FOMC macro data is stronger but rates lower
Dovish Fed speak has likely driven the gap of rate moves & macro data



Source: Bloomberg

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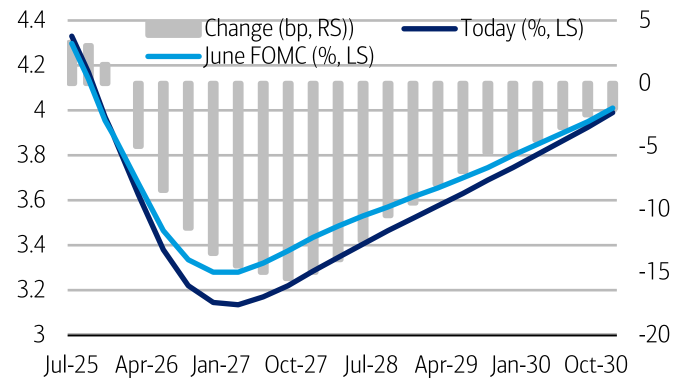
Exhibit 3: SOFR curve since the June FOMC
Dovish Fed guidance has likely shifted pricing lower



Source: Bloomberg

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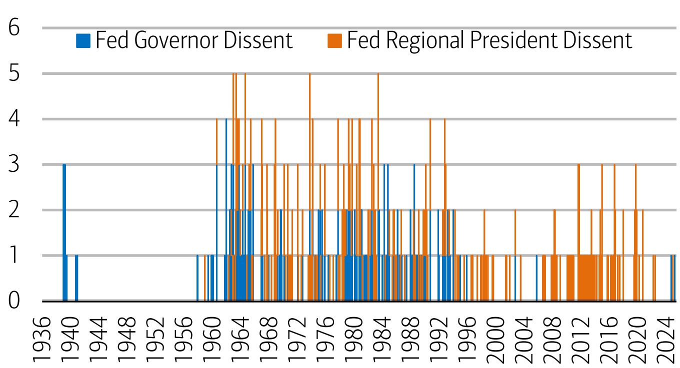
Governor dissents: Our economists expect dovish dissents at this meeting, most likely from Governor Waller & potentially Governor Bowman. This may start a trend of more frequent Fed dissents. In recent years Fed dissents have been few & far between, especially from Fed Governors (Exhibit 4, Exhibit 5). A more divided Fed may raise risks of a less consensus & more contentious institution. It may also raise risks of Fed independence erosion which would likely mean lower nominal & real rates, wider inflation breakevens, steeper UST curve, cheaper long-dated USTs b/c higher inflation risk. We likely being long 10Y inflation breakevens to hedge against this risk. Risk: Risk off flow that sees oil decline. For more detail see the US macro section of the Global Rates Weekly Musical Chairs.

Exhibit 4: Fed Governor & President dissent count by FOMC meeting
Fed Presidents have historically been more likely to dissent vs Governors



Source: St Louis Fed

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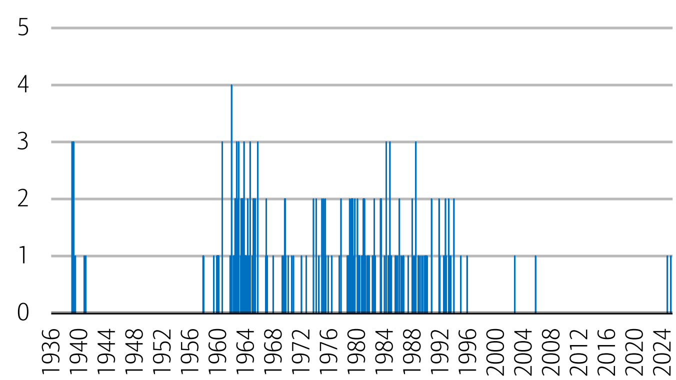
Exhibit 5: Fed Governor dissent count by FOMC meeting
Fed Governors have not dissented much over recent years



Source: St Louis Fed

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Fed policy implementation tools: We will also be watching for any discussion of policy implementation tools given debt limit passage & upcoming Treasury cash balance rebuild. We doubt Powell would provide any material guidance at this meeting. We continue to believe the market is underpricing the extent of upward US repo & money market funding pressures over the course of 2H '26 (see report: Repo sensitivity rising: stay short SOFR/FF). We also believe some at the Fed are overestimating the extent to which reserves can be drained from the system, which risks upward funding pressures (see report: Waller & Fed B/S: assessing ample). We stay short Jul & Oct SOFR/FF.

Bottom line for US rates: we still like being paid Dec '25 FOMC OIS due to solid US data, a strong labor market, & some signs of upward inflation pressure. If Powell does not support recent dovish Fed commentary, the market will likely pare back the extent of recent cuts. We like being long 10Y breakeven inflation for risk of Fed independence erosion. We still think market is underpricing 2H '25 funding pressure. Risk: Fed cuts get priced back into '25

FX: USD: More about NFP than FOMC

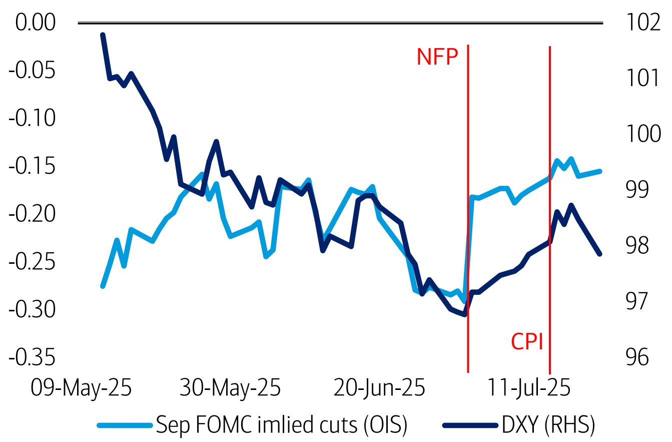
Next week's FOMC meeting is unlikely to be pivotal for the dollar, with the next tariff deadline and US employment report 2 days later shaping up to be bigger market events. While the main Fed-related focus of late has been noise around Powell's future, the overall tone from most (but not all) of the committee has reiterated the patient stance expressed in June. While 1-2 dissents are likely, these are presumably already discounted by the market.

Regarding the statement/press conference, the FX market would be primarily focused on the Fed's assessment of tariff-induced inflation in the June readings. However, concrete guidance on September— which is where the market's attention will be focused—would likely be elusive, in our view. Prior to September, the market will receive 2 labor reports, 2 CPI reports and the Jackson Hole event, which (as noted above) should restrain any near-term forward guidance.

Nevertheless, the September meeting has come into focus as the stark repricing observed this month (from 20% chance of a -50bp cut pre-June US employment, to now 60% for a 25bp cut) corresponded with the USD's July rally from multi-year lows. (Exhibit 6) While we still see a base-case for further gradual USD depreciation, resilient US data could keep the Fed on the sidelines for a bit longer than the market has priced, posing further upside USD risks. That said, Fed independence risks are real and even if these risks do not result in altering near-term FOMC decisions, they could continue to keep risk premia built into the USD, especially if inflation expectations were to rise and relative real interest rates were to keep declining. (Exhibit 7)

Exhibit 6: Decent June employment report marked a turn in Sept Fed pricing and the USD

DXY & Sept FOMC pricing during the intermeeting period



Source: Bloomberg; BofA Global Researh

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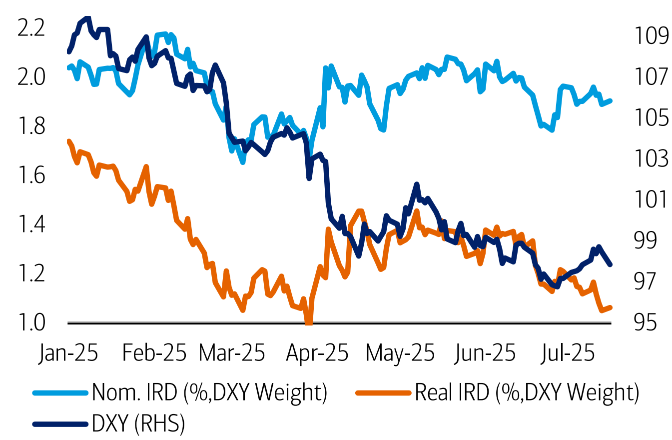
Exhibit 7: Degradation of Fed independence should see the USD decline along with falling real rates

DXY Index vs. nominal and real sovereign interest rate differentials (DXY weighted)



Source: Bloomberg; BofA Global Research; IRD=interest rate differential

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