

Special Coverage: Strong economy and tariff uncertainty keep hawkish Fed on hold again

Key takeaways

- ◆ In a move largely anticipated by markets and us, the Federal Reserve left interest rates unchanged at 4.25%–4.50%, but the meeting was still seen as slightly hawkish. The Fed noted that economic activity has “moderated” in recent months, while inflation remains elevated but continues to ease.
- ◆ Fed Chair Jerome Powell reiterated that the “main number you have to look at now is the unemployment rate,” since labour supply and labour demand appear to be slowing in tandem. Mr. Powell emphasised his data-dependent approach and offered no clear timelines for cuts, signalling the Fed’s intent to keep rates high until inflation convincingly moves toward the 2% target.
- ◆ We maintain our overweight on US equities, given the economy’s relative strength to other markets, strong earnings growth, the Fed’s eventual pivot, and the tailwinds from structural themes around technology and AI revolution, the re-industrialisation of the US economy, and reshoring of key industries, which together support a favourable risk-reward outlook. We remain neutral overall on fixed income but continue to tactically add high quality bonds for income and stability, using an active approach to find selective opportunities. We still forecast 0.75% of cumulative Fed rate cuts through this year and next.



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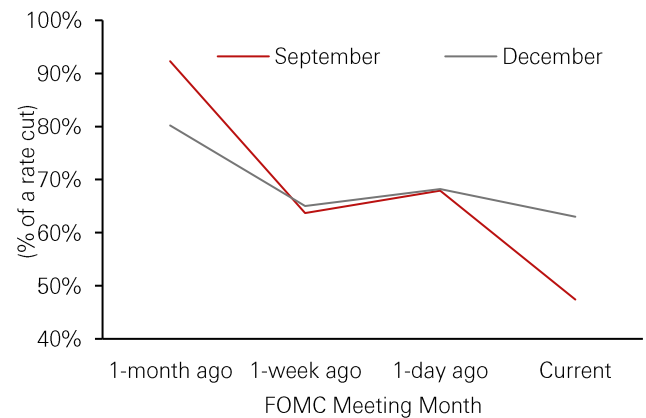
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What happened?

- As widely expected, the Fed kept interest rates unchanged on 30 July, holding the federal funds target range at 4.25%–4.50% for a fifth consecutive meeting. Policymakers voted 9-2 to keep rates on hold, with Governors Michelle Bowman and Christopher Waller arguing for a 0.25% cut.
- The Fed tweaked its wording in their July statement, replacing “economic activity has continued to expand at a solid pace” with “growth of economic activity moderated in the first half of the year.” This acknowledges slower momentum without signalling alarm.
- Mr. Powell reiterated that the Fed’s priority is achieving maximum employment and stable prices, noting that despite elevated uncertainty, the economy remains “in a solid position.” The unemployment rate is at 4.1% and has stayed in a narrow range for the past year. Mr. Powell said the labour market is “at or near maximum employment.”
- Inflation has come down meaningfully since its peak in 2022 but is still running above the Fed’s 2% target. Core PCE rose 2.7% over the past year, showing progress but not completing the Fed’s mission.
- Economic growth slowed to a 1.2% pace in the first half of 2025, down from 2.5% last year. Mr. Powell noted that the moderation reflects softer consumer spending, though business investment has picked up. Activity in the housing sector is still sluggish despite overall economic resilience.
- Mr. Powell stressed the Fed is “well positioned” to respond to new data before adjusting policy. Most measures of long-term inflation expectations remain consistent with the Fed’s 2% goal, and the Fed is committed to keeping them that way.

- Mr. Powell's comments at the latest press conference show that most of the policymakers still support a wait-and-see approach to any future rate cuts. Prior to the next FOMC meeting on 16-17 September, the policymakers will see two more months of labour market and inflation data.
- We expect three 0.25% rate cuts to be delivered in September, December and next March, with inflation remaining well above the FOMC's 2% inflation target through this time horizon. The market currently prices in roughly a 50% chance of a 0.25% cut by September. Our view is somewhat more dovish than market expectations.
- Regarding tariffs' impact on prices, Mr. Powell said the FOMC needs to see evidence that tariffs won't affect consumer prices before easing. He also suggested that tariffs may not be just a one-time shift in prices. In certain sectors, they may push costs higher than markets expect. While goods price inflation may rise, services price inflation continues to fall nicely.

The odds of rate cuts in September and December have decreased



Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 30 July 2025. Forecasts are subject to change.

Investment implications

- Policy clarity is improving, but volatility persists. The trade deals with the EU and China are adding some clarity for markets, but President Trump's latest wave of tariffs, including new actions on Brazil, India and copper products, underscores how quickly the policy backdrop can shift. This mix of clarity and fresh uncertainty keeps markets on edge but also reduces some of the worst case trade scenarios.
- President Trump's agenda may now increasingly focus on deregulation, particularly targeting Financials, Healthcare, Technology and Energy. These moves could enhance competition and disinflationary forces, helping keep inflation in check. If fully realised, they could also support further equity upside.
- Structural themes remain powerful long-term drivers for US equity markets as the technology and AI revolution, the reindustrialisation of the US economy, and reshoring of key industries reinforce our overweight on US equities.
- The US economy should avoid recession, while earnings growth remains strong (FactSet forecasts S&P 500 earnings at 9.6% in 2025 and at 13.9% in 2026), and innovation continues to boost productivity and profitability. Even if the market prices in a more hawkish Fed outlook, it may not matter for risk assets in the short term. Risk assets could come under fire if long rates were to continue to rise due to risks of higher inflation or term premium.
- We maintain neutral overall on fixed income but continue to tactically add high quality bonds for income and stability, using an active management approach to find selective opportunities in higher yielding segments.
- The USD still faces questions over US trade policy, the path for the US budget deficit, and the political pressure on the Fed. Cyclical headwinds for the USD are easing for now, but may return when the Fed resumes its rate cutting cycle. Political and structural headwinds remain in place. Any further weakness in USD could actually improve mega-cap earnings prospects.
- As long as the Fed continues to signal rate cuts down the road, risk assets can take comfort in that and focus on the very positive fundamentals driven by the tech revolution, productivity gains, steady margins, and the improving earnings outlook through year-end 2026.

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