

FX Viewpoint

Currencies
Global

The Fed pauses, as both the ECB and BoE cut rates

- ◆ The Fed held rates unchanged, while both the ECB and the BoE lowered their key rates by 25bp, as widely expected
- ◆ The divergence in both monetary policy and growth between the US and other economies should play to the USD's advantage
- ◆ Unlike the USD, both the EUR and GBP are facing stagflationary challenges, alongside the tariff risks

The Federal Reserve (Fed), the European Central Bank (ECB), and the Bank of England (BoE) did not surprise markets at their first policy meetings in 2025.

The Fed kept the federal funds rate steady at 4.25-4.50% after its 28-29 January meeting. Fed Chair Jerome Powell was basically able to paint a goldilocks picture of a resilient economy and inflation that is well off its highs, even if the last steps towards target are taking longer than anticipated. Our economists still expect 75bp of Fed cuts in 2025, but no longer expect the first cut this year to come in March. Instead, **our macro team look for three rate cuts to be delivered in 25bp steps at 17-18 June, 16-17 September, and 9-10 December policy meetings**, bringing the federal funds target range to 3.50-3.75% by end-2025. The USD was little changed after the announcement. In the end, **uncertainty is likely to remain the key theme**, not least with the US tariff news dominating over the near term. Amid the noise of the news flow, **we expect the USD to remain strong.**

The Fed is in no hurry to cut, probably supporting the USD

A day after the Fed's announcement, **the ECB cut its key policy rates by 25bp**, bringing the key deposit rate down to 2.75% and the main refinancing rate down to 2.90%. The ECB remains confident that disinflation is well on track, and our economists think that **another 25bp cut is likely at its next meeting on 6 March** after which the debate might heat up. Markets expect the ECB rate to finish the year around 1.80% (*Bloomberg*, 6 February 2025). If the tariff threat materialises in earnest, those expectations may need to drop further. As the Eurozone still faces a challenging growth/inflation mix alongside the tariff risks, **the EUR is likely to weaken further this year**, in our view.

For the Eurozone where activity has stagnated, a further headwind to exports would be very untimely, likely weighing on the EUR

Like the ECB, **the BoE also delivered a 25bp rate cut**, sending the Bank Rate to 4.50%. But the monetary policy committee's (MPC) vote was dovish, at 7-2 with **two members** (Catherine Mann and Swati Dhingra) **preferring a larger 50bp move**. That being said, the BoE signalled a "*gradual and careful approach*" to future rate cuts. At the same time, **the central bank's latest forecasts depicted a more stagflationary picture in 2025**, cutting its growth forecast to 0.75% (from its November forecast of 1.50%) but raising its inflation forecast to 3.50% (from 2.75%). GBP-USD dropped below 1.24 before recovering some of its earlier losses. **We expect the GBP to weaken against the USD**, but should the dovish voices grow within the MPC, the risk is that GBP-USD could drop faster and more than expected. Our economists expect the BoE to accelerate its pace of easing, cutting at every meeting from September 2025 to February 2026, taking the Bank Rate down to 3.0% in 1Q26.

The GBP is likely to face slower growth and faster inflation, alongside the possibility of growing dovish voices within BoE's MPC

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