Summary

- US Federal Reserve (Fed) raises rates for the first time in nearly ten years by 25bps, to 0.25-0.50%.
- The future path of rate hikes is now the most important element of US monetary policy and will be the key for US Dollar (USD) direction.
- Fed remains data dependent but expects gradual pace of rate tightening. No change in end-2016 median rate forecasts at 1.4%.
- Fed Funds futures pricing indicates that the market remains behind the Fed's curve, expecting 2 rate hikes in 2016.
- US Dollar likely to peak in Q1 2016 as market expectations catch up to Fed projections.

The Fed finally raises rates

In a highly telegraphed move, the FOMC has increased rates for the first time in nine years by 0.25%. Over the past 5 tightening cycles, the Fed hiked rates 7 times in the first 12 months.

Implications for the US Dollar

Currently the market is pricing two further rate rises for 2016. Recent weakness is expected to turn into strength for the USD in the near–term, but a peak is in sight. We expect the USD to strengthen, but at a slower pace in Q1 2016 as inflationary pressure sees real interest rate differentials narrow. We expect the turning point for the USD will occur when market pricing catches up to the Fed projections of rate hikes in 2016. After Q1, rising inflationary pressure alongside a flattening US yield curve will see the USD decline as growth in real yield differentials turns negative.

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