Allspring

Fed on Hold as Storm Around It Intensifies

The Federal Reserve (Fed) held rates steady amid solid growth and sticky inflation, with markets reassessing rate-cut expectations as rising commodities, a weaker USD, and political uncertainty complicate the outlook.

Authors	Date	Topic
Matthias Scheiber, Ph.D., CFA Rushabh Amin	1/28/2026	Market Events

Key takeaways

- **Inflation pressures remain uneven** as strong commodity prices, shelter rebounds, and a weaker USD challenge further progress despite a slightly softer core inflation reading.
- **Markets are pricing in fewer rate cuts**, supported by robust growth, fiscal spending, and solid corporate earnings, though the inflation trajectory will determine whether that's good news.
- **Policy and political uncertainty persists**, with the upcoming Fed chair selection, Supreme Court tariff rulings, and tensions over Fed independence adding potential volatility to markets.

The Fed holds the federal funds rate at 3.50–3.75%

Today, the Federal Open Market Committee decided to keep interest rates unchanged. A steadier job market and sticky inflation made the Fed wait to see how previous rate cuts will support U.S. economic growth. The current rate level seems to be within reach of the "neutral rate," which shores up employment while keeping inflation in check. That said, the investment and capital spending boom caused by artificial intelligence and the sharp rise of commodity prices, including industrial metals, might result in a stickier inflation path for this year. The market has slowly priced out one of the two rate cuts expected at the end of last year. The big focus will remain on the announcement of the new Fed chair, with the race wide open though a general expectation of someone more dovish to succeed Jerome Powell. Governmental pressure on the Fed to cut interest rates will remain a continued theme this year.

Inflation falls while commodity prices rise

Core inflation came in slightly lower than expected at 2.6% year over year. The figure was likely artificially depressed by the long government shutdown as the BLS had to make some assumptions on unchanged key housing metrics. Shelter costs bounced back, and apparel prices also climbed. Grocery prices continued their way up while used trucks and car prices fell. The report didn't show a lot of pass-through from tariffs, though some of it could have been due to old inventory drawn-down first. The labor market remains robust, and real gross domestic product growth is likely to accelerate in the first quarter to 3%. The strong upward move in commodity prices and the weaker USD are likely to pose a headwind for further inflation progress. The Supreme Court is still to rule on tariffs as well as the administration's effort to oust Fed Governor Cook. Both decisions have the potential to create uncertainty in the markets and around Fed independence.

Fewer cuts expected, but not certain

Market consensus has slowly moved away from multiple rate cuts this year, and even a second cut is not fully priced into the short-term interest rate curve any longer. Fiscal spending is only peaking in the second quarter, a softer USD should support exports, and company earnings are expected to remain robust. This supports ongoing personal consumption and robust growth, and it would help make the case for less rate cuts this year. If fewer rate cuts are driven by better growth, then this scenario would be positive. If, however, inflation is coming back—driven by higher commodity prices and a weaker USD—then this could negatively impact markets.

Our narrative of "run-it-hotter" U.S. growth based on loose fiscal policy and a weaker USD is likely to persist. In this market environment, equities should continue to be supported by strong company earnings, while in the bond space, the interest rate curve is continuing to steepen. We believe commodities remain a clear opportunity, as we can't rule out stickier inflation.

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