

At the October meeting, the U.S. Federal Reserve Open Market Committee voted to reduce the Fed funds rate for the second time in a row, by another -0.25%, to a new range of 3.75-4.00%. There were two dissents, interestingly in both directions, from Gov. Miran (wanting a stronger -0.50% cut) and Kansas City Fed President Schmid (wanting no change in rates).

The formal statement started with the most obvious difference, replacing “Recent” with “Available” indicators, a hint at the lack of data with the U.S. government shutdown. Economic activity “has been expanding at a moderate pace,” up from “moderating” at the last meeting. Job gains were described as having “slowed,” as downside risks “rose in recent months.” Inflation has “moved up since earlier in the year,” staying elevated. Quantitative tightening is also coming to an end as of December 1, which implies a stoppage in selling securities off the balance sheet. While not an easing measure in itself, it serves to stop indirect tightening at the longer end of the yield curve through supply and demand activity.

CME Fed funds futures had assumed today’s quarter-percent move since early September, in a continuation of the prior meeting’s initial quarter-point cut. Looking ahead, markets assume a third straight cut of -0.25% in December, which would bring the year-end 2025 rate to 3.50-3.75%. For 2026, two cuts are predicted, bringing the policy rate down to 3.00-3.25%. While rate estimates for 2027 have just recently rolled out, one cut and one hike are predicted through at least Sept. of that year. That ending 3.00% level is right around the Fed’s self-described long-term ‘neutral rate’—the nominal level that’s considered neither too easy nor too tight, and takes into account a 2% target inflation level (or perhaps slightly higher these days) and up to a 1% ‘real’ rate, seen as historically appropriate.

Economy. The Atlanta Fed GDPNow indicator for Q3 hasn’t been updated as routinely as usual, with far less data to look at, but has risen to 3.9% for the time being. The Blue Chip private economist consensus has also risen from under 1.0% to around the 2.5% range for Q3. The federal government shutdown has delayed key data releases, making it increasingly difficult to make more detailed estimates of where we currently stand. Private economic estimates point to a slowing towards the ~1.5% range for Q4-2025 and Q1-2026, before picking back up toward a ~2.0% level, which is on par with the assumed long-term trend. While slower than the more volatile performances of this year’s growth (on a net basis), reflecting trade imbalances and reactions, recession risk remains at bay due to continued strength in consumer spending for the most part. Business spending has also been decent, but driven primarily by technology, and specifically data center activity, while residential housing continues to languish. Markets will be watchful for signs of consumer and business credit stress, where cracks have been seen in some areas. Long-term, expected productivity enhancements driven by artificial intelligence are hoped to add a few tenths to the GDP number, but translating that technology into growth gains has been opaque. That’s the something that may be required to offset a decline in labor force growth and keep overall growth at a trend pace.

Inflation. For the late-release September Consumer Price Index numbers, headline and core inflation each rose 3.0% over the last 12 months. Core PCE for August continued to run above-target at 2.9%, which continues to be old news as we await fresher data. The main discussion around inflation is how quickly the impact of tariffs is rolling into (and out of) goods and services prices. So far, reiterated by some commentary from corporate executives, consumer price impacts have remained contained as the current inventory being unwound was stockpiled prior to tariffs being applied. As that is replaced by

newer inventory, rising prices are the expectation, with the second question being how much companies will absorb before too much damage is done to profit margins. The rough consensus by analysts and economists is that about half the costs will be absorbed, with the other half passed on to consumers, although that's certainly subject to the magnitude of cost increases and how long punitive tariff rates last.

Employment. The main impetus for the Fed cutting rates is perceived softness in the labor market, although that hasn't translated into outright weakness so far. Even before the government shutdown and lack of new data, there had been some measurement challenges caused by slower immigration patterns (dropping labor supply counts) while labor demand remains fairly stable. Firms appear to be cutting back on job openings and workforce expansion as they navigate trade uncertainty, as opposed to proceeding to the next level of outright layoffs in an environment where workers have been hard to find, particularly in certain highly-skilled areas.

The Fed generally takes one of two approaches to policy interest rate cuts: (1) emergency, to combat the downward spiral of an imminent recession, or (2) insurance cuts, which are slower-paced, and maybe somewhat reactionary to signs of slowing, but intended to ease policy levels down to a perceived neutral level, if they happen to be above it. At this point, we appear to be in the latter. Historically, such 'risk management' cuts have tended to come in groups of several (three, in particular), in line with what's expected this fall.

Chair Powell's term comes to an end in early 2026, and it remains to be seen which of the leading candidates is appointed to the job, as well as how dovish or not committee sentiment turns with the leadership change. Global markets have started to question the independence of the Fed from political influences for the first time in a while (it's happened at times in the past), although the leading candidates for chair are seen as fairly traditional economists, as opposed to those with less conventional ideas (e.g., like wanting to put the U.S. back on a gold standard). Looking ahead, the trajectory of the economy and labor markets could likely outweigh other factors in determining the interest rate path, with still-high inflation remaining a wildcard.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.

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