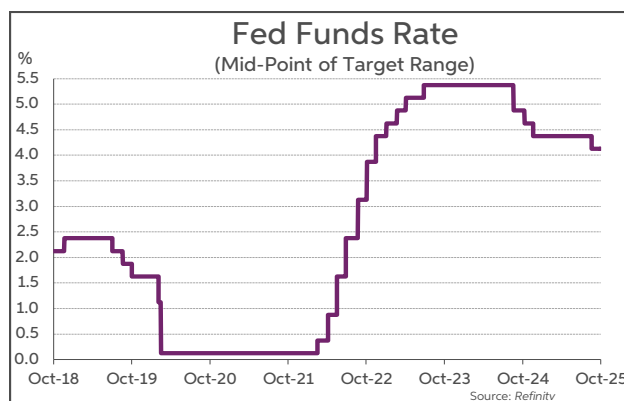


Fed cuts again, but leaves door open to a hold in December

The Federal Reserve Open Market Committee (FOMC) meeting for October saw the central bank cut interest rates by 25bps, with the target range for the Fed funds rate lowered to 3.75-4.00%. This was the second consecutive rate cut from the central bank. The Fed has now cut by 50bps this year and has reduced rates by 150bps since its started to ease policy in September 2024. The decision to cut rates by 25bps was in line with market expectations as it had been well sign-posted by the Fed. The voting breakdown once again showed some differing views within the FOMC. 10 of the 12 members, were in favour of easing policy by 25bp. Governor Miran continued to vote for a 50bps reduction in rates, while one member (Schmid) preferred to leave rates unchanged. Meanwhile, the Fed also announced it will end its quantitative tightening programme on December 1st.

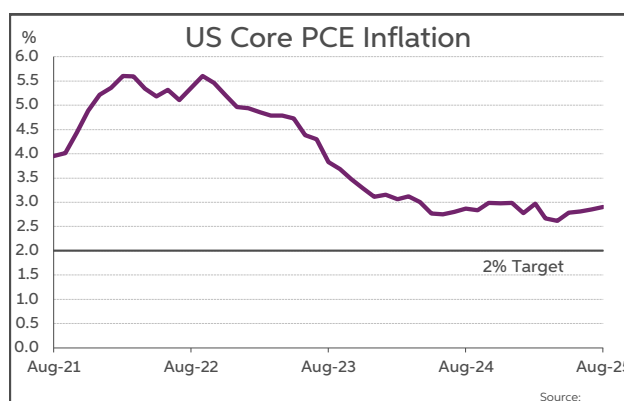
The meeting statement for October was very similar to its September version. The committee described the economy as “expanding at a moderate pace”. In terms of the labour market, it commented that unemployment has “edged up, but remained low through August”. Its characterisation of the inflationary backdrop was that inflation remained “somewhat elevated”.

However, the post meeting press conference saw Chair Powell espouse a less dovish tone and he left the door open to a potential ‘hold’ at its next and final FOMC meeting of the year on December 9th/10th. He stated that a December rate cut was “not a forgone conclusion”, it was “far from it”. There were other aspects of his remarks during the press conference that also had a less dovish slant. This was in his assessment of economic growth and the labour market. Chair Powell noted the potential for stronger GDP growth and also mentioned that the recent deterioration in labour market conditions may be showing signs of easing.



The most recent interest rate projections (i.e. dot plot) from the Fed were published at its September FOMC meeting. These dots were slightly more dovish compared to their June edition but they continued to indicate a relatively gradual pace of policy easing from the Fed over the next 2-3 years. The median projection for 2025 was lowered to 3.50-3.75% by year end, which would see a total of 75bps of easing this year. This entailed 25bps of additional easing compared to the June ‘dots’, which anticipated 50bps of cuts. Meanwhile, the median view for 2026 among the Committee was for one 25bp rate cut to 3.25-3.50%. For 2027, rates were seen declining to 3.00-3.25% by year end. Further out, the “longer run” view was unchanged at 3%.

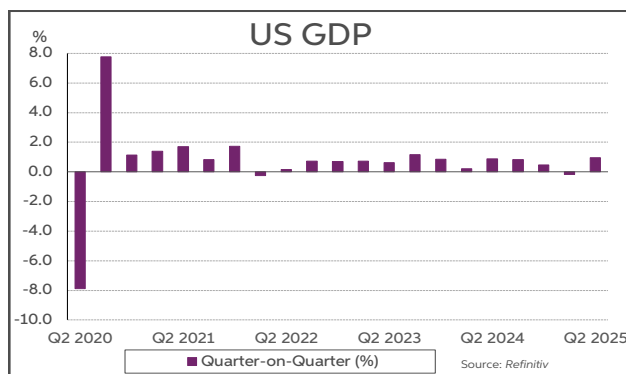
The less dovish tone from Chair Powell’s press conference has seen a firming in market rate expectations. Futures contracts indicate the market now sees around a 70% chance of a 25bps rate cut at the next FOMC meeting in December. Prior to yesterday’s meeting, the market was attaching a 95% probability to this outcome. The market continues to envisage a more aggressive pace of rate cuts next year compared to the Fed’s own projections. Futures contracts imply that the market sees US official rates getting down towards 3% by the end of 2026 (versus Fed projection for 3.4%)



Overall, it is clear from the October Fed press conference that the central bank was keen to signal to the market that a rate cut in December was not nailed-on, as had been priced-in/assumed by futures contracts. This updated guidance from the Fed is a sensible approach to take in the context of the on-going government shutdown, as the FOMC may have very little official macro data to inform a policy decision, at the time of its December meeting. Despite the uncertainty over the flow of incoming data, we would still lean towards another 25bps rate cut in December.

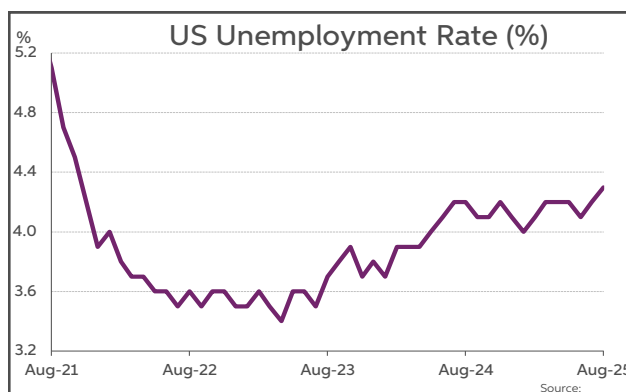
Lack of US data means the Fed is operating in the dark

US economic growth has slowed markedly in the first half of 2025. GDP contracted by 0.2% in the first quarter before rebounding by 0.9% in the second. However, very sharp swings in imports have created significant volatility in the data. Indeed, goods imports surged by 11% q/q in Q1 before falling by 7.7% in Q2. A closer examination of the data, though, also indicates that the US economy has lost some underlying momentum. Personal consumption has risen more slowly, up by 0.2% in Q1 and by 0.6% in Q2, compared to an average growth rate of 0.9% per quarter in 2024. Meanwhile, government spending contracted slightly in the first six months of 2025. Fixed investment has been the one bright spark, increasing at a faster pace in the first half of 2025 (2.8%) compared to last year (1.1%). Against this backdrop, real domestic final sales expanded by just 0.9% in H1 2025, down sharply on the 1.3% and 1.9% rates of expansion seen in 2023 and 2024.



Recently, the availability of timelier data has been curtailed by the ongoing government shutdown. However, the available hard data indicate that the economy may have gathered some steam in Q3. Retail sales increased by 0.6% m/m in July and August, with the control group (core sales metric) rising by 0.5% m/m and 0.7% m/m during the same period. Nominal consumption rose by 0.4% m/m in July and August, the second fastest pace of expansion this year. Industrial production has underperformed though, recovering by a meagre 0.1% in August, following a 0.4% contraction in July. **Survey data have been somewhat mixed in Q3.** The services PMI averaged 54.8 in Q3, up from 52.5 in Q2. The manufacturing PMI averaged 51.6, compared to 51.7 in Q2. At the same time, the manufacturing ISM has stayed in contraction mode throughout the quarter, while the non-manufacturing ISM dropped to 50.0 in September. **However, the flash PMIs for October both improved and printed firmly in expansion mode.** Meantime, the Michigan and the Conference Board measures of consumer confidence remain at weak levels at the start of Q4.

Regarding the labour market, conditions have softened at an accelerating pace this year. Payrolls fell for the first time since December 2020 in June, and the overall pace of expansion slowed to just 30k in the three months to August, down from 111k in Q1, and from 167k during 2024. Meanwhile, the unemployment rate rose to 4.3% in August, having oscillated between 4-4.2% in the 15 months prior. At the same time, labour demand has weakened. JOLTS job openings were just above 7.2m in July and August, which is their lowest level this year. Against this backdrop, average earnings growth has eased, falling to +3.7% y/y in August, matching the year-to-date low from June.



Meanwhile, after some disinflation at the start of the year, there are tentative signs of tariff-related inflationary pressures emerging. Headline CPI fell to 2.3% in April, its lowest level since February 2021, before re-accelerating in four of the five months since. It stood at 3.0% in September. Elsewhere, core-CPI printed between 2.8-3.1% since February, and was at 3.0% in September. Similarly, core-PCE edged down to a low of 2.6% in April, only to re-accelerate steadily to 2.9% in July/August. Looking ahead, the Fed sees core-PCE rising to 3.1% in Q4.

In summary, US economic conditions have deteriorated this year. High levels of uncertainty, especially regarding US trade policy, has weighed on activity. At the same time, conditions in the labour market have weakened. Furthermore, signs are emerging that higher tariff rates are exerting some inflationary pressures on consumer prices. Recently though, the US has agreed several trade frameworks with some of its key trading partners, which should remove some of the uncertainty that has impacted the economy. Nevertheless, slower growth is expected this year, with the IMF forecasting US GDP will rise by 2.0%, compared to 2.8% in 2024. It should be noted though, that 2.0% growth is still relatively solid. Thus, the potential re-emergence of inflation may play a greater role in policy deliberations and could become a key challenge for the Fed in the coming quarters, amid the ongoing political pressure to cut rates aggressively. The protracted government shutdown is also complicating the Fed's job, as a lack of official data releases means they are currently making policy decisions while operating in the dark.

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