First Trust
ECONOMIC RESEARCH REPORT
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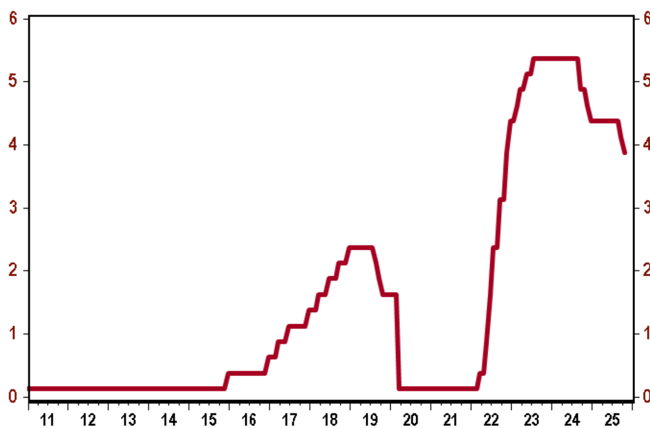
Navigating the Fog

The Federal Reserve cut rates by a further 0.25% today, despite the ongoing government shutdown meaning limited data releases to judge the pace of progress on the dual mandate. At the same time, the Fed announced an end to reducing its balance sheet. Markets have been pricing in another rate cut to come in December, but all eyes were on Powell for any hint at how the Fed is leaning.

Other than the rare cut and end of QT starting December 1, the Fed statement was little changed in substance from the meeting mid-September. Most text changes were simple wording shifts to note that job gains had slowed and the unemployment rate ticked higher as of the last time employment data were released in early September. Meanwhile, last week's CPI release showed inflation still running above the Fed's 2% target. Notably there were two dissents to today's actions, and they moved in opposite directions. Fed Governor Stephen Miran voted for a larger 0.5% cut, while Kansas City Fed President Jeffrey Schmidt voted to hold rates steady.



With little forward guidance on Fed thinking in the published statement, focus shifted to today's press conference for clues on what to expect at the Fed's final FOMC meeting of the year scheduled for December 9-10. And the press conference did not disappoint.

Even before getting into questions before the press, Chair Powell headed off the two questions that were sure to be asked. First, he began by emphasizing that today's meetings saw "strongly differing views on how to proceed in December" and that nothing is set in stone about how the FOMC will proceed at the next meeting. Differing views are in part due to varying levels of risk aversion from voting members, while also in part a question of how to proceed without the normally available data to judge progress. There are some non-governmental data releases – such as the ADP employment data out earlier this month reporting a decline in jobs for September, state level unemployment claims, regional Fed Bank surveys, and the ISM reports – that the Fed can use for guidance, but their preferred measures are out of reach for the foreseeable future. As a result, the Fed is treating the current environment like driving in the fog, you still can still drive forward, but you slow down.

The second item that Powell addressed was the reasoning behind the end to the QT process. Put simply, the Fed has been debating when to end QT for some time, and were watching repo rates – amongst other data – for signs of financial market tightening. Recent weeks have seen an uptick in those signals of tightening, and the Fed feels like current Fed balance sheets now look "ample". At $6.6 trillion, the Fed's balance sheet is multiples larger than it was before the Fed's decision to begin quantitative easing back in 2008, shifting the financial system from a scarce reserve system to an abundant reserve system where the Fed paying banks – not the banks bidding based on demand – dictates rates. We could debate until our faces turn blue the many unintended consequences and policy mistakes associated with QE, but for now the Fed is moving toward a more "neutral" stance with regard to their holdings, and by keeping the balance sheet size constant, it will gradually shrink as a percent of total financial market assets.

We expect the Fed will cut again at the next meeting, and anticipate further cuts to come in 2026 as inflation moderates and employment remains weak (for more on our inflation outlook, check out this week's Monday Morning Outlook).

Much is in motion as we near the end of 2025. Tax policy, tariffs, and the AI building boom have led businesses to pick up the pace of domestic investment. Regulatory changes and productivity gains could push growth to move even faster in the years ahead. But we are also still dealing with the uncomfortable process of moving away from government stimulus and massive deficit spending that have boosted growth numbers in the post-COVID era but were unsustainable. Progress is being made, but there is still much work to do. And with the Fed at the wheel, mistakes aren't out of the question.

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Text of the Federal Reserve's Statement:

Available indicators suggest that economic activity has been expanding at a moderate pace. Job gains have slowed this year, and the unemployment rate has edged up but remained low through August; more recent indicators are consistent with these developments. Inflation has moved up since earlier in the year and remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook remains elevated. The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment rose in recent months.

In support of its goals and in light of the shift in the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 3-3/4 to 4 percent. In considering additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee decided to conclude the reduction of its aggregate securities holdings on December 1. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Alberto G. Musalem; and Christopher J. Waller. Voting against this action were Stephen I. Miran, who preferred to lower the target range for the federal funds rate by 1/2 percentage point at this meeting, and Jeffrey R. Schmid, who preferred no change to the target range for the federal funds rate at this meeting.

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