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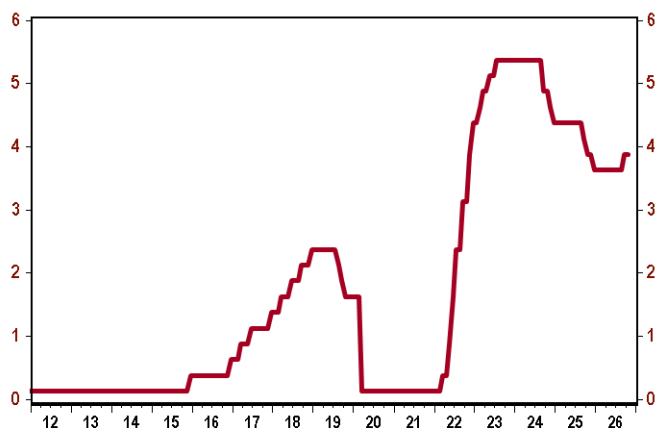
October Pause

The Federal Reserve held rates steady at the last meeting before the mid-term elections, while setting the table for a likely rate move in December.

Before we dive into the details, Chairman Warsh announced a new protocol for Fed meetings starting in 2027. Next year the Fed will continue to hold eight FOMC meetings, but one of those meetings will focus specifically on monetary policy strategy and will not include a vote on rates. In 2028, there will again be eight meetings but two of those meetings will focus on strategy and not on rates. In other words, there will be fewer meetings spent setting interest rates, and more time committed to ensuring the FOMC has clear goals and strategies to operate under moving forward.

Fed Funds Target Rate

EOP, %



Source: Federal Reserve Board/Haver Analytics

Within the Fed statement, there were minimal changes to language. The economy is seen as expanding at a “strong” pace, spending is “resilient”, and capital investment is “robust”. But uncertainty also remains elevated in part due to geopolitical events, and inflation is still above target. This is very much the same story that the Fed noted back in September. The only substantive change came in new “hold” language stating that “The accumulation of more information will help the Committee determine the policy stance appropriate to ensure a timely return of inflation to the Committee’s 2 percent goal.”

In the press conference, Warsh faced multiple questions asking why the Fed paused further rate hikes today when inflation remains above the 2% target. In short, Warsh noted that the rate hike made six weeks ago has had the

generally expected impact – though it’s still early – and hikes come with other potentially negative impacts on areas like employment that need to be considered. The Fed does not view the current rate environment as “tight,” but some recent tightening in financial and credit conditions suggest a movement in the right direction. Over the next six weeks, the Fed will watch to see if the data confirm ongoing improvements, or if additional rate hikes are warranted.

The most notable statement from Warsh came in response to questions related to how the AI boom is impacting demand, and in turn, inflation. The general feeling amongst the FOMC is that the economy is not running too hot or too strong in today’s intensive AI-investment environment that is seeing historic levels of capex spending. In their view, economic and productivity growth in the economy remains strong and is broadening. So for now, the Fed does not want to “throw sand in the gears” of the economy by raising rates to slow demand.

We would argue that without data center spending the economy would be weaker. Housing and auto sales remain subdued. So, holding rates steady is not indefensible.

We do expect, however, the FOMC will raise rates once again in December, but believe further hikes after that will be fewer than the markets are currently pricing in. Unless oil prices once again rise substantially, the impact on year-ago inflation readings will moderate in the spring, while any resolution to the conflict in the Middle East is likely to bring easing to inflation concerns and put the Fed on a prolonged pause.

Brian S. Wesbury, Chief Economist
Robert Stein, Deputy Chief Economist

Text of the Federal Reserve's Statement:

The Federal Open Market Committee approved the following statement for release by a 10 – 2 vote:

The Committee decided to maintain the target range for the federal funds rate at 3-3/4 to 4 percent, in support of the Federal Reserve's dual mandate. The Committee is continuing its policy of maintaining ample reserves in the banking system.

Economic activity is expanding at a strong pace. While uncertainty remains elevated owing, in part, to geopolitical developments, domestic spending has been resilient. Productivity growth is strong, and capital investment is robust. Job gains have kept pace with the workforce, and the unemployment rate has changed little.

Inflation remains elevated. The accumulation of more information will help the Committee determine the policy

stance appropriate to ensure a timely return of inflation to the Committee's 2 percent goal. The Committee will deliver price stability.

Voting against the monetary policy action were Lisa D. Cook and Beth M. Hammack, who preferred to raise the target range for the federal funds rate by 1/4 percentage point at this meeting.