

Fed cuts rates, ends QT, and signals it may pause in December

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It will likely cut rates less than markets are pricing in, with caution extending into 2026 to ensure tariff effects remain a one-off

As widely expected, the FOMC delivered a second consecutive 25bp rate cut, lowering the target range to 3.75-4.00%, amid continued divisions within the Committee. While it was no surprise that Stephen Miran dissented in favor of a 50bp cut, Kansas Fed president Jeffrey Schmid expressed a more hawkish view and voted against the move. This suggests that more than one of the nine participants who in September projected no more than two cuts this year may have maintained that stance in recent weeks. The policy statement once again framed the decision as a response to a “shift in the balance of risks,” noting that “downside risks to employment rose in recent months.” While the statement acknowledged that key official data remain unavailable due to the government shutdown, it still conveyed a slightly upbeat assessment of economic activity, noting that, based on “available” indicators, it “has been expanding at a moderate pace.” Yet, the assessment of labor market conditions was more cautious: while it reiterated that “job gains have slowed,” it noted that the unemployment rate “remained low through August,” and only added that “more recent indicators are consistent with these developments.” The Committee continued to describe inflation—which “has moved up since earlier in the year”—as “somewhat elevated,” and emphasized that uncertainty around the outlook remains high. The Fed also announced that it will end its QT on December 1st.

In his press conference, Chair Powell struck a cautious tone, warning that a rate cut in December was not a “foregone conclusion” and, in fact, was “far from it.” He referenced the upcoming meeting as early as his opening remarks, noting that “there were strongly differing views about how to proceed in December.” In the context of limited data availability, he expressed personal support for a cautious approach should the government shutdown last longer, delaying a clearer picture of the economy: “What do you do if you’re driving in the fog? You slow down.” Nonetheless, Powell left December’s options open, not committing to pause—“I’m just saying it’s certainly a possibility that you would say we really can’t see so let’s slow down”—, and observing that the FOMC is “going to be looking at the data that we have, how that affects the outlook and the balance of risks.” He continued to describe the labor market as likely “gradually cooling,” and avoided bolstering September’s dovish shift, stating: “we don’t see anything that says that the job market is—or really any part of the economy is—making a significant deterioration,” adding that “we’re not seeing an uptick in claims or a downtick in openings.” He also sought to convey confidence in Fed’s ability to detect any major shift in the economy despite the current data blackout: the Fed will be able to recognize “if there were a

significant or material change in the economy one way or another.” Another clear sign of a strategic attempt to recalibrate market expectations came when he observed that, being now “150 basis points closer to neutral [...] than we were a year ago,” there was “a growing chorus now of feeling like maybe this is where we should at least wait a cycle,” adding that “we’re now in that range between 3 and 4% where many estimates of the neutral rate live.” While there was a “strong solid vote in favor of this cut,” there were also “strongly differing views about the future.” He attributed these divergences to differing forecasts, but also to “different risk aversions.”

Financial markets swiftly adjusted to the Fed’s cautious messaging, scaling back easing bets while the Fed continues to rely on alternative labor market data. Treasury yields rose across the curve, with the 2-year and 10-year yields climbing by approximately 10 bps to 3.60% and 4.07%, respectively. In the fed funds futures market, expectations for a third consecutive cut in December retreated notably: while a 25bp rate cut had been fully priced in yesterday, markets now roughly assign a one-in-three chance of a pause. Among Powell’s most market-relevant comments was his acknowledgment that, amid the continued data blackout, the Fed is relying on available high-frequency indicators—specifically initial jobless claims and job openings data from Indeed—to gauge labor market conditions. As a result, these indicators will likely attract heightened market scrutiny in the weeks ahead, serving as key benchmarks for assessing the Fed’s confidence in a labor market that, while facing a weak outlook, still appears relatively stable in the Fed’s view.

Powell clearly warned that markets should not take a third rate cut in December as a given, and hinted that the terminal rate may end up above current expectations. Powell’s message appeared carefully designed to guide markets toward a possible pause in December. From our perspective, the bar for further easing has been raised, and unless upcoming alternative data signal a material weakening in the labor market (i.e., initial jobless claims surge and/or ADP employment data show significant layoffs), the FOMC is likely to move to the sidelines in the next meeting. We are now leaning toward a pause in December. Before the meeting, we already saw scope for fewer cuts than the three currently penciled in for 2026. Following today’s meeting, we now hold a stronger bias toward fewer rate cuts ahead.

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