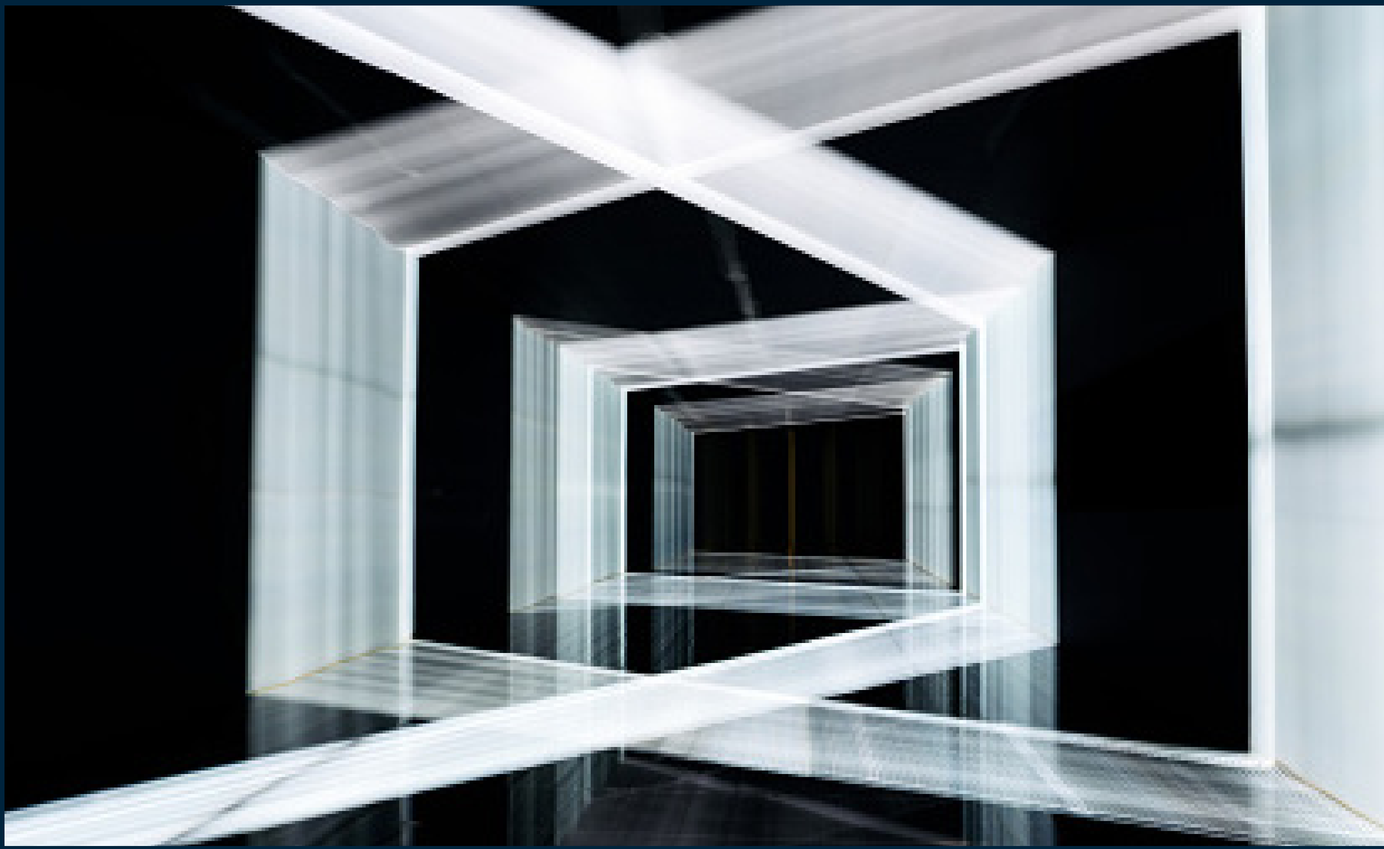

FED THOUGHTS: THE ONCE AND FUTURE FED

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The federal government may have shut down, but the Federal Reserve (Fed) is open for business. Without official data releases, policymakers on the Federal Open Market Committee (FOMC) will be working more in the dark than usual at their upcoming meeting, but that is only one problem on a long list.

Their policy decision is difficult in the face of downside threats to employment and upside threats to inflation that imply, as Jay Powell related at the September meeting, "there's no risk-free path."[1] Their membership is changing, with the Senate confirming a new member of the Board of Governors, Stephen Miran, on the eve of the last meeting. Meanwhile, a court ruled another board member, Lisa Cook, could stay on despite being fired by the President. At the same time, the White House has been interviewing candidates for the successor to Chair Powell, whose term as chair expires in May 2026.

Need to Know

Despite the tumult, we think the FOMC's decision at its October 28–29 meeting is clear. The FOMC is likely to cut the policy rate by a quarter point, bringing the target range to 3.75% to 4.00%, and lean into another cut in December, which is not as certain because it depends on economic performance for the remainder of the year. We also think that dramatic changes may be in the offing. The Administration intends to shift the weight of policy influence toward the Fed Board and away from the broader group of governors and Bank presidents comprising the FOMC. This new majority at the center will likely favor lowering interest rates substantially and quickly. Once personnel settle around midyear 2026, the transformed Fed may keep cutting policy rates until the economy and financial markets stop it, bringing the lower bound of the range to 2.5% percent in 2027.

We unpack these assertions by answering four questions.

1. Why was the September FOMC decision important?
2. How will the Fed cope without official data?
3. When does the center shift?
4. What matters for investors?

Why Was September Important?

The tracks for the policy route at the October meeting were laid in September, when the FOMC delivered as expected, cutting its policy rate a quarter percentage point to bring the target range to 4.00% to 4.25%.

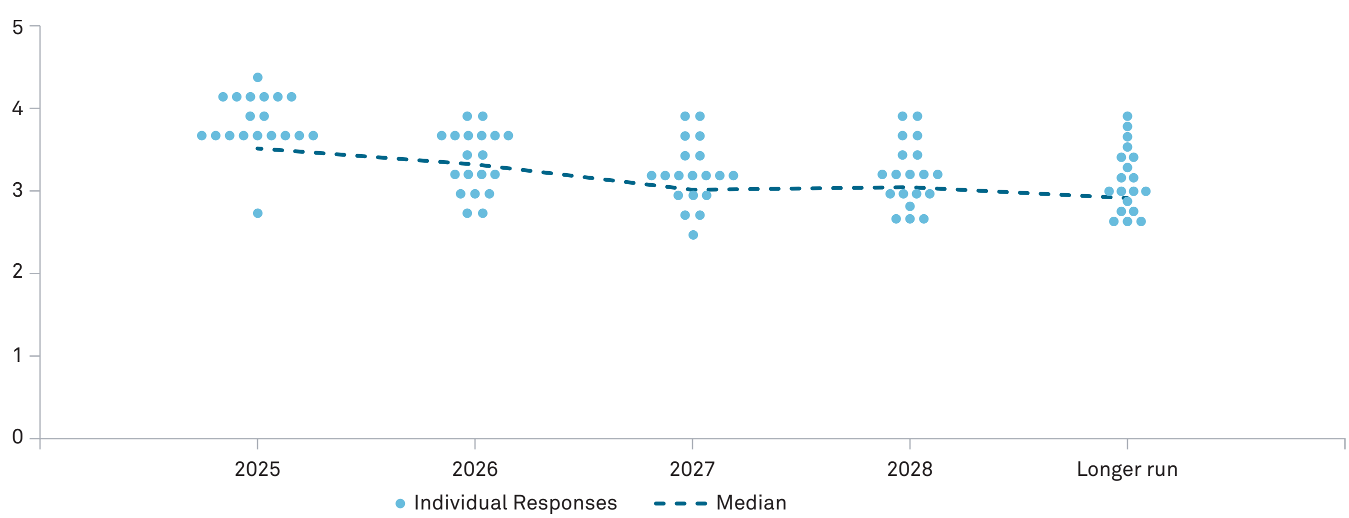
By our reading, the cut was a recalibration of the nominal funds rate to reduce policy restraint in real terms as insurance given that the slowing of employment gains might make the economy less resilient to adverse shocks. FOMC participants apparently deemed the cost of this unemployment insurance to be limited once they concluded, as Chair Powell related in his press conference, that "a reasonable base case is that the effects on inflation will be relatively short lived—a one-time shift in the price level" from the increase in tariffs.[2]

There were deeper currents under the smooth surface of their decision. Reluctant FOMC members were appeased by not sending a strong signal of future action and stressing data dependence in the statement and by conveying their differing policy preferences in the Summary of Economic Projections (SEP).

As for the statement, while the signal wasn't explicit, the FOMC leaned toward additional rate cuts, and its data dependence was narrow and one-sided. The concern expressed is about employment's resilience to potential adverse shocks, not current demand trends. And their operating assumption that tariffs will have a once-off effect on consumer prices sets a high hurdle: Price data well above expectations are required to disprove the base case.

FOMC Participants' Assessments of Appropriate Monetary Policy

Midpoint of target range or target level for the federal funds rate, percent



Source: Federal Reserve, Summary of Economic Projections, retrieved 10/2/2025. Firm analysis.

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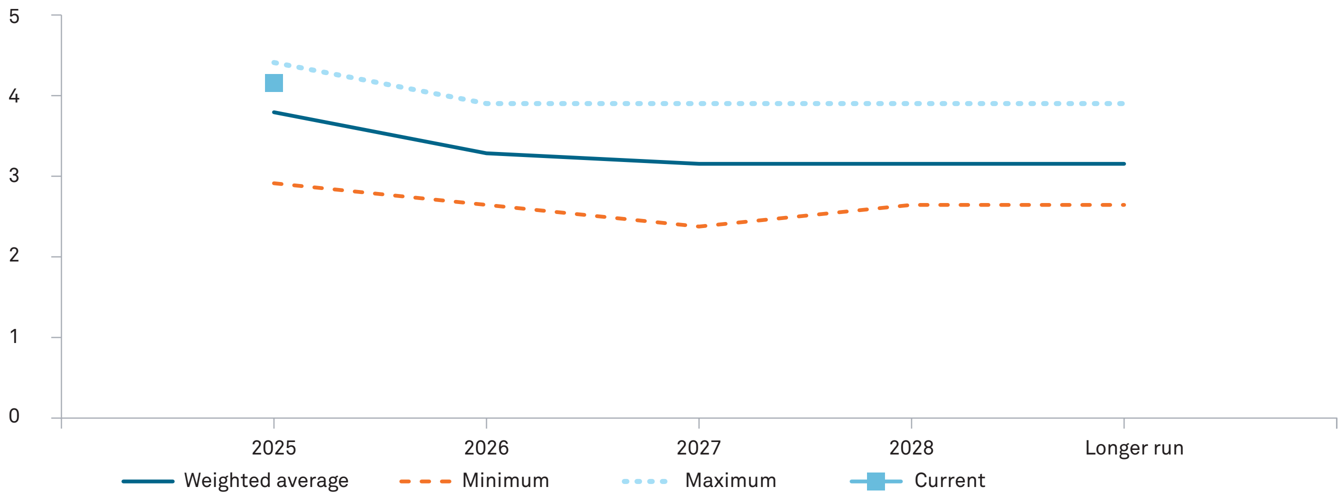

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As for their projections, (shown on the previous page), the median participant envisions the median participant envisions two quarter-point cuts over the remainder of the year, presumably one each at the two remaining 2025 meetings. The message was repeated in the minutes, "Most judged that it likely would be appropriate to ease policy further over the remainder of this year." However, this was a close call, as seven participants didn't think any more easing was appropriate this year, and two called for only one more quarter-point move.[3]

The chart above takes Jay Powell's advice from his press conference to look at the SEP "through the lens of probability" and calculates a weighted-average of interest-rate submissions (the solid line). The average submission is consistent with only a bit more than one more quarter-point ease in 2025. The reluctance of some FOMC members to ease explains why we think action in December is less than a sure thing.

How to Cope Without Data?

With the federal government shut down, less data are available, which leads to our somewhat ironic conclusion: a data-dependent Fed is actually more likely to ease.

First, a few facts. Most data collectors are deemed nonessential, implying information degrades over time as surveys are not taken and automated reports are not checked. The Bureau of Labor Statistics may bring in some staff to publish consumer prices for September, which is essential for cost-of-living adjustments to entitlement programs. Other price information is likely to remain in limbo, including import prices, wages, and the Fed's preferred inflation gauge based on the personal consumption price index produced by the Bureau of Economic Analysis. Required tax and regulatory filings continue.

As a result, the Fed may rely more on surveys, industry reports, Reserve Bank contacts, and "big" data pulled from scraping websites. These data are uneven and typically don't have long histories. In our view, the private sector provides relatively more information on goods prices than on services prices and on employment at large firms than at small firms. Moreover, less of that information is likely to be publicly available, so we'll be operating more in the dark than the Fed.

Also, we believe there is more downside risk to the economy than in previous shutdowns. The administration has been unspecific about whether some furloughed workers will be paid when funding is restored and has threatened a reduction-in-force plan that would permanently eliminate positions.

We think the Fed is more likely to ease the longer the government remains closed. The absence of official employment data increases uncertainty about private sector conditions, making insurance cuts more attractive. Additionally, the administration's threats introduce new concerns about government payrolls. With the government publishing only limited inflation data, the Fed may have fewer facts to challenge its theory that tariffs will have a one-off effect on prices.

When Does the Center Shift?

If forced to reduce the agenda of the Trump Administration to one guiding principle, we would probably choose "personnel is policy." The people appointed to government roles determine how policy is interpreted, implemented, and enforced. The Fed has center stage now, partly as the calendar points to the end of Chair Powell's term and partly because its current people are implementing policy far differently than the President's desire. With Stephen Miran recently confirmed by the Senate, three Trump appointees sit on the seven-member Board of Governors by the September FOMC meeting. If Chair Powell follows the precedent of most of his predecessors, he'll also resign as governor, giving the Administration a working majority no later than May.

That evidently is not fast enough for the White House, as President Trump attempted to remove Fed Governor Lisa Cook, citing mortgage fraud allegations as "sufficient cause." We do not claim to have any edge on the inner workings of the Administration or the merits of the contest in the courts. So, we stick to the facts as we know them. The Board of Governors remains neutral and is likely to follow any formal legal outcome. Cook is contesting the action in court alone, arguing the dismissal violates the Federal Reserve Act and her due process rights. As a result, she remains a sitting member of the Federal Reserve Board of Governors. On October 1, the Supreme Court declined to act immediately, allowing Cook to stay on the Board while it hears oral arguments in January 2026.

In whatever manner achieved, whether through the courts or by the passage of time, once Trump appointees hold four of the seven Board seats, all will be in place for the Fed to deliver on the White House's policy agenda. In the law, the Board has authority over the choice of Bank presidents, constitutes a majority on the FOMC and sets key administered rates.

As for personnel, the terms of all twelve Bank presidents are up in February 2026, and the Board of Governors must approve or reject any nominee with a simple majority.

As for policy setting, in today's "ample reserves" framework, the stance of policy is communicated by a target range for the federal funds rate, but actual control of short-term rates hinges on two administered levers: interest on reserve balances (IORB) and the Overnight Reverse Repo (ON RRP) facility. When reserves are abundant, arbitrage keeps the effective federal funds rate (EFFR) just below IORB; money funds won't lend below ON RRP, banks won't lend below IORB, and the policy corridor holds. However, the two administered anchors that pin money market rates are controlled by different bodies. The first (IORB) is set by the Board of Governors, and the second (ON RRP) is set by the FOMC. That split creates a governance seam that a determined Board majority could exploit. A politically aligned Board majority could vote to cut IORB, lowering the floor on the funds rate, regardless of an FOMC decision.

A determined Board majority can reshape the group relatively quickly with votes on the Bank presidents and reset policy immediately by changing interest on reserve balances.

The path may be bumpy because the Senate must confirm the administration's nominations for Fed positions, the already-sitting Trump appointees must get on board with the new program, and the court will ultimately rule on unconventional attempts to open Board vacancies.

(1) The Senate may get restive at the erosion of the independence of the institution it vested to perform the Constitutional duty of making monetary policy, especially if the midterm elections go poorly for incumbents. Still, defense of Bank presidents may be hard to muster given bipartisan mistrust of private parties participating in decisions of public policy.

(2) The Board members appointed in Trump's first term, Governors Bowman and Waller, may be slow to embrace the change. But their ability to resist will depend in part on court decisions on the legal protection afforded sitting members.

(3) The court will be the ultimate arbiter of unconventional attempts to open Board vacancies.

Over time, Board positions will become available, and four-of-seven governors aligned with the White House will make an effective majority.

What Matters for Investors?

We think that, once formed, the new majority at the center may favor lowering interest rates substantially and quickly. President Trump, who posted on social media in July that the "Fed should cut Rates by 3 Points"[4] sets the direction of travel. The transformed Fed may keep cutting policy rates next year until the economy and financial markets stop it, bringing the lower bound of the range to 2.5% percent.

We don't think that the policy rate in 2026 goes as low as the President's target because the economy and financial markets may not cooperate. If the momentum of aggregate demand in our baseline forecast is sustained, such policy accommodation may boost inflation and potentially lead to higher long-term Treasury yields and a much weaker dollar on foreign exchange markets. In our view, the only clear path to the rate the President wants is for economic activity to falter, perhaps from all the policy tumult, and launch the Fed into reactive mode. The irony here is that the old Fed, which was very sensitive to employment shortfalls, would probably have delivered about as much easing as the new Fed in this case. In our base case, the President may, once again, have buyer's remorse about his Fed picks, suggesting that complaints about monetary policy may recur.[5]

The design principle of our outlook has always been to forecast economic activity and inflation and assume that the Fed will mostly get the alignment of the nominal funds rate right over time. Now, we must accept that the Administration wants more direct influence over monetary policy. While this overturns this century's norms about Fed independence, it seems mostly within the law and within the White House's grasp if it successfully appoints cooperative governors to the Fed Board. The political economy could matter increasingly for the path of interest rates.

We suspect we may see increasing company in our reassessment of the policy rate. Financial markets are currently accommodating to risk, but we don't expect that to continue as worries build about central bank independence. Money market rates may fall some as the expected path of the funds rate rotates down. Over time, private risk spreads may widen. Moreover, a Fed under closer political control may be an outlier in the community of central banks in advanced economies. As the Fed eases by more than others and doubts about the rationale mount, the dollar may come under renewed pressure on foreign exchange markets, and in our view, alternatives to dollar assets may look especially attractive.

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Chief Economist & Macro Strategist

Vincent is the firm's Chief Economist and Macro Strategist. In this role, he is responsible for developing views on the global economy and making relative value recommendations across global bond markets, currencies and sectors.

Previously, Vincent served as the Chief US Economist and a managing director at Morgan Stanley. For the prior four years, he was a resident scholar at the American Enterprise Institute (AEI). Vincent also spent 24 years at the Federal Reserve, holding several roles including Director of the Division of Monetary Affairs and Secretary and Economist of the Federal Open Market Committee (FOMC). His responsibilities at the Federal Reserve included directing research and analysis of monetary policy strategies and the conduct of policy through open market operations, discount window lending and reserve requirements. Prior to these roles, he was the principal liaison with the domestic desk at the Federal Reserve Bank of New York and was responsible for preparing a document outlining policy alternatives for each FOMC meeting. He was Deputy Director in the Division of International Finance and Associate Economist of the FOMC and spent five years at the Federal Reserve Bank of New York in both the domestic and international research departments.

His academic publications primarily concern the conduct of policy and issues related to the monetary transmission mechanism as well as an analysis of alternative auction techniques and Treasury debt management. After an undergraduate training at Fordham University, he received graduate degrees in economics at Columbia University.

Endnotes

1. Transcript of Chair Powell's Press Conference, September 17, 2025. U.S. Federal Reserve website.
2. Transcript of Chair Powell's Press Conference, September 17, 2025. U.S. Federal Reserve website.
3. Minutes of the Federal Open Market Committee. September 16-17, 2025. The new low dot pulling the median one notch lower was evidently submitted by Governor Miran. A few days after the meeting, he delivered a speech arguing that changes in immigration policies, tariffs hikes, tax reform and deregulation had lowered the neutral real rate. He arrived at the conclusion that the Fed was offsides by roughly 200 basis points using the Fed's own tools—a Taylor rule and inflation decompositions. This was also an implicit argument for his presence at the Board table—he is familiar with the policy discussion about those nonmonetary forces that insular central bankers ignored at the economy's peril.
4. Donald J. Trump. Truth Social. July 15, 2025.
5. Nonetheless, we think that the president likely wins the public relations derby in the near term (say up to the Congressional midterm elections in November 2026, which is how the political class views the calendar). Fierce criticism and attempts to change the composition of the Board signal the type of Fed the president may put in place when able. Financial conditions adjust to those expectations of the new Fed even as the old Fed still sits in place.

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