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September 17, 2025

Fed announcement: A dotted landscape

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The Fed cut rates by 25bps today, as expected, and the committee is now signaling a moderately stronger easing bias than it had in June. The accompanying September projection shows the median voter favors two more cuts by the end of the year, so the committee is lined up with the market view. They also continue to expect one cut in each of 2026 and 2027. That adds an additional rate cut to the projected cycle, for a total of 125bps in easing compared to the 100bps in the June projection. That said, there was still material disagreement about the path of policy in what remains of this year. There were nine votes for three total cuts this year -- the SEP median -- but there were two for two total cuts and seven votes for 0 to 1 cut this year. What was likely Miran's dot called for a policy rate below 3% by the end of the year, consistent with his dissent for a 50bps cut in his inaugural meeting. Taking out that outlier pushes the median to 2.5 cuts rather than three when including all voters, a marginal boost to the two cuts favored in the June SEP. In the outer years, the dots continue to be all over the place, including what looks to be close to a uniform distribution for the neutral rate.

It's always hard to infer the story from the dots, but the bottom line here is that the committee appears to be divided between a hawkish camp, which wants to carefully proceed and likely keep policy somewhat restrictive given elevated inflation risks from tariffs and the resilience in the economy, and a second, more dovish camp, which sees a reasonable chance that the job market could be headed into difficult territory. That dovish camp likely sees the inflation risks from demand as limited, and the grounds to bring rates back to neutral rather quickly. There were five votes for modestly accommodative policy in 2026 in this projection, compared to just two in the last projection. So as a whole, the committee is certainly leaning more dovish. The hawks are losing ground, and increasingly, seats.

So it wasn't much of a surprise to see Powell's tone and description shift, putting the job market front and center. He softened his stance on inflation risks, arguing that they were less worrisome than last time. He argued that the slower pace of tariff pass-through, and that companies are so far absorbing tariffs, was playing an important role in containing cost increases. But members of the FOMC could also be relenting to political pressure (especially regional Fed presidents whose jobs could be on the line soon). Higher tariff-price through next year is very likely, especially on cars, and a 4.3% jobless rate is higher than what the US economy has had for the past six months, but it's not full-blown slack. There is a reasonable chance that the long-run unemployment rate is also drifting higher under the weight of a population and tariff shock, keeping demand-supply in balance. Without the theatrics, it's not obvious the Fed would have moved today and also signaled consecutive rate cuts, given that it has never got inflation back to target.

What's may really be happening is Powell and other like-minded hawks made a wise strategic calculation. Defending moderately restrictive policy isn't worth the fight right now, when the job market could be truly less than stellar. The inflation-slack relation in the US fairly weak, and the risk of igniting inflation through that channel is always going to be modest, especially for a couple of cuts and a real policy rate that is restrictive over the projection. The real fight will be when the Fed gets closer to the upper end of the neutral territory, or around 3.5%, and that may be a challenge for a new Chair.

Our view is the Fed will cut once again in October, but then pause to assess the impact, cutting again in the first half of next year to bring rates to 3.5% (upper bound). We're sympathetic to the view that much of the job market weakness rests on supply factors, and judging by the consumer spending numbers, Americans are not feeling the pinch of a slower economy, with wage growth and wealth gains still in firm territory. Getting policy on the path to neutral with a couple of cuts will get the monkey off Powell's back, but not compromise the Fed's dual mandate, and provide an opportunity to see how inflation evolves.

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