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EcoFlash

FOMC: End of balance sheet runoff, another rate cut... but no commitment on the next one

The Fed eased its monetary policy, with two expected announcements: the end of the central bank's balance sheet reduction process from 1st December; and a second straight cut (-25 bp) in the Fed Funds target, without unanimity, bringing it to +3.75% - +4.0%, due to downside risks in the labour market. We anticipate a further 25bp cut in December, driven by the Fed's bias towards employment and downward revisions to our inflation forecasts for the coming quarters. However, this easing cannot be taken for granted, as J. Powell insisted on keeping options open ahead of the upcoming meeting.

Time for moderation: Unsurprisingly, the **FOMC decided to cut its target rate by 25bp to +3.75% - +4.0% (vote 10-2)** in light of the 'shift in the balance of risks' surrounding the dual mandate. In line with the previous meeting, since which 'the outlook has not changed much' according to J. Powell, the aim is to bring monetary policy (which the Fed Chair still deems 'moderately restrictive'), closer to neutrality. However, the dissenting votes of S. Miran (in favour of a larger cut) and J. Schmid (Kansas Fed, in favour of a hold) highlight the tricky balance between rising inflation and falling employment growth (see below). This formal expression of disagreement on the case for more easing tends to reduce the 'unsurprising' nature of the meeting (see our EcoWeek editorial). This prompted J. Powell to distance himself both from the most hawkish members of his board (while expressing their concerns), and from the idea of a guaranteed cut in December (see below). At the same time, as expected, **the Fed specified the timetable for the end of quantitative tightening (QT)**, which began in June 2022: **this will take place on 1st December**, which clearly adds to the less restrictive stance of monetary policy.

Employment, to be handled with caution: The greater focus on employment is therefore confirmed and supported by a statement stressing the late **'rise of downside risks'**. Due to the government shutdown, the committee does not have any official data more recent than the August employment survey, but it bases its negative assessment on alternatives – private data (ADP) and the Beige Book. **However, economic activity remains dynamic, which should, in theory, limit the urgency for easing**: J. Powell acknowledges that pre-shutdown data pointed to a "somewhat firmer than expected" growth trajectory, while **we estimate GDP growth at +2.9% AR in Q3** (+3.9% for the Atlanta Fed's GDPNow). This jobless growth may seem counterintuitive; it constitutes a 'conflict in the data' according to Governor C. Waller, who believes that the two aspects should quickly reconcile. In short, **the sole risk, however uncertain, of a sharper decline in employment is enough for the committee to justify easing**.

Inflation, so far so (relatively) good: **The FOMC's decision was bolstered by lower-than-expected CPI inflation in September**, with headline (+0.1pp) and core (-0.1pp) indices reaching +3.0% y/y against a backdrop of slowing monthly growth (-0.1pp to +0.3% and +0.2% m/m, respectively). There was a positive surprise in new vehicle prices, which could be explained by a reduction in tariffs from 25% to 15% on imports from Japan and the European Union. **This softer (than anticipated) CPI figure has led us to revise downwards our forecast for peak inflation in Q2 2026, to +3.4% y/y from +3.6% previously (+3.3% from +3.7% for core inflation)**. However, there are still some areas of concern. On the one hand, the headline figure of +3.0% y/y is back to its January 2025 level. On the other hand, categories such as furniture and apparel, which are very often imported and have a combined weight greater than cars, are showing upward pressure. Finally, the rise in energy prices (+5.1% y/y for electricity and +4.1% m/m for petrol) is an issue that is as economically significant as it is potentially politically sensitive.

More news in December: The latest data **supports our scenario of a further rate cut (-25bp) at the 10-11 December meeting**. Admittedly, J. **Powell** indicated that a cut was far from a 'foregone conclusion' and **reiterated the 'differing views' that coexist within the committee**. This has led market expectations to fall to a 70% probability of a cut in December, compared with 96% before the FOMC meeting began. In addition, the update of FOMC members' projections for the rate path in 2026 will be particularly instructive, as those for Q3 already showed strong division. This **division between those in favour of preventive cuts in the face of employment risks and those concerned about such moves in a context of rising inflation remains very much present**, according to J. Powell. For the Fed, the challenge will be all the greater in December, both on the rate decision and on the Summary of Economic Projections, given the significant disruption to the publication of economic data linked to the shutdown.

Anis Bensaidani
Economist United States and Japan
anis.bensaidani@bnpparibas.com