FOMC to market – December cut not guaranteed

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Event

Little was expected from the 29 October FOMC, and the initial reaction to the statement was very mild. However, early in the press conference Fed Chair Powell went out of his way to indicate that a December cut was not guaranteed. Money markets had been pricing in a 90%+ probability of a further cut in December, and that probability has retraced to under 70%. The USD rallied 0.4% on the comments.

Implications

Powell went beyond the usual “we are data-determined and noncommittal” to indicate in hard terms that there was no guarantee of a December cut. He further hinted that the FOMC may be deeply divided on whether further cuts were appropriate. We think that his ‘no guarantee’ means that even he is uncertain about whether the FOMC will vote for another cut in December. Kansas City Fed President Schmid dissented, voting for no cut, a possibility we had discussed (*FOMC – Two-sided dissents?*).

2Y UST yields rose 8bps and 10Y UST yields 7bps. Among major currencies, the biggest drops through 4PM ET were in AUD and SEK (0.65%), NZD and ZAR (0.55%), and EUR and CHF (0.5%). CNH was most resilient, falling only about 0.1%. At one point the S&P was down about 0.75% from pre-press conference levels, but it was down only about 0.25% by the end of the press conference.

This uncertainty on future cuts is in line with our contrarian view that the FOMC will not cut in 2026. We still expect the December cut, but a tentative December cut may well curb 2026 cutting expectations. Powell cited mixed official data prior to the government shutdown, and private data since, as explanations for the differing views. Claims are stable and job openings are stable, but there are worries about layoff announcements and the difficulty of finding jobs. For inflation hawks, progress on inflation (even excluding tariffs) is limited. It seems to us that divisions within the FOMC are unlikely to be resolved even if government data become available.

There has been little FX volatility in the absence of economic data, but we expect FOMC comments, at least over the next two weeks, to have a significant FX impact as investors gauge how split the FOMC is. (It will be open season for comments when the blackout ends Friday morning ET). Overall, not even half a 25bps cut has been removed from market pricing, so we see plenty of room for yields and the USD to adjust upwards if Fed divisions turn out to be as deep as Powell’s comments suggest.

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