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Fed Cuts as Expected and Signals Even Lower Rates Ahead; Economic Growth to Gain Traction in 2026 on Lower Rates and Fiscal Stimulus

- **The Fed cut their policy rate as expected in September and signaled more cuts in coming months.**
- **The Fed's latest Dot Plot forecasts stronger growth and higher inflation than they forecast in June, but also shows policymakers think more rate cuts will be appropriate by the end of 2025.**
- **The changes to the Dot Plot are a reaction to recent data showing the jobs market has weakened this year.**
- **Comerica's next interest rate forecast will show the Fed cutting their target rate a quarter percentage point at each of the next two decisions, then holding rates steady in the first half of 2026.**
- **Economic growth is set to gain traction in 2026, supported by lower interest rates.**
- **Fiscal stimulus from tax cuts and increased government spending will give the economy another shot in the arm next year.**

As universally expected, the Federal Open Market Committee cut the federal funds target rate a quarter percent to a range of 4.00% to 4.25% at the September 17 decision. The Fed also altered their policy statement to indicate that additional rate cuts are likely in the months ahead. The decision was a split vote. Eleven members supported the decision, while newly appointed Governor Stephen Miran dissented in favor of a half percentage point cut.

The September policy statement signals more rate cuts ahead by using firmer language to describe the Fed's future plans. The previous policy statement released in July read, "In considering **the extent and timing of** additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks" (Our highlight on the key phrase). The new statement drops "the extent and timing of" from the statement, indicating that the FOMC is more confident that "additional adjustments" will be needed.

The updated Dot Plot (Summary of Economic Projections) makes those expectations even clearer. It shows that 10 FOMC members favor lowering rates by at least another half percent by the end of 2025, while nine members favor a quarter percentage point or less of additional cuts. The split of the dots on the Dot Plot is something to behold. One member thinks the Fed should actually raise rates a quarter percent before year end, and six members think the Fed should hold them steady. Two members see one additional quarter percentage point cut as most appropriate, and nine favor a half percent more of cuts (Which would be quarter percentage point cuts at each of the next two decisions). And one FOMC member thinks the Fed should cut rates another 1.25 percent by the end of the year, to a range of 2.75%-3.00%. This outlier is presumably Governor Miran. FOMC members hold a remarkably wide range of opinion about decisions that are not far in the future.

The rate outlook is all the more striking since the rest of the Dot Plot raises the outlook for growth and inflation, and lowers the outlook for the unemployment rate. The median FOMC member's real GDP forecast was raised 0.2 percentage points in 2025 and 2026 to 1.6% this year and 1.8% next; the 2027 forecast was raised 0.1 percentage point to 1.9%. The forecast for total and core PCE inflation in 2025 was held unchanged at 3.0% and 3.1%, respectively, with both forecasts for 2026 raised 0.2 percentage points to 2.6%. And while the Dot Plot's median forecaster held unchanged the year-end forecast for the unemployment rate at 4.5%, they lowered the forecast for 2026 to 4.4%, and for 2027 to 4.3%. Both are a tenth of a percent lower than in the June Dot Plot.

The Fed is in a pickle, with inflation pulling them one way and a softening job market pulling the other. Ordinarily the Fed reins in plans to cut rates when the economy looks like it will run hotter than they have been expecting, especially if inflation is above their target and rising like it is today. They are doing the opposite now because recent jobs data show the labor market has weakened considerably in 2025. The Preliminary Benchmark Revision to payroll employment lowered average monthly job growth in the year to date to 44,000 from 75,000 previously; payrolls have averaged just a 29,000 monthly increase in the last three months. The unemployment rate has edged up a tenth of a percent over the last year, but would have increased more if not for weak growth of the population and labor force. The Congressional Budget Office estimates that population growth slowed from 0.9% in 2024 to 0.2% in 2025. The job market has lost momentum, and the Fed wants to reverse that trend before it gets worse.

Following the Fed's September decision, Comerica forecasts that the Fed will cut the federal funds target rate a quarter percentage point at each of the next two decisions, in October and December. The Fed is then expected to hold interest rates steady until June 2026.

Economic growth has been in low gear in 2025, but will gain traction in 2026 as lower interest rates support the housing market and other industries that are closely tied to borrowing costs. Also, the economy will get a shot in the arm after the turn of the year as the July 4 fiscal bill goes into effect—the bill will cut taxes and raise government spending next year.

The outlook for monetary policy gets cloudier after Chair Powell's term ends next May 15. Powell was tight-lipped at the post-meeting press conference about his plans after his term expires; separate from his appointment as Chair, his appointment as a Governor of the Federal Reserve Board is through January 2028. Either way, the tone at the Federal Reserve could be very different depending on who is appointed as the next Chair.

In addition to the rate decision, the Fed held unchanged their balance sheet runoff program in September, which allows up to $5 billion per month in Treasuries and $35 billion per month in mortgage-backed securities to mature. This policy reduces the size of the Fed's balance sheet and unwinds the stimulus that helped propel the economy out of the 2020 recession. Comerica forecasts for the Fed to end balance sheet runoff in January 2026, after which they will continue to accept repayment of their mortgage-backed securities as they mature, and reinvest the proceeds into Treasuries.