

Fed Signals an End to Balance Sheet Runoff in Coming Months; Data Available During Shutdown Show Economy Is Growing in Low Gear

- **In a speech on October 14, Chair Powell signaled the Fed would likely end the run-off of its balance sheet in coming months and further reduce interest rates. The Fed is also set to increase the share of longer-term bonds in their bond holdings. Comerica forecasts for the Fed to end run-off in January 2026.**
- **Data sources available during the government shutdown show the economy is growing at a subdued pace.**
- **The economy decelerated in the late summer months, according to the Fed's Beige Book. Small business sentiment fell in September, but earnings trends improved as businesses paid less taxes.**
- **The September CPI report will be released on October 24, and is likely to show inflation ran above the Fed's target again. The report will determine the 2026 Social Security Cost of Living Adjustment (COLA).**

In an October 14 speech, Fed Chair Powell signaled that the central bank is likely to end run-off of their balance sheet in coming months. The (wonky) key phrase in the speech was, "Our long-stated plan is to stop balance sheet runoff when reserves are somewhat above the level we judge consistent with ample reserve conditions. We may approach that point in coming months." The Fed bought trillions of dollars in government backed bonds to stimulate the recovery from the 2020 recession, and has been unwinding that policy in the last few years by accepting repayment of a share of those bonds. Now, the reductions of their holdings are starting to increase the cost of private borrowing in short-term money markets, with the private benchmark borrowing rate SOFR charging nearly the highest premium above the federal funds rate since 2020 as of mid-October. In reaction, the Fed will soon start rolling over the proceeds of maturing bonds into purchases of new ones. Comerica forecasts this change in Fed policy in January. In his speech, Powell also said the Fed will gradually increase the share of longer-maturity bonds in their holdings.

In addition, Powell reinforced impressions that the Fed is likely to cut interest rates at both of their remaining two meetings of the year, saying, "The outlook for employment and inflation does not appear to have changed much since our September meeting four weeks ago." The Fed's September Dot Plot signaled that two additional quarter percentage point cuts are likely by year-end. Powell is signaling that is still the Fed's base case.

There is less data than usual to cross-check the Fed's view of the economy, since the government shutdown is delaying statistical releases. Available data suggest the economy is growing at a subdued pace at the start of the fourth quarter. The Fed's Beige Book reports that "economic activity changed little on balance" from the early summer to the late summer; the Beige Book is the Fed's recurring survey of thousands of contacts across the economy. Among the 12 Federal Reserve districts, three reported marginal growth in the latest period, five

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reported flat activity, and four reported slight declines. This was a little weaker than in the prior Beige Book, when four districts reported modest growth and the other eight reported no change.

Like other data sources, the Beige Book reports that affluent Americans are propelling consumer spending, while cost of living pressures and a weaker labor market squeeze middle- and lower-income Americans. In the national summary, the Beige Book notes that “Spending by higher-income individuals on luxury travel and accommodation was reportedly strong.” At the same time, the Boston Fed reported that “The prevalence of economic precarity increased in many communities, as evidenced by greater food pantry use and increased difficulty paying rent, utilities, and other bills.” In the New York district, “A community health-care center reported that financial distress among Medicaid patients has risen.” The Atlanta Fed reported that “Producers of packaged snack products reported considerably lower sales volumes amid softer consumer demand and some moderate producer-driven price increases,” though this may reflect the impact of new weight-loss drugs rather than consumer finances.

The Beige Book reports employment was “flat” and that slack increased for most segments of the job market, but also that there were labor shortages in occupations and industries that rely heavily on immigrant workers. Prices rose “moderately,” as businesses hesitated to pass on the costs of tariffs and discounted to keep middle-income customers spending. Many businesses report margin pressures as input costs rose faster than selling costs.

Similarly, the National Federation of Independent Business’s Small Business Optimism Index edged down to 98.8 in September from 100.8 in August, undershooting the 100.6 consensus forecast and Comerica’s forecast of 99.5. The biggest contributor to its decline was weaker Economic Expectations, which pulled back to their March-to-June range as tariffs and the government shutdown rattled business owners. The brightest spot in the report was that Earnings Trends rose to the highest since the end of 2021. Corporate income tax receipts fell 35% in the last 90 days, the period covering companies’ estimated tax payments due September 15. The July 4 fiscal bill’s retroactive tax cuts are boosting after-tax corporate profits, a tailwind that will persist into 2026.

Other recent data from private sources and Federal Reserve Banks reinforce impressions that hiring was modest in September, but also that consumer spending was resilient. The LinkedIn Hiring Lab’s October 2025 Workforce Report indicates that hiring fell 3.5% in September from August and was down 8.7% from a year earlier. LinkedIn estimates that nonfarm payroll employment rose 55,000 in September. The Federal Reserve Bank of Chicago estimates that retail sales excluding auto dealers and parts rose 0.5% in September; new car and truck unit sales rose 2.0% according to Ward’s. Cox Automotive estimates that retail used vehicle sales fell 3.9% by value.

Inflation likely ran above the Fed’s target in September. The Federal Reserve Bank of Cleveland “nowcasts” that the September release will show CPI up 0.4% and core CPI excluding food and energy up 0.3%. Comerica forecasts for CPI to rise 0.5% and core CPI 0.3%; the CPI is forecast to rise 3.2% on the year, with core up 3.1%. The report is delayed to October 24 by the shutdown. The September CPI report will determine the Social Security Cost of Living Adjustment (COLA) for 2026; however, the COLA tracks the CPI for Urban Wage Earnings and Clerical Workers (CPI-W), which is slightly different from the CPI for Urban Workers (CPI-U) that economists forecast.

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