

Fed Cuts Target Rate Below 4% to Bolster the Job Market; Balance Sheet Runoff Ending Soon; Additional Rate Cut Forecast in December

- **The Fed cut the target rate a quarter percent at their October 29 decision, as expected.**
- **The Fed also announced an end to balance sheet runoff a.k.a. Quantitative Tightening (“QT”) on Dec 1st.**
- **In the post-decision press conference, Chair Powell was noncommittal about whether the Fed would cut again at its next decision in December. Even so, Comerica continues to see an additional cut then as likely.**
- **Economic growth has likely hit an air pocket in the fourth quarter of this year, but should regain traction in 2026 as both fiscal and monetary policy turn more accommodative.**
- **Hiring has been anemic in 2025. But the job market for white-collar workers will likely stabilize in 2026, and tighten in occupations where recent immigrants comprise a large share of the workforce.**

As expected, the Fed cut the federal funds target a quarter percentage point at their October 29 decision to a range of 3.75% to 4.00%. This was the second consecutive cut after the Fed held rates steady from December 2024 to this July. The October decision was by a 10-2 majority vote. Governor Miran dissented again in favor of a larger, half percentage point cut, while Kansas City Fed President Schmid dissented in favor of holding rates steady.

In the Open Market Committee’s consensus policy statement, the majority justified the cut by saying that while there are “risks to both sides of its dual mandate” for stable prices and maximum employment, the “downside risks to employment rose in recent months.” The government isn’t publishing the monthly jobs report during the shutdown, but privately-produced data from companies like ADP, Revelio, and LinkedIn show that job growth has been anemic in September and early October. And the official jobs data published through August show the trend wasn’t much better in the first eight months of the year.

The Fed also announced they would end run-off of their balance sheet on December 1. The Fed purchased trillions of dollars of government-backed bonds to help the economy recover from the 2020 recession, and has been gradually running off their holdings of those bonds since 2022. Beginning December 1, they will start holding the size of their bond portfolio steady, by reinvesting the principal of maturing Treasury bonds into new Treasuries, and by reinvesting maturing mortgage-backed securities into Treasuries, as well.

The Fed’s balance sheet reductions have started to tighten liquidity conditions in money markets, which is visible in the spread that’s opened between the Secured Overnight Financing Rate (SOFR) and the federal funds rate, among other indicators. Money market conditions will continue to tighten as the Fed holds their bond holdings steady, but at a slower pace, since the economy will continue to grow and the Fed’s balance sheet won’t be keeping

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pace. At some point between March and September 2026, the Fed will likely start increasing the size of their balance sheet to keep pace with growth of the economy.

The Fed is taking their foot off the economy's brake by reducing the federal funds rate to under 4% for the first time since 2022. This is all about bolstering the job market. The unemployment rate has edged higher this year, even though reduced immigration means far fewer new jobs are needed to absorb workforce entrants. And recent layoff announcements, including ones tied to AI, have the Fed worrying that the gap between hiring and the number of jobseekers could widen without a boost from lower interest rates.

In the press conference following the October decision, Chair Powell tried to avoid committing to another rate cut at the Fed's next decision in December, saying another cut "is not a foregone conclusion—far from it." Even so, Comerica continues to forecast for the Fed to cut the federal funds target by another quarter percent then. Even if government funding is restored relatively soon, it will take some time for statistical agencies to catch up with their release schedules. The statisticians look unlikely to be back on schedule by year end. That will likely leave the Fed driving in the dark and wearing sunglasses at their December meeting, making another rate cut look less risky than holding rates steady.

Comerica forecasts for the Fed to hold rates steady from the turn of the year through May 15, which is the end of Jay Powell's term as Fed Chair. After that, a new person will presumably lead the Fed. President Trump has been vocal in calling for the next Fed Chair to be someone who will support his economic agenda with lower interest rates. Accordingly, Comerica forecasts for the Fed to make further rate cuts after the change in Fed leadership, with a cumulative three quarters of a percent in cuts forecast from the end of Powell's term to the end of 2026. That would lower the fed funds target to 2.75%-3.00% at the end of 2026, a level that will probably be about neutral—neither juicing growth nor hindering it.

The economy has likely hit an air pocket in the fourth quarter of 2025 with drags from the government shutdown and lower car sales after the expiry of EV tax credits. But economic growth will likely reaccelerate in early 2026 as fiscal policy turns expansionary. The July 4th tax and spending bill funded a big increase in spending on defense and immigration enforcement, as well as incremental tax cuts for seniors, affluent Americans in high-tax states, and workers who are eligible for overtime or tips. That should offset the headwind to growth from higher tariffs, which (it is worth repeating) are a form of a sales tax targeted at products purchased from outside the country.

The combination of more accommodative fiscal policy and the interest rate reductions between September and December of this year should keep the economy growing in 2026. Next year will likely see the job market for white-collar occupations stabilize, as a broadening of economic growth fuels hiring in some industries at the same time that AI adoption slows hiring in other industries. However, the job market will tighten in agriculture, construction, home nursing care, restaurant kitchens, and other parts of the economy where recent immigrants comprise a large share of the workforce.

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