

EcoFlash

FOMC: Easing Under Constraints

As widely anticipated, the 16-17 September FOMC meeting ended with the Fed reducing its target rate by 25bp, while reasserting its independence. While the marked slowdown in payroll growth prompted the Fed to cut the policy rate for the first time in 2025, it reiterated that future decisions would remain data-dependent. In our view, the downside risks to the labour market cast little doubt about the continuation of monetary easing. We anticipate two further 25bp cuts in October and December, bringing the target range to +3.5% – +3.75%, which is in line with market expectations. However, easing is likely to remain limited in terms of both timing and scope, given the actual and expected rebound in inflation.

No surprise: the 16-17 September FOMC meeting resulted in the unanimously expected cut (-25bp) in the target rate to +4.0% – +4.25%. The Fed lowers its policy rate for the first time in 2025, following a cumulative 100bp reduction between September and December 2024. The sharp deterioration in the labour market and the downside risks surrounding its outlook caused the Fed to implement a risk management approach and prioritize this side of the dual mandate over the upside risks to inflation¹. Unlike the previous FOMC meeting (at the end of July), which saw two dissents (Governors M. Bowman and C. Waller, who favored a cut), this one saw a single, but notable one, from S. Miran, the newly confirmed caretaker governor, who voted in favor of a 50bp cut.

Inflation risk and labour market conditions are not aligned: With regard to inflation, the situation is far different from that of a year ago (when the Fed cut the target rate by 50bp in response to a poor job report). This time around, the Fed is opting to cut rates despite inflation rising without having even returned to target. CPI inflation reached 2.9% y/y in August (compared with 2.5% a year ago) and 3.1% according to the core index (3.2% a year earlier) and is expected to keep rising, peaking at 3.6% for both the CPI and the core index, which we anticipate in May 2026. At the same time, however, the employment developments are more concerning today (nonfarm payrolls at +64k on average for the six months to August 2025, compared with +116k in August 2024, subsequently revised to +132k). The September 2025 statement notably introduced a new reference to 'downside risks' in this area, which was not present during the previous rate-cutting phase in 2024.

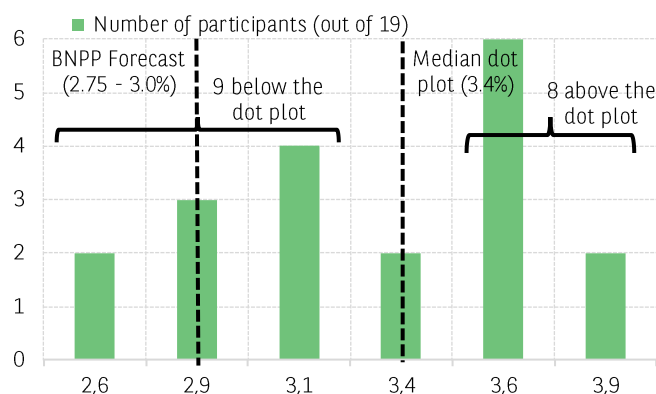


Chart: Distribution of committee members' projections for the Fed Funds rate at the end of 2026
(sources: Summary of Economic Projections from the Federal Reserve, BNP Paribas)

Risk management... and divergences: The Summary of Economic Projections (SEP) outlines the risk management approach presented by Fed Chair J. Powell to justify the rate cut. The projections point to nine committee members anticipating two further cuts before the end of 2025 (and one outlier at five), despite upward revisions to both inflation projections for 2026² and growth projections for 2025 and 2026³. At the same time, the unemployment forecast is unchanged at 4.5% this year and slightly lowered (by -0.1pp per year) for 2026 and 2027 (4.4% and 4.3%). However, this apparent stability in the unemployment rate reflects adverse developments in both labour demand and supply, contributing to downside risks⁴. These risks underpin the choice of easing in spite of accelerating inflation. Indeed, in J. Powell's opinion, these downside risks to employment imply that inflation is unlikely to prove persistent (in other words, that the tariff-driven upturn is unlikely to lead to second-round effects). Yet the median Fed Funds projection for the end of 2025, which incorporates two rate cuts, masks the fact that nine out of 19 members are below this number of cuts, including six members penciling no further movement. This divergence of views is even more pronounced for 2026, with a median dot plot of +3.4% for the end of the year,

¹ See our EcoFlash dated 5 September: [United States: Lackluster summer employment will prompt the Fed to act](#)

² +0.2pp to +2.6% y/y for headline and core PCE inflation in Q4, after +3.0% and +3.1% in Q4 2025.

³ +0.2pp to +1.6% and +1.8% respectively in Q4.

⁴ See our EcoFlash dated 6 August: [United States: Yellow Alert on Activity](#)

which is in fact the projection of only two FOMC members (eight are above and nine below – *see chart*). In this context, a further rate cut cannot be taken for granted and will depend on future job creation trends.

BNP Paribas scenario: We do not see an improvement in the labour market in the short term, and forecast a further rate cut (-25bp) at each FOMC meeting by the end of 2025, bringing the target rate to +3.5%—+3.75%. The process would continue in H1 2026, given the anticipated weakening of the US economy, resulting in a terminal rate of +3.0% (upper limit) in June. The Fed's emphasis on the 'maximum employment' component of its dual mandate suggests that further and faster easing could occur in the event of a more pronounced deterioration in related data, particularly a sharper rise in the unemployment rate.

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