QNB Economics
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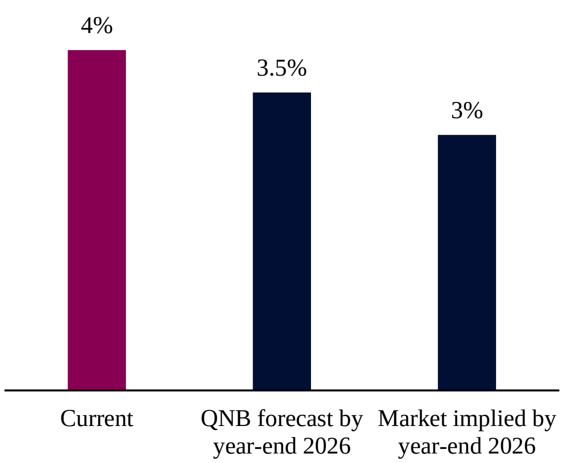
How divided is the US Fed on rate cuts?

The US Federal Reserve (Fed) has entered one of its most contested policy periods in decades. The 25 basis points (bps) policy rate cut delivered in October was notable not for its size, but for the lack of consensus in reaching this decision. As highlighted in our November commentary, Kansas City Fed President Jeffrey Schmid voted against any cut while Governor Stephen Miran dissented in favour of a larger 50 bps reduction. This combination of simultaneous "hawkish" and "dovish" dissents remains exceedingly rare in the modern Fed, an institution that historically prized for consensus and predictability.

The divisions were further illuminated by the latest FOMC minutes released in late November. They show growing disagreement around both the inflation outlook and the appropriate pace of easing. While most participants acknowledged that disinflation is progressing and that labour market slack is widening, the degree of conviction varies widely. Some policymakers view the current stance as still "restrictive," requiring continued steps toward more rate cuts to neutral or even accommodative territory. Others, however, fear that easing too quickly could risk re-accelerating price pressures, especially given uncertainty surrounding tariffs and supply-side bottlenecks.

Fed funds rate
(current versus expectations for year-end 2026)



Sources: Bloomberg, QNB analysis

These divisions have translated into volatile market expectations. There is still significant market uncertainty about rate cuts throughout 2026. The key question is whether the Fed's internal fragmentation will push policy either toward a much deeper easing cycle or toward an early pause if inflation surprises to the upside. We believe neither extreme is likely and reiterate our call for two more rate cuts towards 3.5%, which we consider the low end of the "neutral" level range where rates are neither restrictive nor accommodative. Three main reasons support our view.

First, political pressures and incoming changes in the Board of Governors favour at least a move towards a neutral stance from the Fed. President Trump's increasingly vocal preferences for deeper rate cuts and his early signalling about the type of "dovish" successor he wants for the Chairmanship after Powell's term ends in May 2026 have raised the stakes around every FOMC meeting. This dynamic is compounded by ongoing changes in the Board's composition. Each new appointment or possibility of new appointment shift expectations about the Fed's medium-term bias, making decisions more contentions. At the margin, however, "doves" are getting stronger, even if this has been met with stronger opposition from the dwindling "hawks" that want to prevent too much easing.

Second, inflation uncertainty has declined significantly compared to the peaks witnessed after the "Liberation Day" tariffs. Shelter inflation, previously the main source of inflation stickiness, has moderated steadily, and goods inflation continues to normalize as supply chains adjust. As we discussed in previous notes, tariffs still pose short-term upside risks to inflation but are increasingly seen as transitory and "looked through" by most policymakers, rather than a structural driver of inflation. This opens the door for further rate cuts.

Third, despite month-to-month volatility and uncertainty associated with shutdown date release delays, labour markets trends continue to point to a significant deterioration. Job opening has fallen precipitously, layoffs have accelerated, and private payroll trackers point to further softening. As highlighted in our November commentary on the

Fed, US employers cut more than 150,000 jobs in October, the sharpest reduction for the month in over two decades. For the first time since the pandemic, the labour market "jobs gap" now suggests slack or more civilian labour force than the sum of employment and job openings. This dynamic strengthens the argument for additional easing, even for members of the FOMC who have been cautious about inflation.

All in all, we maintain our view that there is policy space for two additional 25 bps cuts, one later this week in December and another one in Q1 2026, bringing the policy rate close to the lower bound of our neutral level estimate of 3.5%. However, we also believe market expectations for a longer series of cuts throughout 2026 are too optimistic. The economy is slowing but shows no sign of a sharper downturn, and the trajectory for inflation, while improving, faces uncertainties related to tariffs and the speed of convergence back to the 2% target. In other words, the Fed is divided, the debate is intensifying, but the medium-term path is likely to be more moderate than either the most dovish FOMC members or current market pricing suggest.

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