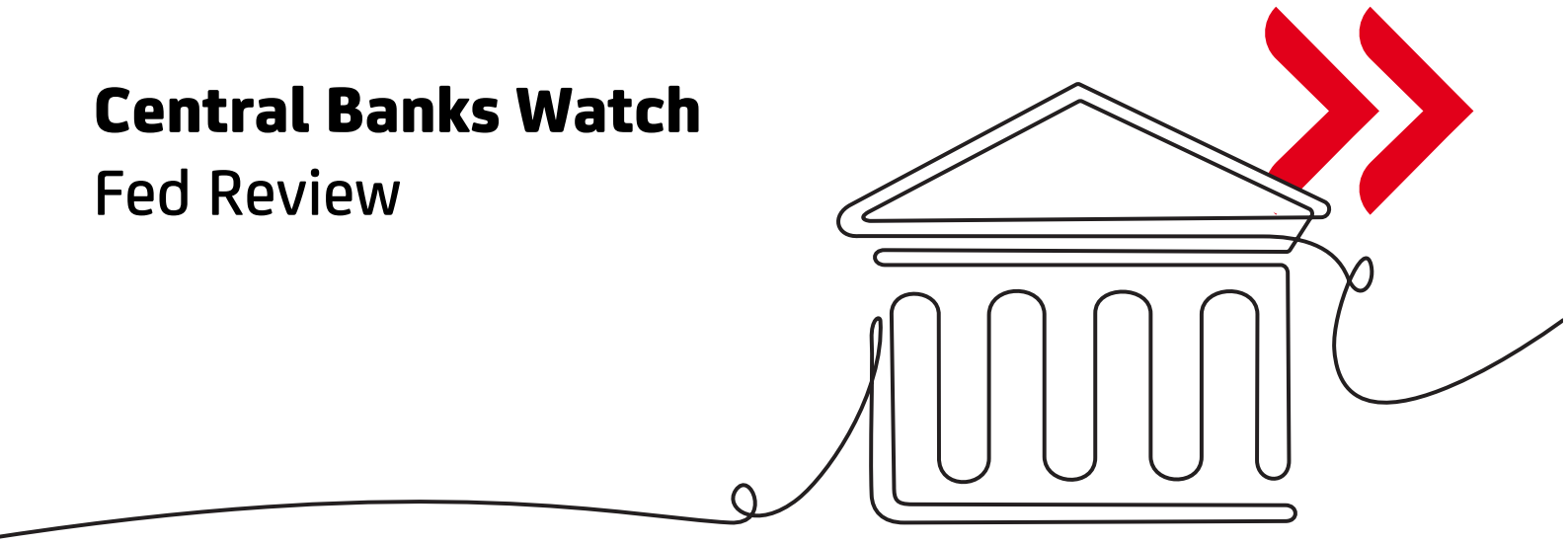
The Investment Institute
by UniCredit

Central Banks Watch
Fed Review



Bullish on the economy, still work to do

29 October 2026

Decision to hold was not unanimous

Yesterday, the Fed kept interest rates unchanged and sounded bullish on economic activity. Two dissenting members voted for a hike. The FOMC acknowledged that financial conditions have tightened but are not tight.

December hike looks very likely

The bar for a 25bp rate increase in December is very low. We still expect steady rates in 2027, but risks are clearly tilted towards additional tightening amid surging energy prices, strong AI-related capex and persistent bottlenecks, which are adding to inflation persistence.

Yesterday, the Fed left the target range for the federal funds rate unchanged at 3.75-4.00%. The decision was in line with our expectations, consensus forecasts and market pricing. The vote split was 10-2, with Governor Lisa Cook and Cleveland Fed President Beth Hammack dissenting in favour of a 25bp rate increase.

In our view, three messages stood out. First, the Fed is becoming even more constructive on the growth outlook. The FOMC statement was largely unchanged from September, except for the characterisation of economic growth, which was upgraded to "strong" from "solid". Fed Chair Kevin Warsh indicated that this assessment reflects upward revisions to GDP growth for 1H26 to above 2% annualised and expectations for growth above 3% in 3Q26, supported by double-digit expansion in business investment. Interestingly, the Fed sees the investment recovery starting to broaden beyond AI-related spending. With the labour market remaining in equilibrium and initial jobless claims hovering near multi-decade lows, the FOMC can focus squarely on the inflation side of its mandate, where persistence remains a concern.

Second, Warsh acknowledged that the September rate hike and accompanying policy signals are feeding through to broader financial conditions, which have tightened. Investors are becoming more selective in allocating capital and credit spreads have widened, developments the Fed views positively as they make the economic expansion more durable. That said, the FOMC does not regard financial conditions as outright tight. In our view, this reinforces the case for additional policy action to contain upside inflation risks.

Third, Warsh emphasised that the economy is running hot, but not excessively so, inflation expectations remain well anchored, and that the Fed is not seeking to "throw sand in the gears". This suggests little urgency to tighten aggressively and is consistent with a quarterly pace of rate hikes. The addition of language highlighting the importance of the "accumulation of more information" before determining the appropriate policy stance further supports the view that the majority of the FOMC favour a gradual approach.

Reflecting all this, the debate within the FOMC appears to be centred on when to act, not whether further tightening is needed. The bar for a December rate increase appears to be very low. Our baseline continues to be for rates to remain unchanged throughout 2027, reflecting our expectation that underlying inflation will gradually moderate as the energy shock subsides. However, in a context of strong economic growth, risks are increasingly skewed towards more Fed tightening as energy prices continue to trend higher while supply-side bottlenecks generated by the AI boom are adding to inflationary pressures.

Beyond the policy outlook, Warsh announced important changes to the FOMC meeting schedule and provided additional details on the work of the five task forces. The FOMC will continue to hold eight meetings per year, but starting in 2027 one meeting will be dedicated to a broad review of the monetary policy strategy with a longer-term view. In 2028, that number will increase to two, leaving six regular policy meetings annually. Regarding the task forces, Warsh noted that while some are likely to meet the year-end deadline, others will require more time. On 16 November, the productivity and jobs task force will hold a hearing examining a broad range of questions related to technology, productivity and their implications for monetary policy. Warsh said he plans to attend in order to "refine" his views on these key issues. The balance sheet task force is expected to present its recommendations to the FOMC in early 1Q27.

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