Fed Preview

26 October 2026

October pause followed by December hike

We expect the Fed to hold policy rates unchanged at the 27-28 October FOMC meeting. After softer comments by some Fed members and recent equity price declines markets are pricing over 90% probability for an unchanged rate. The outlook going forward is more uncertain and will depend on the ongoing conflict in the Middle East, the strength of the US economy and developments in financial conditions. For now, we stick to our view that the Fed will raise rates one more time in December followed by renewed cuts by year-end 2027 and in the first half of 2028. With no change and no new FOMC projections, we may have to wait for more policy clues.

Key points

- Policy rate expected on hold at 3.75-4.00%
- Markets price more than 90% probability for unchanged
- Key policy makers want to pause hikes in October
- Declining equity markets and rising real rates could make financial conditions less supportive
- Fed usually avoids changing rates directly ahead of elections
- Mixed data since September
- Members were united behind September decision but not on why
- We expect one more hike in December, but the outlook is uncertain

Anything but unchanged rates would be a huge surprise

At its 15-16 September policy meeting, the Fed raised rates by 25 bps, in the first such move since July 2023. According to the projections ("dot plots"), members expected at least one more rate increase this year, while Chair Kevin Warsh repeated some of his hawkish views from the speech at Jackson Hole in August. This caused markets to price around 50% probability of another rate hike at the next meeting in October. However, calls for a rate pause from key FOMC members – together with a lack of push-back from Fed Chair Kevin Warsh - and jittery equity and debt markets have shifted market expectations ahead of this week's 27-28 October FOMC policy meeting. Market pricing now indicates over 90% probability that the Fed will leave its Fed funds rate unchanged within the current range of 3.75-4.00%, in line with our long-held forecast.



Source: Macrobond, SEB

Risks for dissent from the hawks

Even if the Fed – or at least its Chair – no longer intends to steer market expectations ahead of meetings, we see it as unlikely that the Fed would want to upset markets with a very unanticipated tightening. Furthermore, we also think that Warsh would prefer the Fed to be unanimous when raising rates to lessen the risks for conflicts with the White House. Recent speeches by the Fed's vice Chairs John Williams and Philip Jefferson, together with Governor Christopher Waller, suggest they will not support another rate increase already at the October meeting. However, we think at least two members, Beth Hammack and Lorie Logan, may dissent in favour of an increase to take rates one step closer towards a restrictive level.

New communication policy limits scope for policy signals at meetings

With an unchanged policy rate, the focus at the meeting will be on the degree of consensus around the decision and whether there are any changes in the Fed's policy statement or in the comments from Kevin Warsh at the press conference. We do not expect any clear signals in either the statement or by Kevin Warsh. Still, markets are likely to take notice of whether Warsh repeats his hawkish views from the speech in Jackson Hole and after the September rate decision, or whether he adopts a more neutral language on policy. Otherwise, and given the lack of new projections, we will have to wait for minutes and for comments from individual Fed members. On 16 November, one of Warsh task forces will hold a hearing in San Francisco about productivity and the labour market which may shed further light on new thinking within the Fed.

Several reasons for an October pause

Our own expectations for unchanged rates have been based on several factors: proximity to the 3 November midterm elections, mixed data and tightening financial conditions after the September meeting and softer signals from Fed members.

The Fed mostly avoids changing rates directly ahead of elections

The Fed has mostly avoided changing rates directly ahead of federal elections. According to one study, by the derivates marketplace CME Group, the Fed left rates unchanged between 1 October and election day ahead of two thirds of federal elections since 1972. The exceptions to this rule have mainly happened during ongoing tightening cycles and deep crises. Markets have, however, not seen the election as an obstacle given that it temporarily priced a relatively high probability for an October hike.

Mixed data since September

The Fed's key inflation measure, the core PCE, was downwardly revised by a larger than expected 0.4%-points in August. Employment growth slowed markedly in August. Because the supply of labour is also slowing, due to an aging domestic population and strict immigration/deportation policies, the Fed is unlikely to start worrying about downside risks to the labour market. But the data implies that the economy may not be as strong as other data have indicated. This could suggest that current policy rates may not be as expansionary as some Fed members have argued. Slower retail sales in September points in the same direction, although one should be careful to draw conclusions from single months. The inflation picture remains worrisome, however. The core PCE still grew at a 3% y/y pace in August, well above target, and the higher-than-expected September CPI, together with increasing price pressures in the PPI, suggests we could see a slight acceleration in the core PCE when September data is published later this week (29 October). The renewed upturn in energy prices has added new upside risks.

Limited support for October rate increase among key policy makers

Influential Fed members – vice Chairs John Williams and Philip Jefferson and Governor Christopher Waller – have all signaled a possible pause in rate increases in October. The Vice Chair, and president of the New York Fed, John Williams said in his speech on 29 September that there is no urgency after the September rate increase and that the Fed has time to gather more information. Vice Chair Philp Jefferson said in a speech on 1 October that it may take more time for the Fed judge the need for any further adjustments. Governor Christopher Waller on October 8 said the Fed does not need to hike at consecutive meetings. Their policy outlook differed, however, as Jefferson discussed the needs for "any further adjustments", Williams said he expected "one further upward adjustment … may be appropriate late this year", while Waller said he anticipated "additional hikes". Fed Chair Kevin Warsh participated in an event with the IMF's managing director Kristalina Georgieva at the IMF meeting in Bangkok, Thailand, on October 16, but did not make any comments on monetary policy. The fact that Warsh refrained from his earlier hawkish comments was seen as dovish by markets.

Declining equity prices could make financial conditions less supportive

The rapid rise in real yields had started to attract attention among the Fed. However, after the recent week's declines, yields are back close to the levels around the September decision. Instead, declining equity prices may lead to an unwanted tightening of financial conditions. In the September minutes, Fed members downplayed the rise in long yields. At the same time, many members believed that rising equity

prices and tight credit spreads meant that financial conditions remained supportive. The minutes also highlighted the support from equity prices to consumer spending.

Minutes showed members united behind hike, but differing on why

The decision to raise rates at the September meeting was supported by all FOMC members. Members were less united behind the reasons for their votes to hike, however, or the extent of further rate increases. Many members saw the hike as insurance against the risks that inflation would get stuck above the target. Others saw the rate hike as necessary given their own inflation outlook. Cleveland Fed's Beth Hammack and the Dallas Fed's Lorie Logan both seem to be in the latter camp and have argued in recent speeches that the Fed needs to get rates to a restrictive level. Hammack explicitly argued for "smaller adjustments… relatively quickly". However, Logan also said that rising real yields could lessen the need for the Fed to raise rates. But for the other members, the insurance argument point to more cautious and gradual rate increases.

Most members expected at least two hikes in September

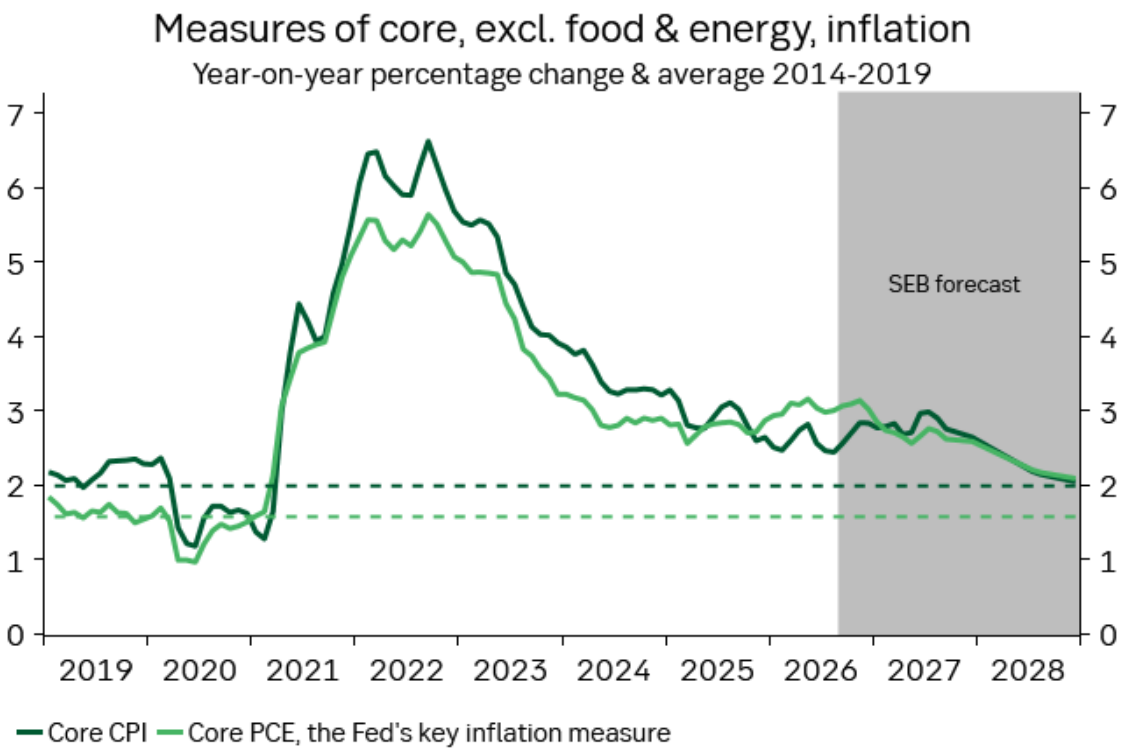
According to the September projections almost all Fed members (16 out of the 18 that submitted their projections) expected one more rate increase this year, or in total two hikes including the September decision. This sets a high bar for not tightening further. Almost half (8 out of 18) expected two further rate increases, by either year-end 2026 or year-end 2027. Since Fed members project the level of rates by the end of the year, the September median forecast for two hikes could also be consistent with another rate increase in 2027 followed by a cut by year-end 2027.

"Two-and-done"-strategy still our main scenario, but conflict in Middle East is an upside risk

We stick to our view that the Fed will deliver one more rate increase at the December meeting. In our view, the successive shocks to inflation from tariffs, energy prices and, to some extent, the AI build-out will have only temporary effects on inflation and we continue to expect inflation to return to target, albeit with a delay. Modest wage increases support a return to target for underlying inflation. Inflation expectations remain in line with the target for longer horizons. In such a scenario, we believe the Fed can start easing policy again by end 2027, followed by two more cuts in the first half of 2028 to a neutral level of around 3.25-3.50%.

Upside risks from the conflict in the Middle East, downside from equities

The outlook for rates is uncertain, however, with both upside and downside risks. The longer energy prices remain high, the larger the risks that energy costs will spread to other prices through, for instance, higher costs for transportation. Last year, the pass-through of tariffs was smaller than expected, as companies partly absorbed some of the increased import costs in their margins. If high energy prices coincide with strong demand, from both the AI build-out and continued surprisingly resilient households, the ability of companies to pass costs forward to their customers may increase. We have raised our core inflation forecast for both 2026 and 2027, but only slightly. Concerns for a renewed escalation in the conflict in the Middle East have pushed oil prices higher lately. Persistently elevated energy prices, with no end in sight to the conflict in the Middle East, could tip the balance within the Fed for a third increase in rates in early 2027. Continued market unrest, with falling equity and debt markets, and rising household mortgage rates could, on the other hand, prolong the current pause.



Markets have scaled back expectations for rate hikes

At the most, in late September, markets fully priced another 100 bps of hikes until end 2027; now markets are pricing a little above 2 ½ rate increases, with the next step expected to come in December. We see this as more reasonable though still somewhat aggressive compared to our forecast of one more hike in December this year and the medium estimate in the latest FOMC members' projections in September.

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