Special Coverage: The Fed reacts to economic uncertainty amidst the government shutdown

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Key takeaways

- The Federal Reserve cut interest rates by 0.25% to the target range of 3.75%–4.00%, its second reduction of the year, while signalling a more balanced stance towards inflation and employment. The FOMC also confirmed plans to end Quantitative Tightening on 1 December, marking a key shift in liquidity management as it transitions towards a neutral policy stance.
- Fed Chair Powell emphasised that central bank policy isn't on a preset course, describing another rate cut in December as "far from a foregone conclusion." He noted that economic growth has moderated, with GDP expanding 1.6% in the first half of 2025, down from 2.4% last year, supported by resilient consumer spending and business investment, but offset by continued housing weakness. Mr Powell also mentioned that inflation has eased signficantly from its highs in mid-2022.
- We still expect a 0.25% rate cut in December but no additional reductions next year, bringing the target range down to 3.50-3.75% by end-2025. For US equities, lower policy rates should be accretive to earnings and help keep valuations in check. For fixed income investors, the Fed cut after a pause provides positive returns in the 12 months after the first cut. Typically, the yield curve follows the policy rates lower, but there may continue to be friction in the Treasury markets due to the government shutdown, federal fiscal issues, and long-term deficit reduction. We remain overweight on US equities and global investment grade bonds. History shows the USD typically weakens when the Fed is easing policy so long as the US economy isn't in recession.

What happened?

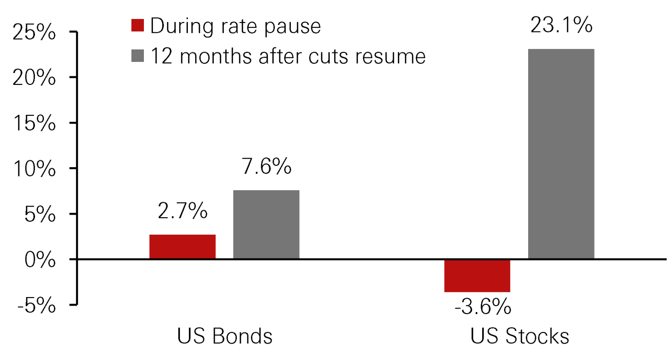
- The Federal Reserve lowered the federal funds rate by 0.25% to 3.75%–4.00%, marking its second cut of 2025. The Committee also announced plans to end Quantitative Tightening (QT) on 1 December, freezing the size of its balance sheet and reinvesting maturing mortgage-backed securities into Treasury bills to shorten duration. Chair Powell emphasised that another rate cut in December is "far from a foregone conclusion."
- Market reactions were mixed following the FOMC meeting: Treasury yields and the dollar rose as Powell's remarks cast doubts on another rate cut in December, while stocks turned negative. Interest-rate swaps showed traders see about a 70% probability of a quarter-point cut in December.
- The Fed's October statement described economic activity as expanding at a moderate pace, while acknowledging that job gains have slowed and downside risks to employment have risen. Inflation has moved up since earlier in the year and remains somewhat elevated, driven partly by tariff-related increases in goods prices. The Committee noted that it will "carefully assess incoming data" when considering additional policy adjustments.
- New language formally concludes balance-sheet runoff on 1 December, with the Fed set to reinvest MBS runoff into Treasury bills, signalling an operational shift to maintain ample reserves. Taken together, the rate cut and QT halt represent a meaningful shift towards easier financial conditions, though the Fed remains cautious and data-dependent ahead of the December meeting.

- Since mid-2022, the Fed's securities holdings have fallen by USD2.2 trillion, from 35% to about 21% of GDP, and the balance sheet will now be held steady while reserves drift lower. This marks what Mr Powell called the "next phase" of policy normalisation, keeping liquidity sufficient while continuing to pursue maximum employment and price stability.
- Mr Powell acknowledged strongly divergent views within the Committee about the policy path ahead. He said the labour market is cooling but not collapsing, with unemployment near 4.3% and job creation slowing sharply amid weaker labour-force growth. The Fed is monitoring corporate layoff announcements and consumer bifurcation, where higher-income households continue to spend but lower-income groups are trading down.
- On inflation, he reiterated that tariff-driven price increases should fade and that underlying inflation is closer to target than headline figures suggest.
- The US government shutdown has now stretched into its fifth week, as of 30 October. Hundreds of thousands of federal workers remain furloughed or unpaid, and several programmes, including food assistance and healthcare subsidies, are running out of money. The shutdown now technically affects the entire government. Mr Powell said the ongoing government shutdown will temporarily weigh on growth, but those effects should reverse once operations resume.

Investment implications

- The combination of lower policy rates and the end of QT provides a more supportive backdrop for risk assets. Lower policy rates are accretive to corporate earnings and should help keep valuations in check. We expect a 0.25% rate cut in December but no additional reductions next year, bringing the target range down to 3.50-3.75% by end-2025.
- In the six prior easing cycles, the S&P 500 gained an average of 23.1% in the 12 months following the resumption of rate cuts, compared with a -3.6% decline during the pause. US bonds also outperformed, returning 7.6% after cuts resumed versus 2.7% during pauses.

US markets outperform after the Fed resumes easing (S&P 500 & US Agg: Average performance using six prior rate cut pauses)



Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 29 October 2025. Forecasts are subject to change.

- Within equities, we see resilient corporate earnings and AI-driven productivity supporting a broadening rally across the US sectors beyond IT. We favour large-cap quality names and see opportunities within the financials, industrials, communication services and utilities sectors, which stand to benefit from stable growth momentum and renewed business investment.
- For fixed income investors, the yield curve typically follows the policy rates lower, but there may continue to be friction in the Treasury markets due to the government shutdown, federal fiscal issues, and long-term deficit reduction. Hence, we reiterate our call of adding to uality bonds, with a preference for global investment grade.
- History shows the USD typically weakens when the Fed is easing policy, so long as the US economy isn't in recession, which we believe is currently the case.

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