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October Fed Meeting: A Pause or a Pivot?

The Fed held rates steady in October, but elevated inflation and resilient economic growth could keep additional tightening on the table as policymakers look toward December.



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KEY TAKEAWAYS

- The U.S. Federal Reserve (Fed) held the federal funds rate at its October 28, 2026, meeting, maintaining the target range of 3.75%–4.00%, indicating that policymakers need more information before hiking again.
- Inflation remains the Fed's primary concern as economic growth and labor markets show continued resilience. Despite higher-than-expected core CPI and PPI readings, the Fed opted to hold rates, citing tighter financial conditions and stable longer-term inflation expectations.
- The economy continues to demonstrate resilience despite higher interest rates. Consumer spending remains healthy, while AI-related investment has supported growth. Although the Fed expects higher rates to influence investment decisions, the extent to which tighter policy will affect economic activity remains uncertain.
- The Fed is keeping its options open while changing how it communicates policy. Federal Reserve Chairman Kevin Warsh offered little guidance on the timing of future hikes and announced plans to dedicate some Federal Open Market Committee (FOMC) meetings to broader policy strategy rather than rate decisions.
- Financial conditions may be playing an increasingly important role in monetary policy decisions. The Fed's October pause suggests policymakers are allowing tighter market conditions to provide some restraint, although relying on market expectations to reinforce monetary tightening carries risks.
- Attractive yields and changing market correlations may offer opportunities for fixed income investors. Historically, higher starting yields have been associated with strong subsequent fixed income returns, while duration may offer diversification benefits by helping offset losses in risk assets during periods of market stress.

The Federal Reserve entered its October 27–28 meeting following September’s 25-basis-point rate increase, which brought the federal funds target range to 3.75%–4.00%. Inflation has ticked higher, while economic growth and labor market conditions have shown continued resilience.

Although markets broadly anticipated a pause in October, the probability of another rate increase in December remained above 80%, according to Bloomberg. The central question is whether the Fed views a pause as an opportunity to assess the effects of tighter policy or as a signal that interest rates may be approaching their peak.

1. Does an October Pause Indicate a Change in the Fed’s Policy Direction?

The Fed remains on a hiking path, but the timing is unclear. There were two dissents for a hike at the October 28, 2026, meeting: Beth Hammock, who also dissented from July’s decision to hold, and Lisa Cook, a new dissenter that surprised most Fed watchers. The reasons given for holding rates at this meeting were not entirely clear. Chair Warsh said that financial conditions had tightened since the hike in September but that he couldn’t call them “tight.” He also acknowledged that inflation remains above target and that the Fed has more work to do to achieve price stability. Economic activity is strong and has likely accelerated in the third quarter.

2. Is Inflation Keeping the Fed on a Tightening Path?

We believe, with the labor market remaining resilient and economic activity strengthening, the Fed’s main focus is on the inflation side of the mandate. Chair Warsh said that the Fed needs to ensure that the rise in energy prices does not broaden out. However, that message is difficult to reconcile with the Fed’s decision to hold rates steady, particularly after September’s core Consumer Price Index (CPI) rose 0.3% versus expectations of 0.2%, while core Producer Price Index (PPI) increased 0.7% versus expectations of 0.3%. The Fed is watching market-based inflation expectations closely and was comforted by longer-term inflation expectations remaining unchanged since the September increase in the fed funds target rate, despite energy prices continuing to rise.

3. How Resilient Is the Economy to Higher Interest Rates?

The economy has already proven to be quite resilient to higher interest rates. The good news is that the U.S. economy did not experience a recession that most had predicted after the Fed’s aggressive hiking cycle in 2022–2023. The primary interest-rate-sensitive area of the economy is housing, which never recovered after 2023 and remains at a standstill. Therefore, the housing sector is unlikely to be a source of further slowdown during the current hiking cycle. Economic growth in the past year has been quite dependent on artificial intelligence- (AI) related investment and spending. Chair Warsh said that he sees signs that growth is broadening out and consumer spending has been resilient in the face of higher gasoline prices. When asked about the sensitivity of growth to interest rates in the press conference, Chair Warsh replied that he is skeptical of the view that AI-related spending and investment is immune to increases in interest rates. He made the argument that September’s rate hike and the expectation for further hikes caused equity declines and credit spread widening in some of the AI-related names after the meeting. He said he believes that rate hikes will cause investors to be more discerning about AI-related financing. However, that is a difficult argument to establish ex ante, given the many factors influencing equity prices and credit spreads, in our view.

4. Did the Fed Provide Any Indications About December and 2027?

Chair Warsh remained steadfast in his refusal to provide any forward guidance about future rate hikes. However, he did make a surprise announcement about the meeting schedule in 2027 and 2028. Starting next fall, one of the eight FOMC meetings in 2027 will be designated as a “strategy” meeting in which no decision on policy will be made. Instead, the committee will use that meeting to discuss its monetary policy framework more broadly, and it may not result in any public communication. In 2028, two of the eight meetings will be strategy meetings, with only six meetings resulting in a policy decision. This should not have any impact on the total number of rate hikes or cuts the Fed can achieve. The Fed retains the flexibility to adjust interest rates between scheduled meetings if necessary. The main impact could be a reduction in transparency and communication, resulting in more uncertainty about the Fed’s current views and reaction function.

5. Are Tighter Financial Conditions Influencing the Fed's Next Move?

The recent tightening in financial conditions was the main reason cited for the Fed remaining on hold at this meeting. This Fed under Chair Warsh has been clear that it will incorporate signals from market movements in its policy decisions. The pause in hikes at this meeting could be interpreted as the Fed allowing the market to do its work for it and waiting to see if financial conditions tighten on their own. But this approach carries some risk, as it depends on a hawkish feedback loop in which markets must believe the Fed will continue raising rates for further hikes to be priced in. If the market loses faith in the Fed's commitment, that feedback loop could break down.

6. Could the Midterm Elections Influence Monetary Policy and Markets?

In the press conference, Chair Warsh was adamant that the upcoming midterm elections had zero bearing on the Fed's decision to hold rates. While political developments may influence market expectations and financial conditions, monetary policy decisions are intended to remain independent of electoral considerations. In general, we do not anticipate a significant reaction in yields to the election results, primarily because a large change in fiscal policy is unlikely under any of the possible outcomes. For example, a divided Congress could make it more difficult to pass major spending or tax legislation, limiting the potential impact on interest rates.

7. What Does the Policy Outlook Mean for Fixed Income Investors?

With the 10-year U.S. Treasury yield above 5%, historical data suggest an attractive starting point for forward fixed income returns.¹ Additionally, recent volatility in credit and equity markets has also seen Treasury yields and risk assets move in the same direction, signaling a return to a positive correlation. This means that as equity prices declined, Treasury yields also fell, causing Treasury bond prices to rise. This suggests that duration may once again potentially provide diversification benefits in a multi-sector portfolio, acting as a hedge as gains from interest-rate-sensitive bonds could help offset losses in risk assets during periods of market stress. However, the effectiveness of this hedge depends on market conditions, including the Fed maintaining credibility in its commitment to price stability.

¹ Source: Bloomberg U.S. Aggregate Bond Index as of September 30, 2026. When the 10-year Treasury yield began between 5% and 5.99%, the Bloomberg U.S. Aggregate Bond Index subsequently generated average annualized returns of 6.7% over three years and 6.6% over five years, based on monthly observations from 1986 through 2026. Past performance is not an indication or guarantee of future results.

Glossary & Index Definitions

Basis point (bp) is one one-hundredth of a percentage point (0.01%). Basis points are commonly used to describe changes in interest rates and credit spreads.

Core Consumer Price Index (Core CPI) measures changes in the prices paid by consumers for goods and services, excluding food and energy, which tend to be more volatile. It is a commonly used measure of underlying inflation.

Core Producer Price Index (Core PPI) measures changes in prices received by domestic producers for goods and services, excluding food and energy. It provides insight into underlying inflation pressures at the producer level.

Credit spread is the difference in yield between a bond and a comparable benchmark, typically a U.S. Treasury security. Credit spreads generally reflect compensation for credit risk and other factors.

Duration measures the sensitivity of a bond's or fixed income portfolio's price to changes in interest rates. Bonds with longer durations generally experience greater price fluctuations when interest rates change.

Ex ante is a Latin term meaning "before the event." In financial analysis, it refers to expectations, forecasts, or assessments made before an outcome is known.

Federal funds rate is the interest rate at which depository institutions lend reserve balances to one another overnight. The Federal Reserve establishes a target range for this rate as a primary tool of monetary policy.

Federal Open Market Committee (FOMC) is the Federal Reserve committee responsible for setting U.S. monetary policy, including decisions about the target range for the federal funds rate.

Financial conditions refer to the overall environment affecting the availability and cost of financing in an economy, including interest rates, credit spreads, equity prices, and lending conditions.

Fiscal policy refers to government decisions regarding taxation and spending that influence economic activity, employment, and inflation.

Forward guidance refers to communications from a central bank about its expectations or intentions regarding future monetary policy, intended to help shape market expectations and financial conditions.

Hawkish monetary policy describes a central bank stance that prioritizes controlling inflation, typically through higher interest rates or maintaining restrictive monetary policy.

Interest rate sensitivity refers to the degree to which an investment, business, or sector is affected by changes in interest rates.

Market-based inflation expectations are estimates of future inflation derived from financial market prices, including Treasury Inflation-Protected Securities (TIPS), nominal Treasury bonds, and inflation derivatives. These measures reflect expected inflation compensation as well as inflation risk premiums and other market factors.

Monetary policy refers to actions taken by a central bank to influence interest rates, financial conditions, and economic activity to achieve its policy objectives, including price stability and maximum employment.

Monetary policy reaction function describes how a central bank is expected to adjust monetary policy in response to changes in economic conditions, particularly inflation, employment, and growth.

Nominal Treasury yield is the yield on a U.S. Treasury security before adjusting for inflation. It reflects market interest rates and incorporates expectations about inflation, real interest rates, and other factors.

Positive correlation describes a statistical relationship in which two variables generally move in the same direction. In the article, it refers to Treasury yields and risk asset prices moving together during periods of market volatility.

Price stability is a monetary policy objective generally associated with maintaining low and stable inflation. The Federal Reserve defines price

stability as inflation averaging 2% over time, measured by the Personal Consumption Expenditures (PCE) Price Index.

Risk assets are investments, such as equities and corporate credit, whose values are generally more sensitive to economic conditions, investor risk appetite, and changes in market sentiment.

Starting yield is the yield available on a bond or fixed income investment at the time of purchase or at the beginning of a measurement period. It can be an important indicator of potential future returns, although actual returns depend on subsequent market conditions.

10-year U.S. Treasury yield is the yield on U.S. government debt securities with approximately 10 years to maturity. It is widely used as a benchmark for long-term interest rates and borrowing costs.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. Yield-to-maturity (YTM) represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. Yield-to-worst refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

Index Definition

Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the performance of the U.S. investment-grade, taxable fixed income market, including government, corporate, mortgage-backed, and asset-backed securities.

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