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Out to Lunch

THE LEAD | November 6, 2025

The Fed's rate cut last week of 25 bps brings the funds benchmark down to 3.75-4.00%. That's roughly 150 bps lower than its peak back in July 2023. Buried in this news were two interesting developments.

Chair Powell remarked that "there were strongly differing views on how to proceed in December." Of the twelve FOMC members, there were two dissenting votes – one in favor of a stronger 50 bps cut, the other in favor of leaving rates unchanged. A similar split occurred in July, the first time since 1993 that as many as two members dissented.

While perhaps indications of future disagreements, these votes are a far cry from 1973 when major inflationary shocks – food prices and oil supplies – created deep philosophical debates about monetary policy. In October of that year, a motion on a 10.5% funds rate target squeaked by with a 6-5 vote.

More significantly last week the board also discontinued its bond buying program, begun in 2020, as another means of draining liquidity out of the financial system. While less noted, this represents a major step in reducing the money supply and easing inflationary pressures.

The question markets are currently wrestling with is does Powell's hawkish statement put the Fed on a collision path with administration officials who believe "lower and faster" is the best way to keep the economy growing. Particularly in a critical election year.

Looming over these discussions is the US government shutdown. Now the longest in US history (see our *Chart of the Week*), the shutdown threatens to undermine what has been a strong year for growth and earnings, despite April's tariff surprise.

Effects are just beginning to be felt. Over 1 million Federal employees are not getting paid. Travelers have already noted the absence of full air-traffic control staff on duty – a less-than comforting thought. Non-government contractors are also sidelined without pay, since major projects are being delayed.

The Congressional Budget Office estimates the shutdown will lower GDP by 1-2% for the current quarter, with roughly $10 billion in non-recoverable revenues for that period. It also estimates that an end to the shutdown will result in boost to growth as workers return and business resumes. But the lack of a functioning Bureau of Labor Statistics is making analysis a challenge.

Meanwhile, capital markets are open for business. Equities are higher, thanks to a favorable jobs report. Public debt markets are on pace for a record year, albeit via refinancings and repricings. The private markets keep issuing new buyout financings, particularly in the middle market, where deal flow is focused on better performing defensive sectors. Rate cuts will keep that momentum going.