



# STREET SMARTS: MONETARY POLICY TAKES CENTER STAGE

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September 2025

NEPC sits down with Phillip Nelson, Head of Asset Allocation, to discuss the recent actions of the Federal Reserve and the future path of monetary policy in the U.S. and other central banks around the world, and the potential consequences of these changes in interest rates.

## **1. The Federal Reserve cut rates by 25 basis points this week, its first rate reduction this year. What's your biggest takeaway from the Federal Open Market Committee meeting?**

As expected, there were no surprises with the quarter-point rate cut. The most interesting takeaway from the FOMC meeting is that the members have clearly observed the weakness in the labor market and are giving themselves more flexibility over the next year to potentially move to a faster pace of rate cuts.

In addition, Chairperson Powell's reference to the rate reduction as a risk management cut underscores the central bank's wait-and-see approach. If there is further softness in the labor market, we can expect the Fed to assume an accelerated path to cutting rates in the next 12 months.

## **2. How does the recent uptick in inflation complicate the Fed's plan to loosen monetary policy?**

There appears to be less concern about the inflationary impact of tariffs flowing through the economy. There are nine participants at the FOMC meeting this week who indicated that they could see the fed funds rate below 3.25% by the end of 2026, compared to four in June. The tail risk being associated with inflation seems to be abating in the marketplace.

## **3. Stephen Miran, chair of the White House's Council of Economic Advisers, joined the Fed's board of governors, as part of the 12-member panel that sets interest rates and monetary policy. Does NEPC have any concerns about the market impact of a Fed with diminished independence?**

There is a lot of speculation about Miran's influence on the FOMC and what this means for the successor of Fed chair Powell in May 2026. Miran, a Trump appointee confirmed by the Senate to the Fed Board of Governors just a day before the two-day FOMC meeting, was the sole dissenter with his preference for a half-point cut.

At this point, it doesn't appear that the market has concerns about the Fed's independence and neither do we. The recent FOMC meeting points to the Fed entering an easing cycle in a bull market which has historically benefitted equities. We think the market is likely to look favorably on interest rate cuts as many believe the Fed has been overly cautious about lowering rates.

However, the administration has been vocal in its support for lower interest rates and if the central bank cuts rates too aggressively—below 3% by the end of 2026—the market may start to think the Fed is moving too fast, potentially raising questions about its independence. If the Fed acts more forcefully than expected, its moves can transmit volatility into currencies and interest rates.

#### **4. Other central banks—European Central Bank, Bank of England and Bank of Japan—are also in the limelight with potential rate moves. What does this mean for investors?**

The Bank of England and the ECB are likely on a much slower path to easing rates than the Fed, and the easing bias in the U.S. relative to other central banks is likely to fuel positive sentiment in U.S. equities. The Bank of Japan, the biggest focal point for monetary policy buffs, is expected to raise interest rates sometime this year by 25 basis points as it seeks to gradually normalize rates. But history has shown that raising rates in Japan can fuel volatility, especially in fixed-income markets. A surprise move can lead to an uptick in market volatility in currencies and interest rates across Japan and developed markets.

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