Weekly Global Market Commentary

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Tight Ropes: Fed and US Government balancing precariously

by James Balfour, CFA, Senior Portfolio Manager

Any economy is always striving for full employment and limited price inflation; the reality typically is that these two forces operate in conflict with each other. The Federal Reserve has the dual mandate of balancing these factors, using interest rates to prevent either one blowing out of normalized ranges. The move to cut rates by 25 basis points was expected but the commentary indicated the Fed were now more concerned with employment in the economy. This represents a change in focus compared to the last few years where controlling inflation rates has been forefront of any decisions. The stickiness in inflation has led to only 125 basis points of cuts in the last 18 months, when the market had originally expected more than this through 2024. Inflation remains above the Fed target rate of 2% but it has become clear there is more fear in the stability of US job market than the rate of inflation that is potentially being boosted by tariff impacts. Inflation has risen since the April low and is now hovering just below 3%, demonstrating the concern there is for jobs. There are always revisions but over the summer the US economy has only added 95k jobs, a rule of thumb has been 200k a month for economic growth, so over a 300k shortfall, this is why the Fed has shifted focus. With unemployment rising to 4.3% the tight rope that must be walked is what level of inflation can be endured as rates are cut to support the economy. The path for any central bank is never clear as the only clarity they have is historic data, therefore they must balance the various leading indicators and assumptions on how economies will react.

Data is critical, a government shutdown that limits the release of information and slows the working of the economy is another impediment to any clarity that the Fed believes it has. Estimates of over 750,000 furloughed government employees and potential billions of dollars of impact on the economy further muddies the water on how the economy is operating. The stalemate between parties could extend for a significant period given where negotiating lines appear to have been drawn. The drip down effects however remain significant, federal funding for infrastructure projects in New York has already been put on hold, delays of this nature will setback the underlying construction for no doubt longer than the period of government shutdown. Long term economic growth is underpinned by infrastructure investments, delivering a launchpad for growth while sustaining significant jobs withing the economy. The debate over approving the fiscal budget could roll into November, all the while stalling significant portions of the economy that are potentially on a tipping point to slowing down. The risk would therefore be a sharper drop in economic output than Chairman Powell is expecting, forcing the market to price in more rate cuts that the anticipated 50 basis points across the remaining 2 meetings this year.

Healthcare subsidies are the immovable blockage between the parties, Democrats refusing to sign any stop-gap measures unless there is an extension to the credits. Analysis concludes that providers could see a shortfall of $32bn in revenues driving significant price increases through policies to cover the shortfall. The impact would be felt across the industry from healthcare providers to insurance companies. Democrats are arguing that without the extension of these credits then millions would be left uninsured. President Trump has looked to reduce drug prices in recent days, with announcements alongside pharmaceutical bosses, however any progress in this space only accounts for up to 15% of total bills therefore not enough to counter the potential impacts from credits dropping out. The debate on healthcare and the system in the US has always been one of significant discussion and clamor for change, but it remains highly unlikely that a government shutdown is going to create long lasting positive change for the industry.

LOM Asset Management Ltd., The LOM Building, 27 Reid Street, Hamilton HM 11, Bermuda
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