ICBA Securities

A fresh perspective

FOMC's 2025 roster has some new voters.

By Jim Reber, ICBA Securities

While we in the financial services sector start thinking about monetary policy in the coming year, there's a new wrinkle to consider. Many Fed-watchers, rate prognosticators, economists and even investors had been betting on substantially lower rates in 2025 for many months. It looked like the corner had been turned with the 50 basis-point (0.50%) cut to fed funds on September 18. Almost immediately thereafter, persistently strong economic data caused members of the Federal Reserve Board to at least orally tamp down market expectations for aggressive cutting in the near future.

The "wrinkle" is the makeup of the Federal Open Market Committee (FOMC) next year. The people who actually cast a vote for our central bank's monetary policy is a subset of the entire Federal Reserve Board. The FOMC consists of 12 members from two separate groups. The seven governors—who are nominated by the U. S. President and confirmed by the Senate and include Chairman Jay Powell—vote at each of the meetings. The remaining five members are, most of the time, an annually rotating set of regional Federal Reserve district presidents elected by their constituents.

New for 2025

Next year, the five regional bank presidents on the committee are:

John Williams	New York
Austan Goolsbee	Chicago
Susan Collins	Boston
Alberto Musalem	St. Louis
Jeff Schmid	Kansas City

The New York Fed president is the only permanently-voting member in the group. The Fed's open market operations, which is where rubber meets the road on interest rates, are conducted through the New York bank, and hence the permanent spot on the FOMC.

The other four are perhaps wild cards, at least as Fed-watchers are concerned. Susan Collins has voted for only one year since her election in 2022; the same goes for Austan Goolsbee in 2023.
The other two have not yet voted, given their elections since 2022. So, these voters will have their words and actions very closely parsed for "dovish" or "hawkish" leanings relative to interest rates.

But let's not oversell the impact: The votes at the conclusion of the FOMC's meetings are usually unanimous. I can't think of the last time there was more than one dissenting vote. It's also true that the other seven regional bank presidents who are not voters in a given year participate in the discussions and deliberations. Still, it's unusual for the FOMC to have this number of voters with little or no track record.

Tools in the shed

Now that we've had a refresher course, let's talk about what the Fed can do regarding interest rates, which certainly have direct impact on community bank profitability. The most visible (and talked about) rate is fed funds, which is what financial institutions charge one another for overnight borrowings. The Fed controls that rate through the setting of reserve requirements; if it wants Fed Funds to drop, it decreases the level of reserves required in the system, thereby freeing up more money to be lent and invested.

It also runs the discount window as part of its mission of being the "lender of last resort." Fed members, including community banks, have access to these short-term borrowing which can help manage liquidity risk, especially during times of market disruptions. The discount rate is set by the Fed and highly correlated to fed funds.

Not least among its kit is the open market operations mentioned previously. If the Fed decides it needs to impact interest rates that have longer terms that money markets, it has capacity to invest vast sums in securities to bring down costs of borrowing. In doing so, the Fed effectively subsidizes all manner of debtors: consumers, homeowners, corporations, municipalities and even the largest borrower on earth: the federal government. Never was this more visible than the early stages of the COVID pandemic, when the Fed purchased over $4 trillion in treasuries and mortgage-backed securities—most of which it still owns—in 2020 alone.

Current forecast

As we get ready to close out another year, what do the financial markets expect in 2025? This time last year, around 175 basis points in rate cuts were in the 2024 futures numbers. Perhaps because of that (i. e., grossly overestimating the decrease in fed funds), the U. S. economy's impressive resilience, and inflation's refusal to get back into its 2% box, we're still singing from the "higher for longer" hymnal.

But that should bode well for community banks. It appears that cost of funds has finally started to level off as the effects of the first rate cut take hold. Overall, borrower financial health appears to be holding up, so loan demand should be at least average. And maybe, if the interest rate curve ever returns to a normal slope, community bankers can get back to pricing relative risk into their balance sheets. Perhaps the first lap for several new FOMC voters will be steady as she goes.

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Research resource

Most of the data used in this column is from the Federal Reserve's website. It contains a wealth of information on the history and structure of the central bank, as well as archival facts on FOMC meetings and the execution of monetary policy. Visit federalreserve.gov/monetarypolicy

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