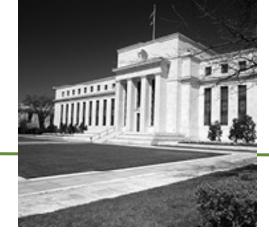
## MARKET SIGHT LINES



# The Fed Cuts Rates... and Signals a Possible Pause

By Michael O'Keeffe, Chief Investment Officer







The Federal Reserve held its final meeting of 2025, cutting its benchmark Fed funds rate by 0.25% to a range of 3.5%-3.75%, bringing borrowing costs to their lowest level since 2022. Fed officials had been talking a lot about the two elements of its dual mandate – maximum employment and stable prices – with officials holding mixed views as they seek to avoid policy error. Cut too quickly, and inflation can reignite, but cut too slowly, and tight conditions can drive more job weakness and the eventual risk of recession. The Fed's Summary of Economic Projections – the SEP – reinforces that officials have differing views. And, overall, officials are signaling they may pause cuts for a while.

#### THE TAKEAWAY: THE FED ACTS BUT WORRIES ABOUT THE FUTURE

The Fed cut rates a quarter point as expected, but the SEP shows that officials have differing views about that action and the future. In summary:

- The Fed cut its benchmark funds rate a quarter of a point, as expected.
- The SEP, which provides insights into the individual projections of Fed officials, showed that officials had varying views of this action.
- The projections also show the potential for just one cut next year.
- This is due, in part, to the view that inflation will be firmer than previously thought.
- In addition, officials see continued economic growth over the next few years, in line with consensus expectations, and at a higher level than previously forecast.
- Interestingly, the SEP also projects that the labor market may improve.
- In his post-meeting press conference, Fed Chair Jerome Powell indicated that the central bank may move to a "wait and see" stance, even as labor market and inflation risks remain.



### IN-DEPTH: THE FED ACTS AS EXPECTED, BUT FORECASTS SHOW OFFICIALS ARE WORRIED ABOUT THE FUTURE

At its December meeting, the Fed cut rates a quarter point as expected, but the SEP confirmed that officials have differing views about both that action and what to expect in the future. Going deeper:

- As expected, the Fed cut its benchmark funds rate a quarter of a point:
  - o Fed funds futures had priced in a 90% chance of a cut at this meeting.
  - o The new range of 3.5%-3.75% brings borrowing costs to their lowest level since 2022.
- The SEP, reflecting Fed officials' individual projections, showed officials had varying views of this action:
  - o The "dot plot" showed six officials preferred no cut, and one preferred a half-point cut.
  - o The policy vote was divided one official preferred a half-point cut, and two preferred none.
- The SEP projections also show the potential for fewer cuts next year:
  - o Projections show the likelihood of only one cut next year.
  - o Fed funds futures are still pricing in two cuts in 2026, but then no change in 2027.
- This may be due, at least in part, to the view that inflation will be firmer than previously thought:
  - The SEP core Personal Consumption Expenditures inflation 2026 median projection is 2.5%, up from 2.2% last December.
  - o Market inflation breakeven rates sit at 2.5% for one year and 2.3% for five years.
- Also, officials see continued, strong economic growth over the next few years, in line with consensus expectations, and at a higher level than previously forecast:
  - o The SEP median projection of 2026 GDP growth is now 2.3%, up from 1.8% in September.
  - o The consensus median economist forecast for 2026 GDP is now 2%.
- Interestingly, despite signaling worries about a slowdown, officials indicate they think the labor market may eventually improve:
  - o The SEP median projection for unemployment is 4.4% at year-end 2026.
  - o This rate is then expected to fall to 4.2% in 2027.
- In his post-meeting press conference, Fed Chair Jerome Powell indicated that the Fed may pause:
  - o He said, "We're well positioned to wait and see how the economy evolves from here."
  - He also indicated that labor market risks tipped the scales to a cut, but officials don't feel it is "mission accomplished" on inflation.
  - o Ultimately, Powell reiterated that the Fed will be data dependent going into the January meeting.

#### CONCLUSION

The Fed cut rates at its final meeting this year, bringing its benchmark Fed funds rate to a range of 3.5%-3.75%. Fed officials have focused the two elements of its dual mandate – maximum employment and stable prices – with mixed views on how to avoid policy error. Cutting too quickly can trigger inflation, but going too slow – or not cutting enough – puts the job market and economy at risk. But officials, while divided, ultimately responded to labor market risks, even as they signaled a potential pause from here.

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