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Review: The Federal Reserve Cut Rates, With a Divided FOMC

by

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Executive Summary

- **Decision Made**: *The Fed cut US interest rates in December.* The FOMC its target Fed funds range by 25 bps to 3.50% - 3.75%. The Fed maintained its data-dependent approach. The FOMC remained divided: Powell and eight members supported the move, while Miran pushed for a 50 bp cut and Goolsbee and Schmid preferred no change. It was Miran's third dissent and Schmid's second, echoing the committee's broader hawk-dove split.

  The dot plot still shows one cut in 2026 and another in 2027, keeping the long-run rate near 3%, but it highlights continued disagreement, with additional soft dissents and several officials expecting no cuts next year. The Fed also announced it will resume Treasury purchases after ending runoff in October. With reserves deemed ample and funding strains emerging, it will begin buying $40 billion in T-bills on Friday, with elevated purchases for a few months before tapering.

- **Policy Discussion**: *The 9–3 vote again exposed both hawkish and dovish dissent, reflecting a committee divided as the Fed adopts a wait-and-see stance.* Governor Stephen Miran argued for a 50 bp cut, while Jeffrey Schmid and Austan Goolsbee preferred holding rates steady. Powell emphasized that a rate hike is not anyone's base case and described the decision as a "close call," noting that with policy now near neutral after substantial easing, the Fed is positioned to watch incoming data before deciding on additional moves.

  A notable surprise was the decision to resume Treasury bill purchases after signs that reserves had tightened. The Fed will buy $40 billion in the first month, with elevated purchases likely for a few months to ease near-term money-market pressures before tapering depending on conditions. The step comes at a sensitive moment, with Powell nearing the end of his term and only three meetings remaining before Trump's nominee—widely expected to be Kevin Hassett, according to prediction markets—assumes the chair.

  Powell said monetary policy is working but tariffs have pushed goods inflation higher, adding that the impact is concentrated in sectors directly affected by tariffs. He expects the peak tariff effect to hit early next year, though timing remains uncertain and any additional inflation pressures should be modest. On the labor market, Powell pointed out that despite high-profile layoffs in tech and retail, overall layoff rates remain low. AI may eventually reshape the workforce, he said, but it is not yet a major driver of job insecurity. Financial markets continue to price in more easing than the Fed projects. While officials foresee only one rate cut in 2026, futures markets imply roughly a 68% chance of two or more cuts next year, highlighting skepticism that the Fed will stay on its stated path.

- **Changes to Economic Forecasts:** *The Fed's new projections still show just one 25 bp cut in 2026 and another in 2027, keeping the long-run rate near 3% and underscoring divisions within the committee*. With federal data still delayed, indicators point to a cooling labor market, elevated inflation, and moderate growth supported by consumers and business investment. GDP is projected at 1.7% this year and 2.3% next year, with unemployment expected to reach 4.5% before easing; private data hint at deeper layoffs ahead.

  September data showed stronger hiring but unemployment rising to 4.4%, and inflation firming despite milder-than-expected tariff effects. The officials expect inflation to stay above target until 2028. September PCE inflation was 2.8%—well off its peak but still high—with forecasts pointing to 2.4% by year-end. With inflation risks tilted up and employment risks rising, the Fed judged a 25-bp cut appropriate to balance its dual mandate.

Key Picture: US Federal Reserve Forecasts – 2025-2028

	2025*f*			2026*f*		2027*f*		2028*f*		Longer Run	
	Latest Reading	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report
GDP *(real growth, y-o-y)*	2.1	1.7	1.6	2.3	1.8	2.0	1.9	1.9	1.8	1.8	1.8
Unemployment rate *(%, y-o-y)*	4.4	4.5	4.5	4.4	4.4	4.2	4.3	4.2	4.2	4.2	4.2
PCE Inflation *(%, y-o-y)*	2.8	2.9	3.0	2.4	2.6	2.1	2.1	2.0	2.0	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	2.8	3.0	3.1	2.5	2.6	2.1	2.1	2.0	2.0	-	-
Federal Funds Rate *(%)*	4.327	3.6	3.6	3.4	3.4	3.1	3.1	3.1	3.1	3.0	3.0

Source: Federal Reserve '*Summary of Economic Projections'* June and September 2025. *Note:* 1. GDP reading for Q2-2025; 2. Unemployment rate as of September 2025; 3. PCE and core PCE inflation as of September 2025; 4. Projections reflect the median of FOMC projection

Analysis

- **DECISION MADE**: *On December 10, the US Federal Reserve's FOMC cut its Fed funds range by 25 bps to 3.50% - 3.75%.* FOMC was divided: Powell and 8 others voted for the policy; voting against the action were Stephen I. Miran, who favored a 50-basis-point rate cut, and Austan D. Goolsbee and Jeffrey R. Schmid, who preferred leaving the target range unchanged. This marked Miran's third straight dissent before his January departure, and Schmid's second. The last meeting with three dissents also reflected a similar split between those favoring tighter versus looser policy.

  Regarding *forward guidance*, the Fed continues to be data-dependent with decisions being made meeting by meeting. The post-meeting statement reused language from last year's FOMC communication. It said: "*In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks*".

  The updated dot plot still shows one cut in 2026 and another in 2027, keeping the longer-run rate near 3%, but it also highlights clear divisions within the committee. Beyond the two dovish dissents, four nonvoting participants signaled "soft" disagreement, and seven officials indicated they expect no cuts next year.

  Regarding *balance sheet policies*, the Fed said it will restart Treasury purchases, building on its October announcement to stop balance sheet runoff. According to the statement, reserve balances are now considered ample, and the Committee will buy short-term Treasuries as needed to keep them at that level.The shift reflects concerns about strains in overnight funding markets. It will begin with $40 billion in Treasury bill purchases starting Friday, with elevated buying expected for the next few months before tapering sharply.

- **POLICY DISCUSSION:** *The 9–3 vote once again included both hawkish and dovish dissents, while the Fed is now in a wait-and-see stance.* The Fed's December decision comes against mixed economic signals as it tries to balance price stability with labor-market conditions. Policymakers now face a key question for 2025: whether to cut rates again or pause amid lingering uncertainty. Governor Stephen Miran pushed for a larger half-point cut, while Kansas City's Jeffrey Schmid and Chicago's Austan Goolsbee preferred to keep rates unchanged.

  Powell said a rate hike is not anyone's base case, pushing back on fears of a hawkish shift after the Fed's third cut of the year. He emphasized that the central bank is now in a wait-and-see stance, noting that with rates near neutral after substantial easing since last September, policymakers are well positioned to assess incoming data and determine whether further adjustments are needed. Powell also acknowledged that today's cut was a difficult choice, calling it a "close call" in a highly uncertain environment.

One unexpected element in the announcement was the Fed's plan to resume Treasury purchases. the Committee noted that money-market rates have been tightening relative to administered rates, suggesting reserves have fallen to ample levels. sTo maintain sufficient reserves, the Fed will begin buying short-term Treasuries, mainly bills. Purchases will total $40 billion in the first month and may stay elevated for a few months to ease near-term money-market pressures before tapering, depending on conditions. The move comes at a particularly delicate time for the central bank. Powell works to preserve consensus among policymakers, his second term as chair is nearing its end. He has only three meetings remaining before President Donald Trump's nominee takes over. Trump has signaled that his Fed nominee must favor lower rates, rather than prioritizing the traditional dual mandate of stable prices and full employment. Prediction markets currently see National Economic Council Chair Kevin Hassett as the frontrunner, giving him a 72% chance of being nominated, with former Governor Kevin Warsh and current Governor Christopher Waller far behind. Many in financial circles view Hassett as someone who would align closely with Trump's preferences.

Powell stressed that monetary policy is working but tariffs are pushing inflation higher, saying the tariff impact is clear: goods inflation is rising only in sectors affected by tariffs. He said the Fed faces no risk-free path as it balances inflation against weakening employment. Powell said that if no new tariffs are introduced, their peak inflation impact should hit around the first quarter of next year, though the timing is uncertain and any additional effects should be modest. Regarding the labour market. Powell said that despite headline layoffs in tech and retail, overall layoff rates remain low. AI may boost jobs and productivity, but its impact on the workforce is still uncertain—and not yet a major driver of job insecurity.

Markets expect more easing than the Fed projects. While policymakers still anticipate just one cut in 2026, traders are betting on deeper reductions. Fed funds futures now imply about a 68% chance of two or more cuts next year, according to CME's FedWatch tool.

- **CHANGES TO ECONOMIC FORECASTS:** *New projections show the median official still expects only one 25 bp cut in 2026, unchanged from September.* The updated dot plot still shows one cut in 2026 and another in 2027, keeping the longer-run rate near 3%, but it also highlights clear divisions within the committee. The committee upgraded its 2026 GDP forecast to 2.3%, half a percentage point above the September estimate, and still expects inflation to stay above the 2% target until 2028. Inflation remains elevated: the Fed's preferred measure showed a 2.8% annual rate in September. Though down sharply from earlier peaks, it remains well above the 2% goal. Inflation is forecast to ease to about 2.4% by year-end and unemployment holds at a moderate 4.4%.
- **ECONOMIC ASSESSMENT:** *September's delayed report showed stronger hiring but unemployment rising to a four-year high of 4.4%, while price pressures firmed despite Trump's tariffs proving less inflationary than expected.* With key federal data still delayed, available indicators suggest little change in the outlook since October: the labor market is cooling gradually and inflation remains elevated. Economic activity continues to grow at a moderate pace, supported by solid consumer spending and business investment, though housing is weak. The government shutdown likely dampened current-quarter growth but should be offset next quarter. Median forecasts now show GDP rising 1.7% this year and 2.3% next year.

  Labor-market evidence points to slower hiring and a modest rise in unemployment to 4.4% in September, reflecting softer demand and slower labor-force growth. The median projection puts unemployment at 4.5% by year-end before easing. A labor market stuck in a low-hiring, low-firing pattern, as employers hesitate to either expand or cut staff. However, unofficial indicators suggest deeper layoffs may be coming, with announced job cuts through November exceeding 1.1 million, according to Challenger, Gray & Christmas.

Inflation has eased from its 2022 peak but is still above target. September data showed headline and core PCE at 2.8%, with goods inflation boosted by tariffs and services disinflation continuing. Inflation expectations have fallen in the near term and remain anchored longer term. The median forecast sees PCE inflation at 2.9% this year, 2.4% next year, and 2% thereafter.

In the near term, inflation risks are skewed upward while employment risks have shifted downward, creating a difficult policy trade-off. Tariff effects on prices are likely to be short-lived, but the Fed must prevent a one-time price jump from turning into persistent inflation. With employment risks increasing in recent months, the balance of risks has changed, and the Committee judged a 25-bps rate cut appropriate as part of a balanced approach to its dual mandate.

- **OUR TAKE:** *The Fed is likely to cut more in 2026*. Given the premises, it is more likely than not that the Fed will cut rates again in 2026, the only questions relate to the timing of the move, and the extent. Will the Fed cut only once in 2026, or more? This will crucially depend on the choice of the next Fed Chair, which is likely to be revealed in coming weeks.
- **MARKET REACTION AND IMPLICATIONS:** *Yields extend decline after the Fed cut rates*. *In the fixed-income space,* 2-year Treasury yield fell to 3.54% from 3.60%. 10-year Treasury yield edged down by 4 bps to 4.15%. *In the currency space,* dollar tumbled to fresh intraday lows after the decision was announced. At the time of writing, the Dollar index trades around 98.6. EUR/USD briefly spiked toward 1.1670 after the expected Fed rate cut, but gains faded following Powell's cautious remarks. *In the equity space,* shortly after the Fed decision, the Dow Jones surged and S&P headed for a record close. The Dow extended its rally after the Fed's third rate cut of the year, climbing 424.79 points, or 0.9%, as Powell spoke. The S&P 500 rose 0.8% to 6894, while the Nasdaq eked out a small gain of under 0.1%.