

December 10th, 2025 • 630.517.7756 • www.ftportfolios.com

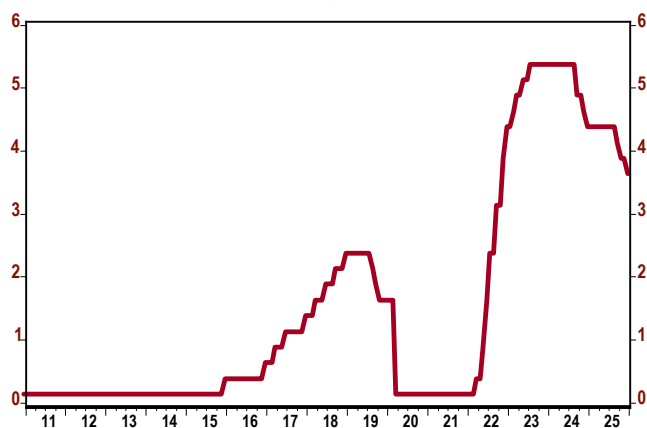
No Risk-Free Path

The Federal Reserve cut rates by another quarter percentage point today, the last meeting of 2025, and maintained its outlook for only one cut in 2026.

Beyond today's rate cut, the Fed statement was little changed from the meeting in October. There was one new section added, in which the Fed – which ended the quantitative tightening process at the last meeting – announced that they will begin making short-term Treasury purchases as needed to maintain ample reserves in the banking system. In the section related to the employment market, text was removed that had previously stated the unemployment rate “remained low” and now simply notes that the unemployment rate has “edged up” from earlier this year. Notably there were three dissents to today's actions, as Fed Governor Stephen Miran voted for a larger 0.5% cut, while Kansas City Fed President Jeffrey Schmidt and Chicago Fed President Austan Goolsbee voted to hold rates steady.

Fed Funds Target Rate

EOP, %



Source: Federal Reserve Board/Haver Analytics

With little forward guidance on Fed thinking in the published statement, focus shifted to today's release of updated economic projections for hints on what the Fed believes is set to come. For 2026, the largest change came in the real GDP forecast, which rose to 2.3% from 1.8% at the September meeting. Meanwhile, the forecast for PCE inflation declined to 2.4% in 2026, from the 2.6% forecast in September, and there was no change to the unemployment rate forecast of 4.4%. Forecasts beyond 2026 were little changed.

Early in the press conference, Chair Powell was asked what led to the more optimistic forecast on the growth front, which would be a notable pickup after a slowing of growth in 2025. Put simply, consumers continue to spend and the rise in business investment in AI and associated data centers has run ahead of expectations, and looks likely to continue to be

strong in the year ahead. This hasn't substantively shifted the employment outlook, as history shows innovations haven't historically resulted in broad job loss, but rather have created new – and often higher-paying – jobs in areas related to the new technology. While some companies have reported job cuts, broader data on unemployment claims are yet to show much reaction from AI deployment to-date.

The question that caught our attention was related to the Fed's announcement around potential Treasury purchases to support banking reserve levels. We believe that quantitative easing and the massive increase in the size of the Fed's balance sheet – moving us from a scarce reserve system to an abundant reserve system, in which the Fed now pays banks hundreds of billions of dollars per year to simply hold the reserves – was a massive mistake, and think the banking system and monetary policy in general would benefit from a return to the system in place before extraordinary measures were taken. The Fed has taken an opposing view, believing that its balance sheet should remain exceptionally large, and argued today that it should probably expand by around 25 billion dollars per month to keep pace with growth in the broader economy. There is a hearing scheduled by the Senate Committee on Homeland Security and Governmental Affairs for tomorrow – at which Brian Wesbury will be testifying – to discuss this very issue, and we hope it shines light on a problem that too few are paying attention to.

Between now and the Fed's next meeting in late January, there will be a plethora of data on both inflation and employment to clear some of the fog that remains from the government shutdown and associated lack of data releases. Given today's comments, we expect the Fed to hold at that meeting, but we also believe that a March cut could be on the table if employment data weakens further. Chair Powell's term ends in May, and regardless of whether he is replaced by National Economic Council head Kevin Hassett or former Fed Governor Kevin Warsh (either would give President Trump a 4-3 majority of appointees), there could be a substantive shift in the tone coming from the Fed with the changing of the guard. From rates to reserves to potential changes to the regional Fed bank system itself, 2026 could be a boisterous year for Fed watchers. We, meanwhile, will be keeping our eyes on what it all means for the M2 money supply, which remains our North Star on inflation.

Brian S. Wesbury, Chief Economist
Robert Stein, Deputy Chief Economist

Text of the Federal Reserve's Statement:

Available indicators suggest that economic activity has been expanding at a moderate pace. Job gains have slowed this

year, and the unemployment rate has edged up through September. More recent indicators are consistent with these developments. Inflation has moved up since earlier in the year and remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook remains elevated. The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment rose in recent months.

In support of its goals and in light of the shift in the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 3-1/2 to 3-3/4 percent. 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 Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of

incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

The Committee judges that reserve balances have declined to ample levels and will initiate purchases of shorter-term Treasury securities as needed to maintain an ample supply of reserves on an ongoing basis.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Philip N. Jefferson; Alberto G. Musalem; and Christopher J. Waller. Voting against this action were Stephen I. Miran, who preferred to lower the target range for the federal funds rate by 1/2 percentage point at this meeting; and Austan D. Goolsbee and Jeffrey R. Schmid, who preferred no change to the target range for the federal funds rate at this meeting.