At the December meeting, the U.S. Federal Reserve Open Market Committee voted by majority to reduce the Fed funds rate by another -0.25% to a new range of 3.50-3.75%. The vote was 9-3, with dissents from members Miran (wanting a -0.50% cut, like last meeting), as well as Goolsbee and Schmid (who each preferred no change).

The formal statement saw hardly any change in language, other than a reference to the unemployment had "remained low" being removed, as it had "edged up." Also included was a notation mentioning the "extent and timing" considerations for "additional adjustments," which has been used in the past for periods where interest in cuts could be fading looking ahead at future months.

A 'hawkish cut' was expected, implying that despite the actual easing itself, language in the statement and/or post-meeting press conference would hint at more hesitancy about further cuts, just to pull in the reins on expectations a bit. The quarterly Summary of Economic Projections (SEP) released by the FOMC for December showed an estimated median year-end 2026 Fed funds rate of 3.4%, 3.1% for 2027 and 2028 (all unchanged from September), and a steady long-term rate estimate of 3.0%. However, the range in dots is wide for the next few years, ranging from 2.0% to 4.0%, showing a continued divergence of views on the committee.

CME Fed funds futures had vacillated between cut and no cut for several weeks, as markets digested both the delayed economic data from the federal government as it slowly reopened, as well as various opinions from FOMC members. As time wore on, higher odds of a cut became clearer as inflation concerns faded in favor of front-running further weakness in the labor market (although even this morning, the odds of a cut today didn't rise above 90%). Also, from a logistics and messaging standpoint, a calendar break between two cuts, as opposed to cutting in consecutive meetings, runs the risk of looking awkward and less committal. For 2026, the highest market odds point to 2 cuts (in June and October) to a year-end rate of 3.00-3.25%. For 2027, through October at least, the highest odds point to no cuts, although chances of a reversal into a rate hike had appeared for a while. That's too far in the future to be overly helpful, but points to a broader assumption that policy rates are expected to stabilize around where the committee pegs the long-term 'neutral' Fed funds rate (at around 3%).

Economy. The Atlanta Fed GDPNow prediction indicator for Q3 came in at a robust 3.8%, following a few weeks of spotty data during the government shutdown. The Fed's December SEP estimated median 2025 real GDP growth at 1.7% (up from 1.6% in September), 2.3% for 2026 (up sharply from 1.8% in Sept.), 2.0% for 2027 (from 1.9%), 1.9% for 2028 (up from 1.8%), and the long-term trend estimate of 1.8%. Considering that data is again flowing, but mostly stale, getting assumptions back on track is a work in progress. A consensus of private sector estimates puts real GDP growth at around 1.5-2.5% for both Q4-2025 and Q1-2026, which doesn't tell us too much, since the midpoint is right around long-term trend. After the back-and-forth in net export data earlier this year convoluting the numbers, estimates have gradually fallen based on tariffs acting as an added tax on consumers and businesses. However, those effects could be offset by a positive fiscal boost and deregulation efforts in 2026.

Inflation. CPI data has also been delayed, with the latest September headline and core (ex-food and energy) CPI each showing a trailing 12-month rise of 3.0%. Core PCE inflation for September came in at 2.8%. The Fed's SEP assumed core PCE of 2.5% for year-end 2026 (down a tenth from the September estimate), 2.1% for 2027, and 2.0% in 2028 (each matching the prior SEP), along with a consistent 2.0% for the longer run, in line with the Fed's policy objective. While overall inflation levels have stabilized, they still run at levels well above the Fed's target. Assumed timelines for getting to target continue to be either pushed out to 2026-27 or perhaps have been unofficially conceded toward a new normal of being somewhere in the 2-3% range—at least for the time being. Being that average U.S. inflation over the last 100 years has been around 3%, with the more recent sub-2% periods being somewhat of an anomaly, there has been some re-thinking by economists about what inflation range is acceptable, and if drifts by a half-percent or percent in either direction are worth worrying too much about as long as they don't veer more extreme.

Employment. The SEP showed an expected unemployment rate of 4.4% for year-end 2026 (unchanged from Sept.), 4.2% for 2027 (down a tenth), and 4.2% for 2028 (unchanged) as well as over the long term. Labor markets have been best described as being in a 'no hiring, no firing' stasis. The premise for a rate cut on labor considerations is based on some signs of some additional layoff activity, the trend of job growth being too low to keep pace with labor supply growth, as well as a slowly rising unemployment rate. (October's employment situation report was canceled, leaving the latest unemployment number at 4.4% for September, which was up from 4.0% in January, after rising a few tenths in 2024.) Employment will no doubt remain closely-watched over the next few months, as conditions seem to be right on the edge of 'ok' and 'not ok.'

Recent FOMC meetings continue to feature robust discussions, with less consensus than in past years, as members search for common ground between above-target inflation and softening employment. That focus has been leaning toward the labor side, hence the votes for easing, but there might not be as many cuts ahead in 2026 as markets initially hoped for. Fewer cuts reduce the extra 'juice' to propel credit and risk assets to the same degree as deeper cuts. Though, the main (positive) takeaway is that the economy and inflation are not falling off a cliff and don't need the extra.

The economy has moved toward what's been described as a 'K-shape,' referring to a split in two divergent directions. Specifically, higher-income households have fared best, as they often do, due to the wealth effects of a rising stock market plus the results of the past few years' worth of robust home price gains (which have since started to flatten out). They are also expected to benefit most from the OBBBA tax legislation, which kicks into full gear in 2026. On the other hand, lower income groups continue to feel the burdens of higher food prices, housing unaffordability, and still-high interest rates on auto and consumer loans. Such conditions generate grass-roots political pressure for relief, and the Fed itself has acknowledged sympathy for these consumers, although the blunt tool of short-term policy interest rates can only do so much in that regard, aside from hoped-for trickle down effects.

Speculation has also swirled around who the next Fed Chair will be in May 2026, with the highest odds now pointing to National Economic Council Director Kevin Hassett. (Other candidates include current Fed Govs. Christopher Waller and Michelle Bowman, former Gov. Kevin Warsh, as well as BlackRock's fixed income head Rick Rieder.) It's assumed that the nominee will be thought of as more dovish than Chair Powell, although it remains to be seen how FOMC group voting would deviate from today. A lean toward lower policy interest rates can be stimulative in the near term by firstly removing the headwinds of tighter policy, promoting spending instead of saving, and, to an indirect degree, impacts on lending for homes, autos, and businesses, although those have closer ties to the intermediate- to longer-term maturities of the U.S. Treasury yield curve. (Longer-term yields have been largely range-bound since the Fed started cutting again in September, with sentiment driven by fiscal policy, the deficit, and overall rising debt levels.) Conventional economists generally realize and warn that rates 'too low' for 'too long,' if economic growth, inflation, or labor don't warrant them, can encourage excess leverage and financial asset speculation, which can be unpleasant to repair if/when they unwind. Such known risks perhaps keep a floor on how low policy rates can fall for the time being.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.