

# MARKET COMMENTARY

The Fed cuts and remains committed to limited further easing.

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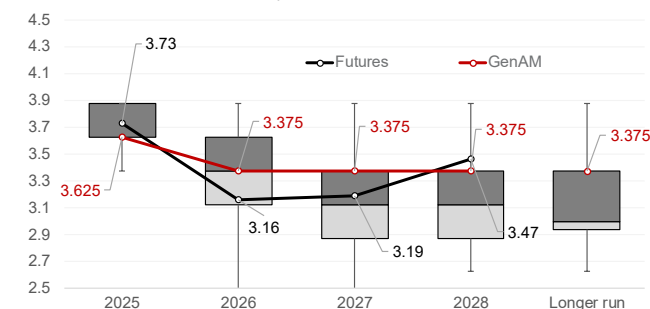
- The widely expected cut faced both hawkish and dovish dissent. The Fed has chosen to stick to the plans outlined in September, i.e. a rate cut in both 2026 and 2027. The outlook for growth and inflation has improved, but not that for the unemployment rate.
- Incomplete data and the tension between upside risks for inflation and downside ones for employment suggest caution, and, with the policy rate now within the neutral range, the Fed sees itself in a good position to respond to possible surprises.
- The Fed will start buying T-bills to keep an ample supply of reserve; it aimed at smoothing the functioning of overnight market and does not represent a change in monetary policy
- We stick to our forecast of another- and final - cut next year, but it may occur later than March, especially if growth picks up in Q1. The market pricing of more than two cuts remains too dovish

The economy remains on a solid footing, but downside risks to employment continues to matter more to the FOMC than upside risk for inflation. Having brought the policy rate at the upper end of the range of neutral estimates, the board can now wait for more data before deciding the extent and pace of further rate cuts. Therefore, the expected path for policy rate has not changed since September: after the cut at the December meeting, it envisages two more 25bps cuts, one next year and one in 2027.

**FOMC "dots" and Fed fund rates forecasts**

Middle of the range.

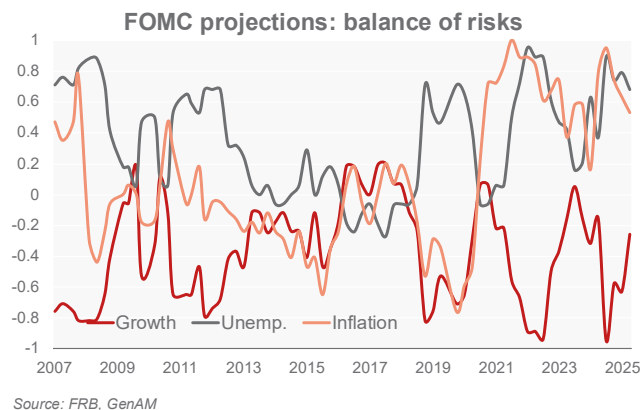
Year-end, median, quartiles and extremes of the distribution



Source: Federal Reserve Board, NY Fed; Datastream, GenAM estimates

The press release contained two small, but significant changes: the unemployment rate is not longer considered “low” and the policy part of the communiqué explicitly stated that the way for rates is down, as the Committee is “considering the extent and timing of additional adjustment”. The FOMC kept and easing bias as it did not expect an improved outlook for growth to do much to employment.

Median Projection					
	2025	2026	2027	2028	Longer run
Change in real GDP	1.7	2.3	2.0	1.9	1.8
Sep. projection	1.6	1.8	1.9	1.8	1.8
Unemployment rate	4.5	4.4	4.2	4.2	4.2
Sep. projection	4.5	4.4	4.3	4.2	4.2
PCE inflation	2.9	2.4	2.1	2.0	2.0
Sep. projection	3.0	2.6	2.1	2.0	2.0
Core PCE inflation	3.0	2.6	2.1	2.0	2.0
Sep. projection	3.1	2.6	2.1	2.0	2.0
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
Sep. projection	3.6	3.4	3.1	3.1	3.0



The decision to cut today was backed by nine out of twelve voting members. The presidents of the Chicago and Kansas City Fed backed no action and, unsurprisingly, governor Miran called for a 50-bps cut. Chair Powell downplayed the importance of this split: the FOMC agrees that risks to inflation are tilted to the upside and those for employment to the downside, what differs is how each member weights these them and on how much further easing is needed. Nobody thinks that the next move will be a hike.

Distribution of the projected year-end Fed funds rate									
Estimate of year-end appropriate rate by each FOMC member, by meeting. Boxed: median									
2025		2026		2027		2028		Long term	
Sep-25	Dec-25	Sep-25	Dec-25	Sep-25	Dec-25	Sep-25	Dec-25	Sep-25	Dec-25
4.38	3.88	3.88	3.88	3.88	3.88	3.88	3.88	3.88	3.88
4.13	3.88	3.88	3.88	3.88	3.88	3.88	3.88	3.75	3.75
4.13	3.88	3.63	3.88	3.63	3.63	3.63	3.63	3.63	3.63
4.13	3.88	3.63	3.63	3.63	3.63	3.63	3.63	3.50	3.50
4.13	3.88	3.63	3.63	3.38	3.38	3.38	3.38	3.38	3.38
4.13	3.88	3.63	3.63	3.38	3.38	3.38	3.38	3.38	3.38
4.13	3.63	3.63	3.63	3.13	3.38	3.13	3.13	3.25	3.25
3.88	3.63	3.63	3.38	3.13	3.13	3.13	3.13	3.13	3.13
3.88	3.63	3.38	3.38	3.13	3.13	3.13	3.13	3.13	3.13
3.63	3.63	3.38	3.38	3.13	3.13	3.13	3.13	3.00	3.00
3.63	3.63	3.13	3.38	3.13	3.13	3.13	3.13	3.00	3.00
3.63	3.63	3.13	3.13	3.13	3.13	2.88	3.13	3.00	3.00
3.63	3.63	3.13	3.13	2.88	2.88	2.88	2.88	2.88	3.00
3.63	3.63	2.88	3.13	2.88	2.88	2.88	2.88	2.75	2.88
3.63	3.63	2.88	2.88	2.88	2.88	2.75	2.75	2.75	2.75
3.63	3.63	2.63	2.88	2.63	2.63	2.63	2.63	2.63	2.63
3.63	3.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63	2.63
2.88	3.38	2.63	2.13	2.38	2.38	2.63	2.63	2.63	2.63

Source: Federal Reserve Board, GenAM

In the Q&A session chair Powell reiterated the quite rosy view of the economy. GDP growth continued to be boosted by consumption and AI related capex, and in 2026 fiscal easing will help activity to accelerate from the current 1.7% growth rate. Labour market has cooled, a bit faster than what the FOMC expected back in September; this reflects both slower labour demand and supply. Powell noted that the current payroll growth estimates are probably inflated, and the final data could see a reduction in the number of employees over the last months. Despite low and stable unemployment claims, the labour market remains fragile as unemployed have a hard time finding another job. The FOMC is confident that the lagged effect of the 75bps cut enacted this year should be enough to stabilize the unemployment rate. Asked about the K-shape of the current expansion, Powell noted that the best the Fed can do to support the less well-off is to deliver a prolonged period of low unemployment, like the that prevailing pre-COVID. This would also prop up real wages, helping offset the past drag from past high inflation.

Inflation eased significantly but remains somehow elevated. From the relatively little information gathered during the shutdown goods prices keep increasing due to tariffs, while in the services sector there is more evidence of disinflation. The Fed is convinced that excess inflation is now concentrated in goods exposed to tariffs: it is reasonable to expect that they will have relatively short lived

impact. It will take a few more months for the effect to materialise in full and inflation is expected to peak in Q1 at around 0.2pp level higher than the current level (2.8% yoy for the core PCE in October, according to the FOMC); then, in the back end of 2026 inflation will decrease strongly as the impact of tariffs on the price level vanishes. But risks remain tilted to the upside, also given the strength of demand.

Powell reiterated that, given the current tension between the inflation and unemployment mandates, there is no risk-free path for policy. But, with today's cut, the Fed sees itself in a good place to react to surprises and can afford to wait and see for more and clearer data. Moreover, he hinted several times at the strong increase in productivity, which is expected to continue as AI usage becomes more widespread: the obvious corollary is that the economy can withstand a higher level of the policy rate.

Finally, the Fed will start buying T-Bills: purchases will amount to around 40bn in the first month, remain high for some time and then decline. The sole purpose of the program is to maintain ample reserve in the face of increasing demand, to ensure a smooth transmission of monetary policy. Powell was careful in noting that the move has no implications for the monetary policy stance.

Our forecast of another rate cut next year is in line with what expected by the Fed, but we think that easing will stop there. What we may reconsider is its timing and push it back toward mid-year. The pick-up in activity expected for Q1 may reduce the worries about the labour market, allowing the Fed more time to assess the situation. Before the meeting markets were still expecting more than two cuts next year.

The December meeting contained no real surprises, markets took relief at the hawkish stance, with the S&P up 0.8% and the two-year yield down by 7bps.

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