December 10, 2025

Federal Reserve cuts interest rates 0.25% and increases growth projections for 2026

Key takeaways

- The U.S. Federal Reserve reduced its policy interest rate by 0.25% to a range of 3.50%-3.75%, as expected, and signaled a measured approach to future policy changes.
- Economic growth and inflation forecasts for 2026 improved, supporting a constructive market outlook.
- Global central banks continue to ease policy, boosting liquidity and supporting diversified investment strategies.

The Federal Reserve (Fed) lowered its target federal funds interest rate by 0.25%, setting the new range at 3.50%-3.75%. Investors anticipated this move, and most voting members supported it, though three dissented — one favored a 0.50% cut while two preferred no change. The Fed committee members' updated projections now point to stronger economic growth and lower inflation forecasts for 2026 relative to September, with a median expectation of one rate cut in next year, while investors expect two.

Chairman Jerome Powell, whose term expires in May 2026, emphasized that future policy decisions will be data dependent, reinforcing his earlier message in November that the path forward is "far from" a foregone conclusion. The Fed previously cut rates 1% in 2024's second half and 0.75% in 2025's second half.

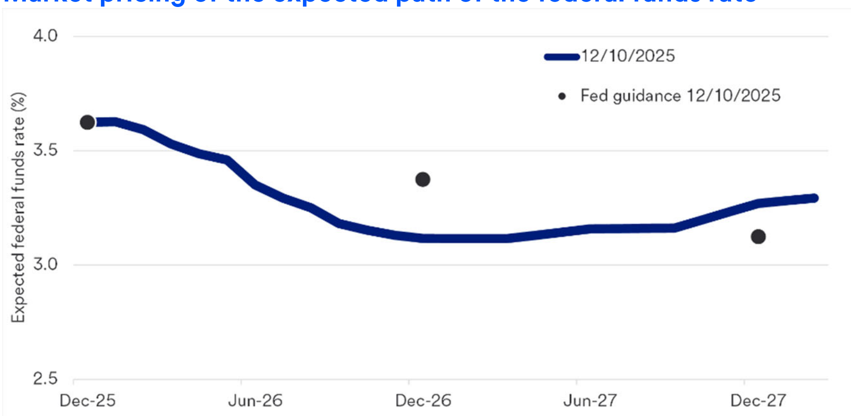
Policy rates had been somewhat restrictive, meaning high enough to moderate economic activity and reduce inflation. Softer labor market data contributed to recent policy rate reductions. Powell highlighted today that recent interest rate adjustments, "bring our policy within a broad range of estimates of neutral," indicating the Committee perceives a higher bar for additional rate cuts in coming months.

The Fed's official statement changed little compared to the October statement, but its updated Summary of Economic Projections highlights growing optimism around the economic outlook. Members' median economic growth projection in 2026 rose to 2.3%, up from September's 1.8% median. Core personal consumption expenditures (core PCE) projections, the Fed's preferred inflation gauge, fell to 2.5% in 2026 from 2.6%. Unemployment rate projections for 2026 remained at 4.4%, consistent with recent readings.

Aggressive rate hikes from early 2022 to mid-2023 helped bring Core PCE inflation down from a peak above 5.5% year-over-year in 2022 to 2.8% by August. During the press conference, Powell said, "Inflation from core goods should peak in the first quarter" from tariff impacts, with inflation easing in the back half of 2026. We anticipate shelter costs, which comprise a large share of inflation indexes, should continue decelerating, allowing for additional rate cuts in 2026.

On December 1, the Fed stopped shrinking its $6.2 trillion in current bond holdings, which peaked at $8.5 trillion in 2022 before they allowed some bonds to mature without replacement each month through November 2025. The Fed will now buy short-term Treasury bills to ensure ample banking system reserves and keep short-term interest rates near its intended policy rate. Fed balance sheet expansion via announced Treasury bill purchases improves market liquidity, since investors will not need to absorb the incremental supply of bonds. Liquidity refers to the amount of money readily available to buy goods, services and financial assets in an economy. Strong liquidity can also provide cushion against unforeseen financial market shocks, and liquidity measures remain constructive for now.

Market pricing of the expected path of the federal funds rate

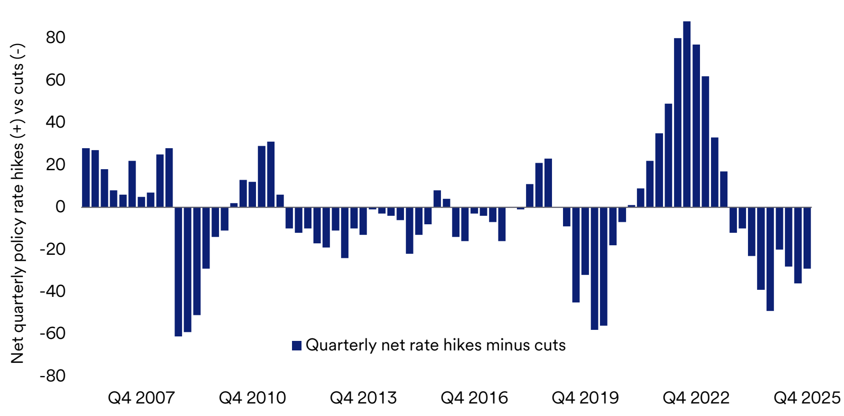


Sources: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg, 12/10/2025.

Stocks and bonds responded positively to the Fed's decision. Large stocks, represented by the S&P 500, rose 0.67%. Small stocks, which can be more sensitive to interest rates, rose 1.3%, represented by the Russell 2000 Index. Ten-year Treasury bond yields fell 0.04% to 4.15%, while two-year Treasury yields fell 0.07% to 3.54%.

Globally, central banks have eased policy this year: the European Central Bank and the Bank of Canada cut rates by 1.00%, while the Bank of England and Reserve Bank of Australia cut by 0.75%.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Sources: U.S. Bank Asset Management Group Research, FactSet, 4/1/2006-12/10/2025.

We maintain a constructive outlook for diversified portfolios, with opportunities in growth-oriented allocations including globally diversified stocks, global infrastructure and structured credit. Consumer spending and corporate earnings growth remain resilient, aided by lower policy interest rates and supportive fiscal policy in the form of lower corporate and individual taxes. Modest tariff-related price increases remain a factor, albeit less than many economists anticipated. Labor markets have softened in recent months, increasing the importance of monitoring metrics including job creation and layoff announcements. We will keep you informed of our views as new data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.