

Special Coverage:

Fed likely moving to a hold after its December cut as FOMC is split

Key takeaways

- ◆ The Fed delivered a 0.25% rate cut as expected, lowering the target range to 3.50–3.75%. It also introduced reserve-management purchases of short-term instruments, which will begin with roughly USD40bn in Treasury bills but they are not QE (quantitative easing) and carry no implications for the policy stance. The 'DOTS' chart with Fed members' views of the future rate path was little changed, with continued wide dispersion in views.
- ◆ We continue to expect the policy rate to remain unchanged through 2026–27, with meaningful two-sided risks as the economy transitions into 2026. The economic projections show stronger growth and lower inflation, with a notable mechanical rebound in 2026 GDP following the shutdown.
- ◆ The policy rate cut is accretive to corporate earnings and should help keep valuations in check. Technology, AI, and productivity-linked sectors stand to benefit from lower real yields and improving macro conditions. The cut is also positive for rate-sensitive sectors and companies benefitting from AI-driven investment and the ongoing US re-industrialisation trend. Even if the Fed does not cut any further and P/E multiples stagnate, equities can do well as the underlying economy remains robust with corporate earnings projected to grow by roughly 14.5% in 2026. For fixed income, the Fed's monitoring of inflation and the continued decline in inflation expectations provide a supportive backdrop, while the USD could see short-term downside before a more lasting base is formed during Q1 2026.



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What happened?

- The Federal Reserve lowered the federal funds rate by 0.25% at its December meeting, bringing the target range down to 3.50%–3.75% and marking its third consecutive rate cut of 2025. The decision passed after a 9-3 vote, with two policymakers preferring to hold rates steady while one in favour of a 0.50% cut. Chair Powell noted that with this latest cut, policy is now “within a broad range of plausible estimates of neutral,” reinforcing the Committee's ability to pause and assess how the economy evolves.
- In addition, the Fed announced the start of reserve-management purchases, where it will begin purchasing US Treasury bills starting 12 December, with roughly USD40 billion scheduled over the next 30 days. Powell emphasised that these purchases are strictly technical operations aimed at maintaining ample reserves and are not intended to ease financial conditions or signal a shift towards quantitative easing.
- The December statement removed its previous reference to the unemployment rate having “remained low,” potentially acknowledging that unemployment has edged up and that downside risks to employment have increased.
- In a key signalling change, the Fed reinstated the phrase “the extent and timing of additional adjustments” to policy. Historically, this language has appeared when the Committee wants to avoid committing to a preset path of rate moves, typically when preparing for a pause.
- The Fed also formally suggested that reserve balances have declined to ‘sufficient’ levels, prompting it to initiate purchases of shorter-term Treasuries to maintain those balances. The earlier reference to concluding the reduction of securities holdings was removed.

- The Summary of Economic Projections (SEP) indicated an environment with stronger growth, lower inflation, and a steady policy-rate path. The most striking revision was the significant upgrade to the 2026 growth forecast, which reflects “mechanical” effects from the recent government shutdown with temporarily depressed Q4 activity expected to reverse in early 2026. Policymakers now expect real GDP to rise 2.3%, up from 1.8% in September. Growth forecasts for 2027 and 2028 were also nudged slightly higher.
- On inflation, Powell highlighted that while price pressures have fallen from their mid-2022 peaks, inflation remains “somewhat elevated.” Both headline and core PCE inflation rose 2.8% over the twelve months ending in September. Goods inflation has risen recently due to tariff effects, while disinflation continues in the services sector. He reiterated that most measures of long-term inflation expectations remain well anchored at around 2.0%.
- Powell described economic activity as expanding at a moderate pace, supported by solid consumer spending and continued business investment. The labour market continues to cool, with available evidence showing hiring and layoffs remain low. He also emphasised that AI-induced disruptions have not yet appeared in labour-market data, suggesting that the recent softening in labour conditions is cyclical rather than the result of technological displacement. He framed AI as a legitimate and expanding source of corporate investment and medium-term productivity potential.
- The updated dot plot highlighted a notable divergence of views within the Committee. While the median policy path remained unchanged from September, implying a federal funds rate of 3.6% at end-2025, 3.4% at end-2026, and 3.1% in both 2027 and 2028, the underlying distribution widened meaningfully. Six participants projected that the appropriate rate at year-end 2025 was the pre-meeting level of 3.75%, consistent with those who would have preferred no cut at the December meeting. For 2026, the full range of projections ran from roughly 2.125% to 3.875%, underscoring the uncertainty around the speed and timing of future easing.
- Currently the market is pricing in two rate cuts for 2026 while we still believe that the FOMC will keep the federal funds target range unchanged at 3.50-3.75% through 2026 and 2027.

Investment implications

- The combination of lower policy rates and the end of QT provides a more supportive financial backdrop for risk assets. Lower policy rates are accretive to corporate earnings and should help keep valuations in check. Technology, AI, and productivity-linked sectors stand to benefit from lower real yields and improving macro conditions. We remain overweight on US equities and diversify sector exposure with Industrials and Utilities, which are the clear beneficiaries of the AI trade. Meanwhile, Financials can provide style diversification to growth-heavy portfolios. Lower long-term rates also support rate-sensitive sectors and companies benefitting from AI-driven investment and the ongoing US re-industrialisation trend. Importantly, we believe markets do not require the Fed to continue easing aggressively next year, as the underlying economy remains robust with corporate earnings projected to grow by roughly 14.5% in 2026.
- For fixed income, the Fed’s monitoring of inflation and the continued decline in inflation expectations are supportive. We prefer US investment grade bonds with medium duration but remain cautious on high yield.
- The US dollar could see short-term downside before a more lasting base is formed during Q1 2026 as activity remains resilient. Historically, USD has softened when the Fed cuts rates ; markets may also continue to speculate about more cuts with a new Fed Chair set to arrive. Questions about Fed independence may also foster some additional USD weakness.
- A data-dependent Fed, moderating inflation, and resilient earnings create a favourable macro environment for diversified multi-asset portfolios across quality credit and equities, as well as AI-linked productivity themes.

Median of the FOMC economic projections: December 2025

Variable %	Median				
	2025	2026	2027	2028	Longer run
Change in real GDP	1.7	2.3	2.0	1.9	1.8
September projection	1.6	1.8	1.9	1.8	1.8
Unemployment rate	4.5	4.4	4.2	4.2	4.2
September projection	4.5	4.4	4.3	4.2	4.2
PCE inflation	2.9	2.4	2.1	2.0	2.0
September projection	3.0	2.6	2.1	2.0	2.0
Core PCE inflation	3.0	2.5	2.1	2.0	
September projection	3.1	2.6	2.1	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
September projection	3.6	3.4	3.1	3.1	3.0

Source: Federal Reserve, HSBC Private Bank and Premier Wealth as at 10 December 2025. Forecasts are subject to change.

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