December 12, 2025

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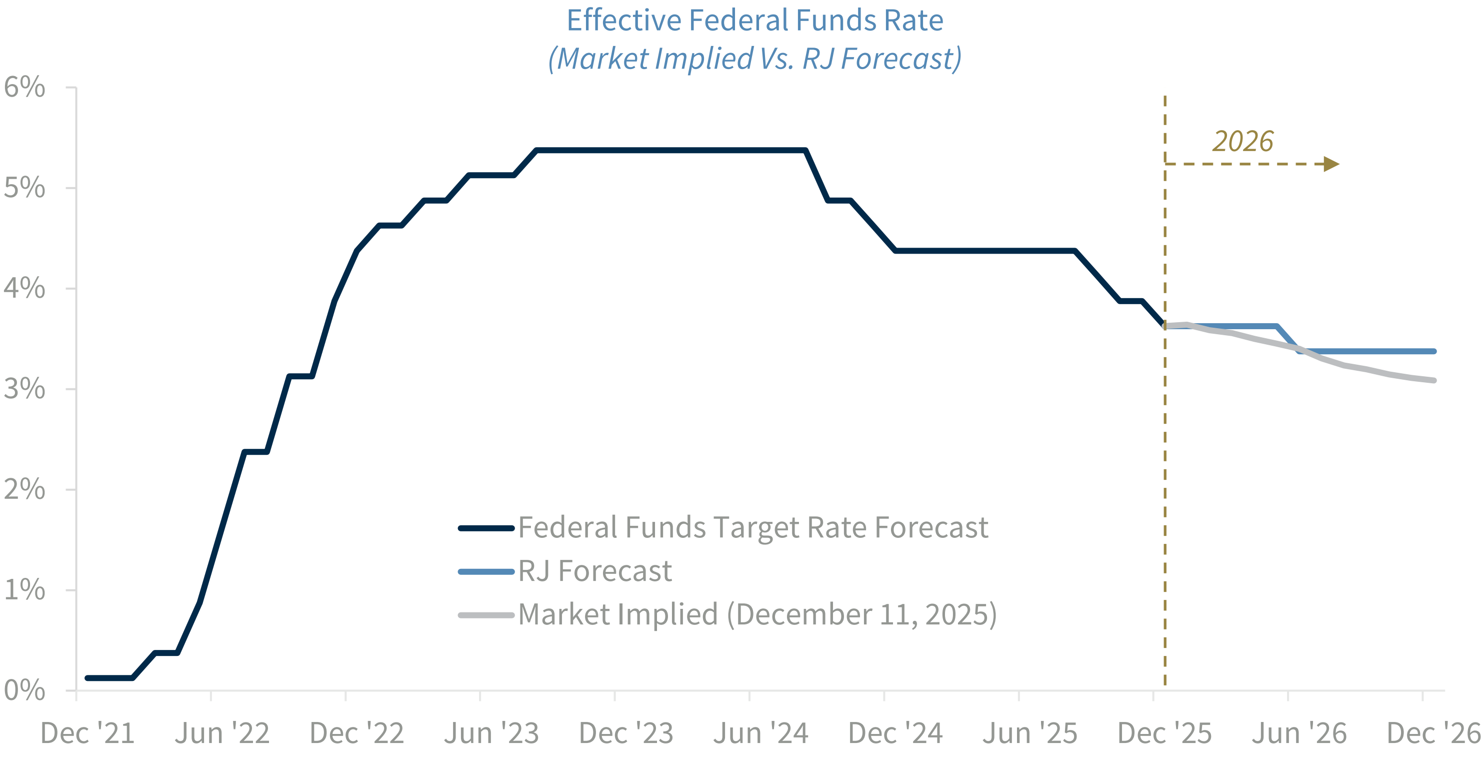
THOUGHTS OF THE WEEK

Consensus Is Great; Dissent Is Even Better!

This week, the Federal Reserve's (Fed) Federal Open Market Committee (FOMC) delivered another 25 basis point reduction in the federal funds rate in what some called a "hawkish" cut. The argument for it being a hawkish cut was because out of the three members who dissented, two of those members dissented because they wanted no cuts during the meeting. The third dissenter was highly dovish and wanted a 50 basis point cut rather than a 25 basis point cut.



Source: FactSet, RJ Economics

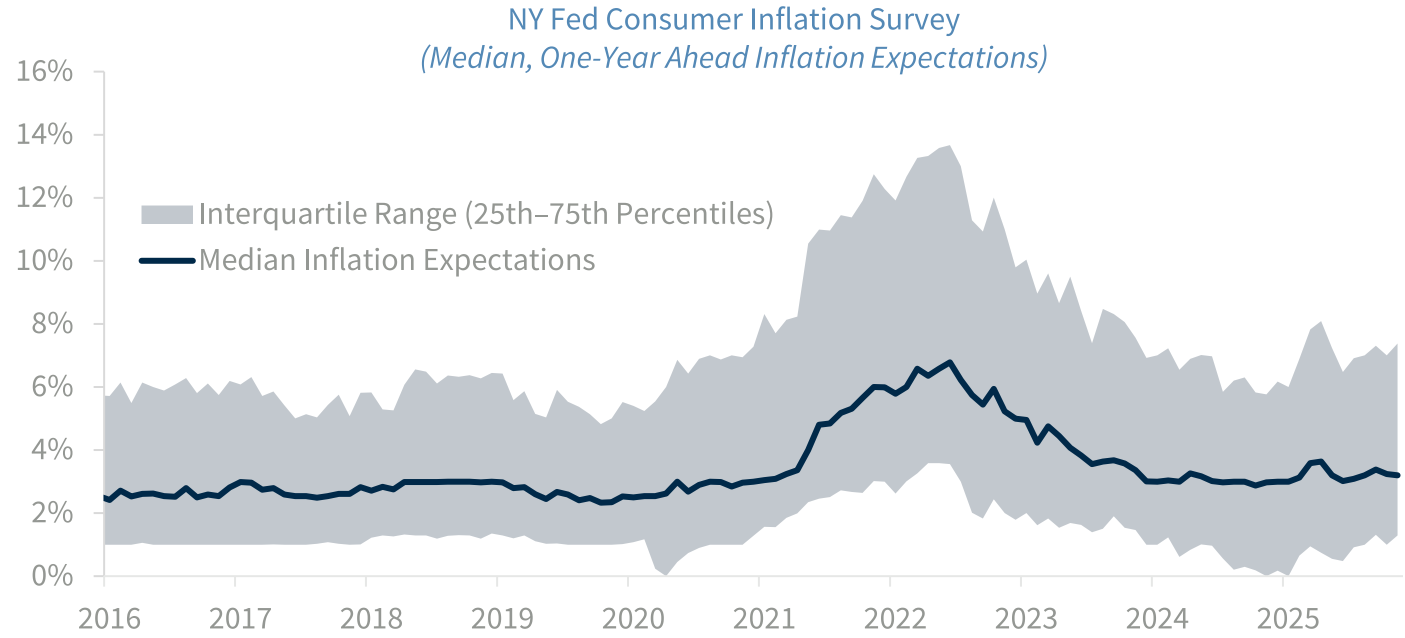
Many times, criticism of the Fed has come associated with the argument that it is "a good friend's club" exposing a "group think mentality." However, nothing could be further from the truth with this group. Anybody that knows how economists think knows that they are always accused of being two handed, that is, "on the one hand and on the second hand." There have been cases when we have encountered three or even four handed economists, so nothing is farthest from the truth that Fed officials are suffering from some sort of group think in their monetary policy decisions.

Furthermore, achieving consensus at the FOMC level is not the same thing as steadfast agreement on the decisions the committee makes, it is just a negotiated consensus after considering all of the alternatives. Thus, when that consensus is broken, it is not because the institution is broken, it is because the institution is working as it is intended to work.

We favored a rate cut at this time. However, we realize that a very good case could have been made, from a monetary policy as well as an economic point of view, for no cuts or even higher rates, although the latter alternative had a very, very, high bar, as the Chairman of the Fed seems to have alluded to during the press conference after the FOMC decision.

In fact, we believe that Fed officials finally decided to go ahead with a rate cut as a way to buy time to get a better reading on economic activity after the delay in data releases due to the government shutdown. However, it is clear that there was an important lack of conviction that a rate cut was really needed at this time, which is why two dissenters opted for no cut in rates during the meeting.

For the majority of FOMC members, they were probably indifferent between cutting by 25 basis points or keeping rates steady, as long as markets kept upward pressure on longer term rates, as it has been the case since September of 2024, when the cycle started. Meanwhile, those preferring to keep rates unchanged were probably more concerned with inflation expectations being affected by the political pressure coming from the Trump administration to lower rates more forcefully.



Source: FactSet, RJ Economics

Going forward, although FOMC members left the door open for another 25 basis point cut during 2026, the bar to proceed with such a cut is very, very high and would require a severe deterioration in the labor market, which is not part of our forecast nor is it embedded in the Fed forecast.

At the same time, the dissents prove that no matter who is chosen to become the new Chairman of the Fed, the institution will maintain its policy independence as long as political pressures do not threaten how the institution works. If we see further intervention in the Fed decision making process coming from the political system, then all bets are off and the risks for higher inflation will skyrocket.

That is, although much lower interest rates are good in many circumstances, this is not one of those many circumstances. Inflation is still not securely heading towards the Fed 2% long run target and we are probably going to see some more tariff induced price increases during 2026. Once these tariff effects subside, then the Fed will probably resume their search for the long term federal funds rate, which they estimate to be close to 3.0%.

Forecast Table

	Actual						Forecast										Actual		Forecast		
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	1Q27	2Q27	3Q27	4Q27	2023	2024	2025	2026	2027
Real Gross Domestic Product [1]	**1.6**	**3.0**	**3.3**	**1.9**	**-0.6**	**3.8**	**2.7**	**0.2**	**2.4**	**2.7**	**2.6**	**2.4**	**2.4**	**2.1**	**2.1**	**2.3**	**2.9**	**2.8**	**1.8**	**2.2**	**2.3**
Real Gross Domestic Product [2]	2.9	3.1	2.8	2.4	2.0	2.1	1.9	1.5	2.3	2.0	2.0	2.5	2.5	2.4	2.2	2.2	2.9	2.5			
Consumer Price Index [2]	**3.2**	**3.2**	**2.7**	**2.7**	**2.7**	**2.4**	**2.9**	**3.0**	**2.7**	**2.8**	**3.0**	**3.0**	**2.7**	**2.5**	**2.3**	**2.3**	**4.1**	**3.0**	**2.8**	**2.9**	**2.4**
Ex-food & energy [2]	3.8	3.4	3.3	3.3	3.1	2.8	3.1	3.1	2.8	2.8	2.8	2.7	2.6	2.5	2.2	2.1	4.8	3.4	3.0	2.8	2.4
PCE Price Index [2]	**2.8**	**2.7**	**2.4**	**2.6**	**2.6**	**2.4**	**2.7**	**2.8**	**2.7**	**2.8**	**2.7**	**2.6**	**2.4**	**2.3**	**2.3**	**2.2**	**3.8**	**2.6**	**2.6**	**2.7**	**2.3**
Ex-food & energy [2]	3.1	2.8	2.8	3.0	2.8	2.7	2.9	2.9	2.7	2.7	2.6	2.5	2.4	2.3	2.2	2.1	4.2	2.9	2.8	2.6	2.2
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.1**	**4.1**	**4.2**	**4.3**	**4.4**	**4.5**	**4.4**	**4.3**	**4.3**	**4.3**	**4.3**	**4.3**	**4.3**	**3.6**	**4.0**	**4.3**	**4.4**	**4.3**
Fed Funds Rate [3]	4.00	5.50	5.00	4.50	4.50	4.50	4.25	3.75	3.75	3.50	3.50	3.50	3.50	3.25	3.25	3.25	5.1	5.1	4.3	3.6	3.3

[1] Annualized Quarter-Over-Quarter Growth
[2] Year-Over-Year SA Percentage Change
[3] Upper Bound of the Federal Funds Target Range

Economic Releases

JOLTS: Although job openings were unchanged in October compared to September at 7.7 million, they were higher than the 7.2 million recorded in August. The hires, separations, and quits rates were all lower in October than in September. However, we caution that these numbers are probably going to experience large revisions due to the fact that September estimates were made with partial information collected during the government shutdown. As expected, the level and the rate of quits in the federal government were the highest in September as the majority of government workers ended their careers after accepting early retirement or the ‘Fork in the Road’ program. Job openings in October were basically unchanged from September, at 7.7 million, according to the Bureau of Labor Statistics, which indicated that the September estimate was constructed with partial information submitted during the government shutdown plus information received in November. The hires rate was lower in October, at 3.2% compared to 3.4% in September, while the total separations rate was also lower, at 3.2% compared to 3.3% in September. The quits rate was also lower in October at 1.8% after increasing to 2.0% in September. The quits rate in September for federal government employees was 1.6%, or a level of 46,000, the highest level recorded. September job openings estimates were constructed with partial information submitted during the government shutdown plus information received in November, according to the release. Thus, September numbers should be taken with caution.”

Employment Cost Index: The ECI increased by less than expected during the third quarter of the year, up just 0.8%, quarter-over-quarter, and 3.5% compared to a year earlier. However, the release indicated that the government shutdown affected the response rate of the survey, which may indicate that these results could experience higher revisions than usual. Nevertheless, this is good news for today’s Federal Reserve (Fed) decision on rates because these numbers reinforce the Fed Chairman’s argument over the last year that labor costs, so far, are not behind the recent increase in inflation. The Employment Cost Index (ECI) increased by a less than expected 0.8% during the third quarter of the year, at a seasonally adjusted, quarter-over-quarter rate, according to the Bureau of Labor Statistics. Wages and salaries, as well as benefit costs, increased at the same rate, 0.8% compared to the quarter ending in June. The ECI was also lower than expected on a year-over-year basis, up just 3.5% compared to the third quarter of last year, according to the release. Compensation costs for private industry workers increased by 3.5% on a year-over-year basis, as wages and salaries increased by 3.6% while benefit costs increased by 3.5%. In real terms, wages and salaries increased by just 0.6% compared to the previous year. Compensation costs for state and local government workers increased by 3.6% year-over-year as wages and salaries increased by 3.5% while benefit costs increased by 3.8%. In real terms, wages and salaries increased by 0.5% compared to a year earlier. The release indicated that “Collection of September data had not been completed before the federal government shutdown. After funding had been restored, any data self-reported by establishments during the shutdown were reviewed and included; however, survey response rates decreased in September.

Trade Balance: The trade balance in goods was significantly lower than expected in September, marking the lowest level since June 2020, when the US economy was in the midst of the COVID-19 pandemic. Exports increased by 3.0%, month-on-month, while imports increased by 0.6%. Once again, trade in nonmonetary gold was very strong, with exports surging by $6.1 billion. On the imports side, imports of pharmaceutical preparations surged by $12.9 billion while capital goods imports declined considerably. This lower than expected increase in the deficit will probably push higher estimates for real GDP during the third quarter. The trade balance in goods and services was much lower than expected in September, at $52.8 billion compared to a deficit of $59.3 billion in August, according to the US Census Bureau and the US Bureau of Economic Analysis. Exports of goods and services were $289.3 billion or up 3.0% compared to August while imports of goods and services were $342.1 billion, or up 0.6%. Exports of goods on a Census basis were up $8.8 billion during the month of September as exports of industrial supplies and materials increased $7.2 billion. Most of this increase was due to an increase of exports of nonmonetary gold, up $6.1 billion during the month. Exports of consumer goods increased by $4.1 billion as exports of pharmaceutical preparations increased by $3.1 billion. However, exports of capital goods declined by $3.3 billion as exports of computers declined by $2.3 billion. Imports of goods on a Census basis increased by $1.7 billion as imports of consumer goods increased by $10.2 billion due to a surge of $12.9 billion in imports of pharmaceutical preparations while imports of industrial supplies and materials were up by less than $0.1 billion. Imports of capital goods declined by $5.6 billion as imports of computers declined by $4.7 billion while imports of electric apparatus declined by $1.5 billion. This was the lowest trade deficit in goods and services since June of 2020, when the US economy was in the midst of the COVID pandemic.

Economic Releases

FOMC Meeting: The Federal Reserve's FOMC delivered what markets have been expecting, lowering the federal funds rate by 25 basis points to 3.50% to 3.75% while the dot plot indicated that it is looking for only one more rate cut next year, unchanged from what the dot plot in September of this year. Although today's decision looked more hawkish because there were three dissenters, one wanting a 50 basis point reduction, two members wanted no change in the federal funds rate, one more than during the September meeting. This was the first time we had three members dissenting in six years. Because two of the dissenters advocated for no cuts, this rate cut looks a bit more hawkish than the rate cut in September. Our view is that, although the dot plot shows one cut next year, the path to that cut will be data dependent. As expected, the Federal Open Market Committee (FOMC) of the Federal Reserve (Fed) decided to lower the federal funds rate by 25 basis points, to 3.50% to 3.75%. The decision from the committee was not unanimous, as expected, with Stephen I Miran preferring a 50 basis points cut, while Austan D Goolsbee joined Jeffrey R. Schmid, preferring no change in rates at this time. The median dot plot for the federal funds rate during the next several years remained unchanged, while the longer-term federal funds rate also stayed at 3.0%. For next year, the dot plot still expects one rate cut and another rate cut in 2027, also unchanged from the September dot plot. On real GDP growth, the FOMC Summary of Economic (SEP) projections increased to 1.7% during this release, compared to 1.6% in the September SEP. Real economic growth next year increased to 2.3% compared to 1.8% in the September SEP. The rate of unemployment remained unchanged for 2026, at 4.4% while the rate of unemployment in 2027 was lowered to 4.2%. The headline PCE price index for 2025 was lowered to 2.9% during this SEP compared to 3.0% during September's SEP, while the headline PCE price index for 2026 was lowered to 2.4% compared to 2.6% in the September SEP. The rest of the years were left unchanged, at 2.1% in 2027 and 2.0% in 2028. The core PCE price index was also lowered, to 3.0% in 2025 from a rate of 3.1% in September SEP, while the 2026 rate was lowered to 2.5% from 2.6%. The core PCE price index for 2027 and 2028 were unchanged, at 2.1% and 2.0%.

Press Conference Commentary by Chairman Powell

- Economic activity expanding at a moderate pace
- Consumer demand showed relative strength
- However, the housing market is struggling
- Inflation on goods has increased due to the effects of tariffs
- Risks to inflation are tilted to the upside while risks for employment are tilted to the downside
- The balance of risks has shifted, with the Fed putting more weight on the employment side of the mandate
- The baseline, due to high investment in AI, is for solid economic growth. This is the reason why the SEP has higher economic growth for next year
- We have to be careful with data on CPI, or the Household Survey, etc., will need to be looked at more carefully because of the government shutdown, which has affected the reliability of some of the surveys
- The Chairman said that no member showed an inclination to raise rates, just no cuts or fewer cuts over the next years
- Gradual cooling of the labor market has continued, so that's why we are putting more emphasis on the employment side of our mandate
- Services inflation coming down while goods inflation has picked up because of tariffs
- The Fed also indicated that it would restart its purchases of Treasury securities as the Chairman indicated that "we need to keep ample reserves in the system."

Disclosures

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers’ confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

Employment cost Index: The Employment Cost Index (ECI) measures the change in the hourly labor cost to employers over time. The ECI uses a fixed “basket” of labor to produce a pure cost change, free from the effects of workers moving between occupations and industries and includes both the cost of wages and salaries and the cost of benefits.

US Dollar Index: The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA HPI is a broad measure of the movement of single-family house prices. The FHFA HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties.

Disclosures

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

The ISM Manufacturing Index: The GDP Now Institute of Supply Management (ISM) Manufacturing Measures the health of the manufacturing sector by surveying purchasing managers at manufacturing firms. The survey asks about current business conditions and expectations for the future, including new orders, inventories, employment, and deliveries.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Source: FactSet, data as of 12/12/2025

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