

US ECONOMICS ANALYST

December FOMC Preview: Raising the Bar for Further Cuts

- The FOMC is widely expected to deliver a third consecutive 25bp interest rate cut to 3.5-3.75% at what will likely be a contentious December meeting next week.
- The case for a cut is solid, in our view. Job growth remains too low to keep up with labor supply growth, the unemployment rate has risen for three months in a row to 4.4%, other measures of labor market tightness have weakened more on average, and some alternative data measures of layoffs have begun to rise recently, presenting a new and potentially more serious downside risk.
- Most investors expect a hawkish cut, though this could be interpreted in a number of ways. It is not realistic to expect the FOMC to box itself in too much by signaling a very strong bias toward a pause in January because if the labor market is still actively softening at that point, a cut might be appropriate. In fact, participants will be even more uncertain than usual about what will be appropriate at the next meeting because we are now two employment reports behind schedule.
- But the meeting will likely have a few hawkish elements. First, the statement will likely borrow the “extent and timing of additional adjustments” language used a year ago to convey that the bar for any further cuts will be somewhat higher. Second, Powell will also likely get across that the bar has risen in his press conference and will likely again make a point of explaining the views of participants who opposed a cut. Third, there will most likely be two hawkish dissents in the statement, and we expect five participants to register soft dissents in their 2025 dots. But we are not sure that all of this would add up to meaningful new information for the market.
- In the Summary of Economic Projections, we expect the median GDP growth forecast to rise for 2025 (+0.4pp to 2%) and 2026 (+0.2pp to 2%) and the median core PCE inflation forecast to decline by 0.1pp to 3% for 2025 and 2.5% for 2026, above our 2026 forecast of 2.2%. We expect the dots to show one cut in 2026 to 3.375% and one more in 2027 to 3.125%, as in September.
- Looking ahead to 2026, we expect GDP growth to pick up somewhat as the tariff drag gives way to a fiscal boost, which should be enough to stabilize the labor market. But we see this as the greatest uncertainty and the most important question for 2026: Will somewhat firmer growth really be enough to stabilize a labor market where job growth outside of healthcare has been running negative

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recently and companies are increasingly focused on using AI to cut labor costs?

- If the labor market does stabilize and inflation continues to fall to just over 2% as we expect, then the FOMC would likely shift from risk management mode to normalization mode next year. Participants will likely have a range of views on the appropriate terminal rate, and we expect them to meet in the middle by delivering two more 25bp cuts to 3-3.25%. On a probability-weighted basis, our Fed forecast remains more dovish than market pricing.

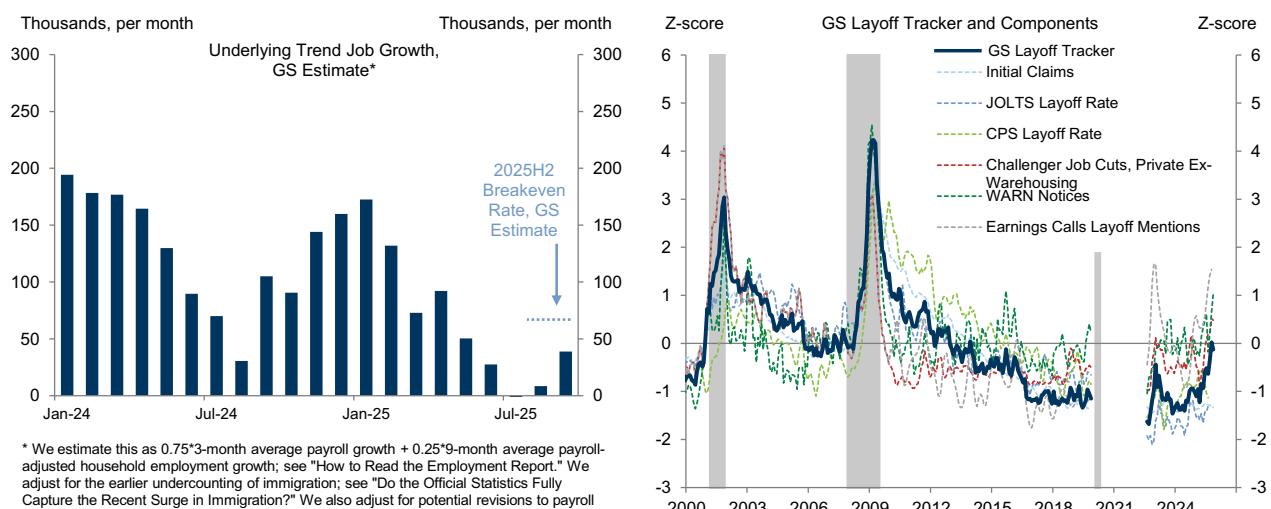
December FOMC Preview: Raising the Bar for Further Cuts

The FOMC is widely expected to deliver a third consecutive 25bp interest rate cut to 3.5-3.75% at its December meeting. Many FOMC participants expressed skepticism about the case for a third cut during the intermeeting meeting, as noted in our FOMC Chatterbox, and the meeting will likely be contentious.

A Solid Case for a Third Cut

But the case for a cut is solid, in our view. The original rationale for the first cut in September remains—our estimate of underlying trend monthly job growth at about 40k remains a bit too low to keep up with our estimate of trend labor supply growth at around 70k (Exhibit 1, left). In addition, hints of a new and potentially more serious downside risk have emerged during the intermeeting period as some alternative data-based measures of layoffs have begun to increase (Exhibit 1, right).

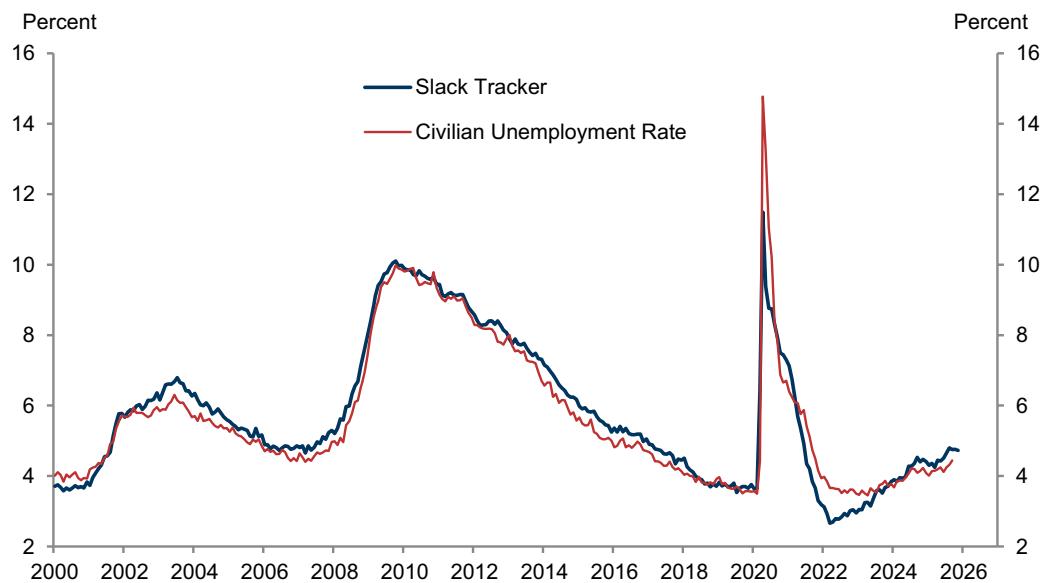
Exhibit 1: We Estimate That Underlying Trend Monthly Job Growth Has Fallen to 40k, Below Our 70k Estimate of the Breakeven Rate, and Recent Alternative Data Also Point to a New Risk of Rising Layoffs



Source: Goldman Sachs Global Investment Research, Department of Labor, Department of Commerce, Challenger

The unemployment rate also rose by 0.1pp for a third consecutive month in September to 4.4%. While this is fairly low by historical or international standards, it is noticeably higher than the 3.7% average in 2019 and it is threatening to trend higher still. Moreover, our broader slack tracker—a composite of sixteen official and alternative measures of labor market tightness—has weakened more significantly and suggests that the labor market is a bit softer than the unemployment rate implies (Exhibit 2).

Exhibit 2: The Unemployment Rate Has Now Risen for Three Months in a Row to 4.4%, and Our Broader Slack Tracker Suggests That the Labor Market Is a Bit Softer Than the Unemployment Rate Implies

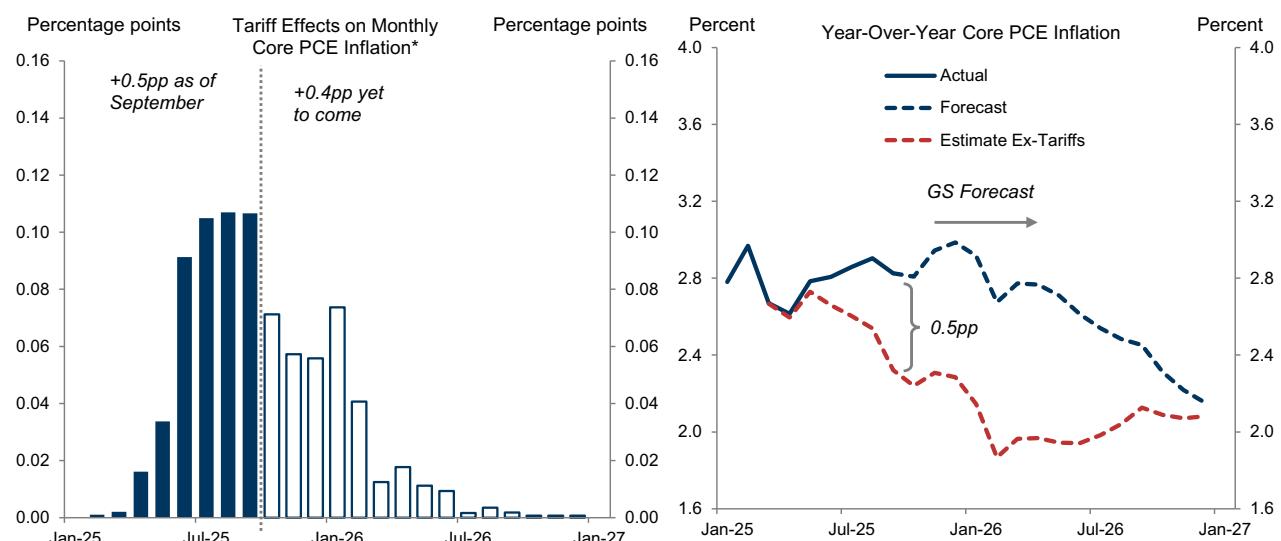


Source: Goldman Sachs Global Investment Research, Department of Labor

Meanwhile, inflation risk has continued to recede. There are now several estimates available of the cumulative impact of tariffs on year-on-year inflation so far—our own at 0.5pp as well as similar to slightly larger estimates from the Fed Board staff, [St. Louis Fed economists](#), and the [Harvard Pricing Lab](#). This implies that core PCE inflation net of tariffs effects has trended lower this year to roughly 2.3%.

We expect core inflation net of tariff effects to reach 2% by the first half of 2026 as labor market rebalancing and the fading of catch-up inflation provide a modest further disinflationary dividend. And we now expect only a tiny further increase in the effective tariff rate next year, so that even the official core PCE inflation rate inclusive of tariff effects is likely to reach 2.2% by the end of 2026.

Exhibit 3: We Estimate That Core PCE Inflation Net of a 0.5pp Tariff Effect Is Now Just 2.3% Year-on-Year and Expect Even the Official Measure Inclusive of Tariff Effects to Fall to 2.2% by the End of 2026



*Our baseline assumes the passthrough to core consumer prices will rise from 60% after 7 months to 70% after 10 months.

Source: Goldman Sachs Global Investment Research

The December Meeting: A Hawkish Cut?

Most investors expect the FOMC to deliver a hawkish cut at the December meeting, though this could be interpreted in a number of ways. We think it is unrealistic to expect the FOMC to box itself in too much by signaling a very strong bias toward a pause in January because if the labor market is still actively softening at that point and in particular if the unemployment rate has risen above the 4.5% peak that we and the FOMC are currently forecasting, then another cut might be appropriate in January. In fact, participants will be even more uncertain than usual about what will be appropriate at their next meeting and even less able to pre-commit because we are now two employment reports behind schedule.

That said, the December meeting will likely have a few hawkish elements.

First, the statement will likely borrow the “extent and timing of additional adjustments” language used in December 2024 under quite similar circumstances to convey that the bar for any further cuts will be somewhat higher (Exhibit 4).

Second, Powell will also likely get across that the bar has risen in his press conference. For example, he could simply note that the FOMC has now delivered the three rate cuts this year that the median dot in September signaled or say that the Committee expects those cuts to provide meaningful support for the economy and the labor market in particular. Powell will also likely again make a point of explaining the perspective of those FOMC participants who opposed a cut, as he did at the October meeting.

Third, there will most likely be two hawkish dissents in the statement, with another dissent from President Schmid and more likely than not one more. We also expect five participants to register soft dissents by submitting 3.875% as the appropriate 2025 funds rate in their dots. Dissents might actually be somewhat helpful to Powell in getting across that the bar for another rate cut will be higher.

While all of this would send a hawkish message, we doubt that it would come as a surprise at this point or add up to meaningful new information for the bond market.

Exhibit 4: We Expect the FOMC to Borrow the December 2024 “Extent and Timing of Additional Adjustments” Language to Make It Clear That the Bar for Any Further Cuts Will Be Somewhat Higher

Available indicators suggest that economic activity has continued to been-expanding at a moderate pace. Job gains have slowed this year, and the unemployment rate has edged up but remained low through AugustSeptember; more recent indicators are consistent with these developments. Inflation has moved up since earlier in the year and remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook remains elevated. The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment rose in recent months.

In support of its goals and in light of the shift in the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 3-1/2-3/4 to 3-3/4 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee decided to conclude the reduction of its aggregate securities holdings on December 1. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

Source: Goldman Sachs Global Investment Research

In the economic projections, we expect the median GDP growth forecast to rise for 2025 (+0.4pp to 2%) and 2026 (+0.2pp to 2%). We also expect the median core PCE inflation forecast to decline by 0.1pp to 3% for 2025 and 2.5% for 2026, which would still be solidly above our own forecast of 2.2% for 2026.

Exhibit 5: The Median GDP Growth Forecast Will Likely Rise and the Inflation Forecast Will Likely Decline

Summary of Economic Projections	2025	2026	2027	2028	Longer run
Real GDP Growth*					
GS Forecast	2.1	2.3	2.1	2.1	
GS Forecast of December SEP	2.0	2.0	1.9	1.8	1.8
September SEP	1.6	1.8	1.9	1.8	1.8
Unemployment*					
GS Forecast	4.5	4.3	4.1	3.9	
GS Forecast of December SEP	4.5	4.4	4.3	4.2	4.2
September SEP	4.5	4.4	4.3	4.2	4.2
PCE Inflation*					
GS Forecast	2.8	2.2	2.0	2.0	
GS Forecast of December SEP	2.9	2.5	2.1	2.0	2.0
September SEP	3.0	2.6	2.1	2.0	2.0
Core PCE Inflation*					
GS Forecast	2.9	2.2	2.0	2.0	
GS Forecast of December SEP	3.0	2.5	2.1	2.0	
September SEP	3.1	2.6	2.1	2.0	
Fed Funds Rate* (Median)					
GS Forecast	3.625	3.125	3.125	3.125	
GS Forecast of December SEP	3.625	3.375	3.125	3.125	3.000
September SEP	3.625	3.375	3.125	3.125	3.000
Addenda: Fed Funds Rate (Mean)					
GS Forecast of December SEP	3.68	3.27	3.13	3.13	3.12
September SEP	3.81	3.30	3.15	3.13	3.12

* Data shown are medians.

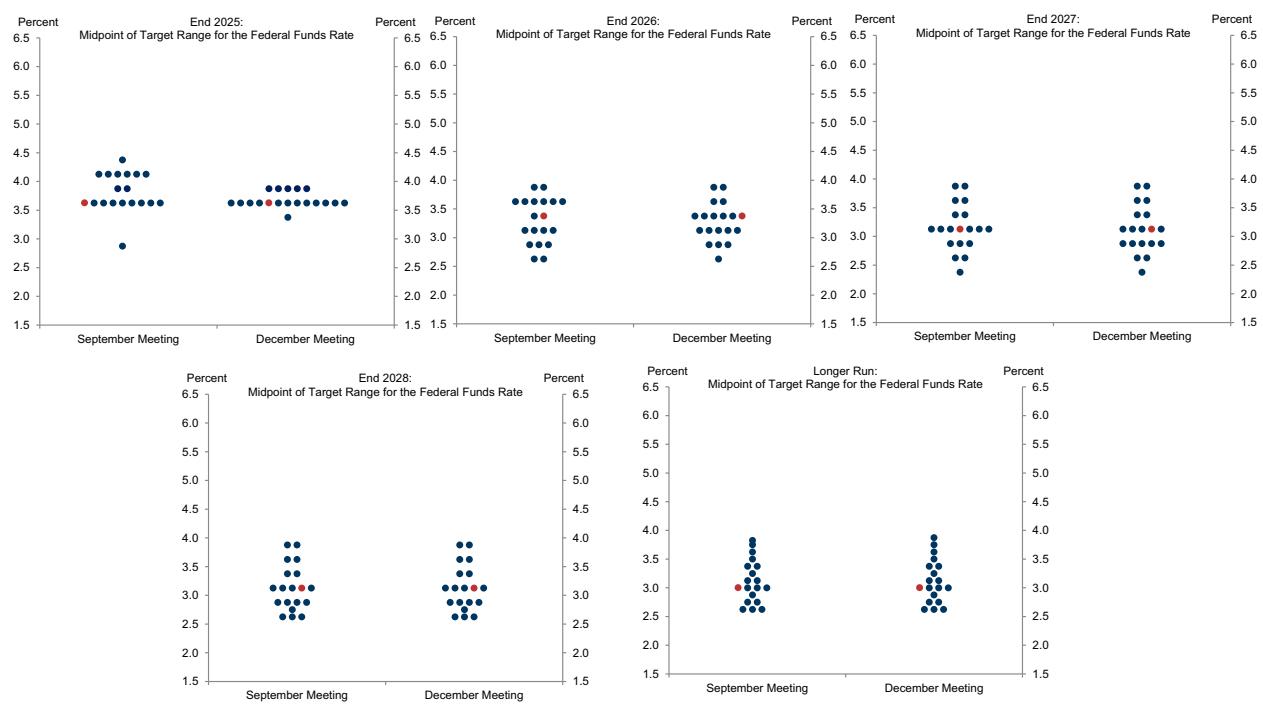
Note: GDP growth and inflation forecasts are Q4/Q4. Unemployment is the Q4 average. The funds rate is the level at the end of the year.

Source: Federal Reserve. Goldman Sachs Global Investment Research.

Source: Goldman Sachs Global Investment Research, Federal Reserve Board

In the dot plot, we expect the median projection to show one rate cut in 2026 to 3.375% and one more in 2027 to 3.125%, as it did in September, though it is a close call that comes down to a single participant in our attribution. In general, we expect fairly little movement in the dots relative to September because there has not been much economic data or other news relevant to the outlook.

Exhibit 6: We Expect the Median Dot to Show One Cut in Each of 2026 and 2027, as in September; We Also Expect Five Participants to Register a Soft Dissent Against Next Week's Cut with a 2025 Dot of 3.875%



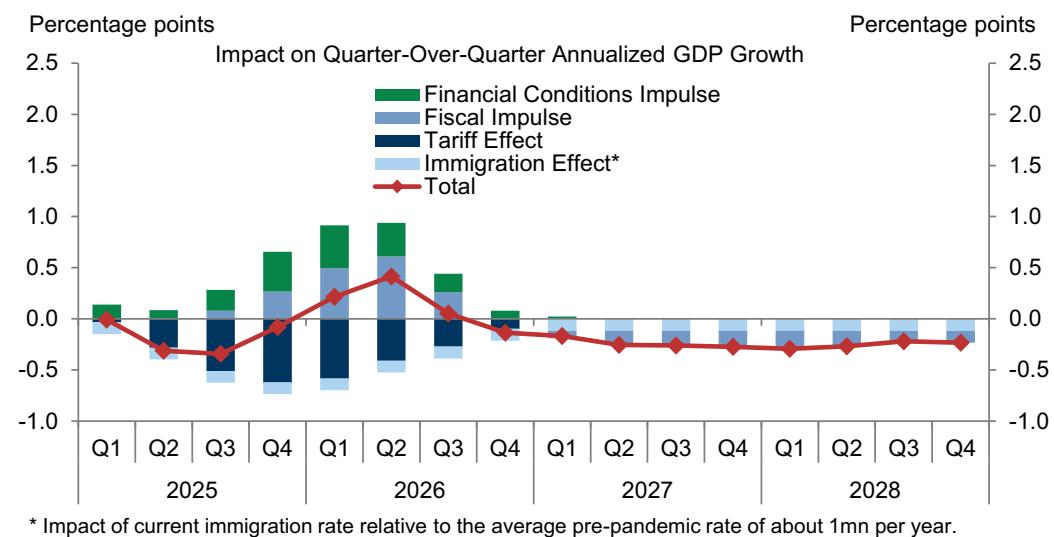
Note: Red dots show the median.

Source: Goldman Sachs Global Investment Research, Federal Reserve Board

The Terminal Rate Debate in 2026

Looking ahead to 2026, we expect GDP growth to pick up somewhat as the tariff drag gives way to a fiscal boost. Exhibit 7 shows that our estimate of the net impact on GDP growth from policy changes and changes in financial conditions bottoms out in 2025Q3 and rises over the next few quarters, reaching a peak in the first half of 2026 when the fiscal impulse is most positive. Our baseline economic forecast assumes that this pickup in GDP growth will be enough to boost hiring and stabilize the labor market.

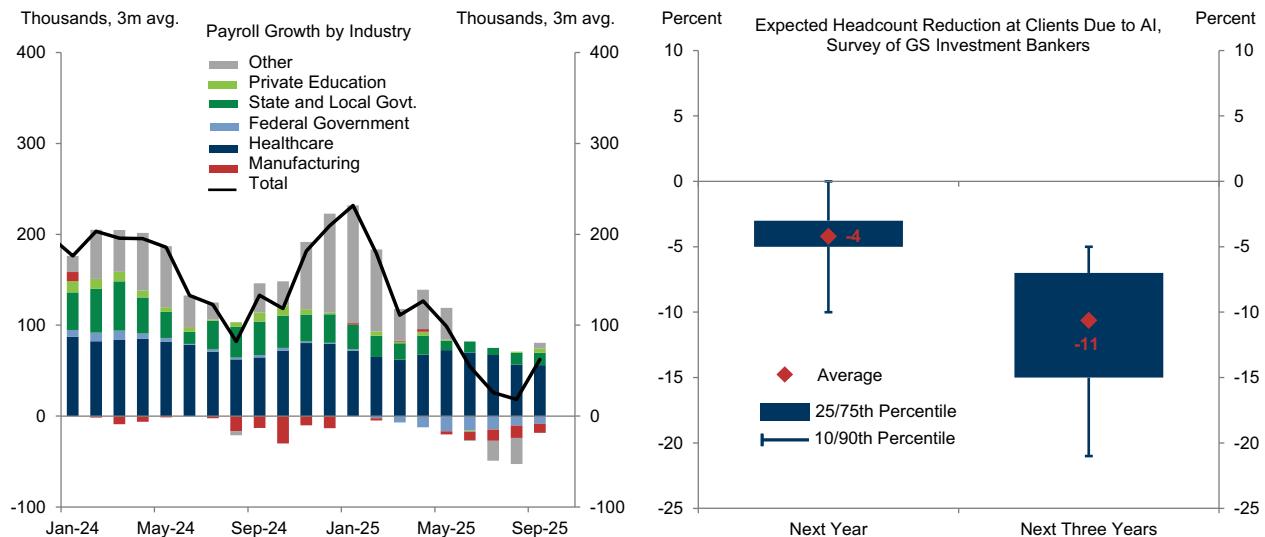
Exhibit 7: As the Tariff Drag on Growth in 2025 Gives Way to a Fiscal Boost in 2026, We Expect GDP Growth to Pick up, Which Should Help to Stabilize the Labor Market



Source: Goldman Sachs Global Investment Research

But we see this as the greatest uncertainty and the most important question for 2026: Will somewhat firmer GDP growth really be enough to stabilize the labor market? We think this is an open question for two main reasons. First, the starting point for the labor market is weak, with job growth outside of healthcare running negative on average over the last six months even before accounting for likely future downward revisions (Exhibit 8, left). Second, companies are increasingly focused on using AI to reduce labor costs, which could lead to more restrained hiring or even a rise in layoffs next year (Exhibit 8, right).

Exhibit 8: But the Key Question for 2026 Is Whether Firmer Growth Will Be Enough to Stabilize a Labor Market Where Job Growth Outside of Healthcare Is Negative and AI Could Lead to Headcount Reductions



Source: Goldman Sachs Global Investment Research, Department of Labor

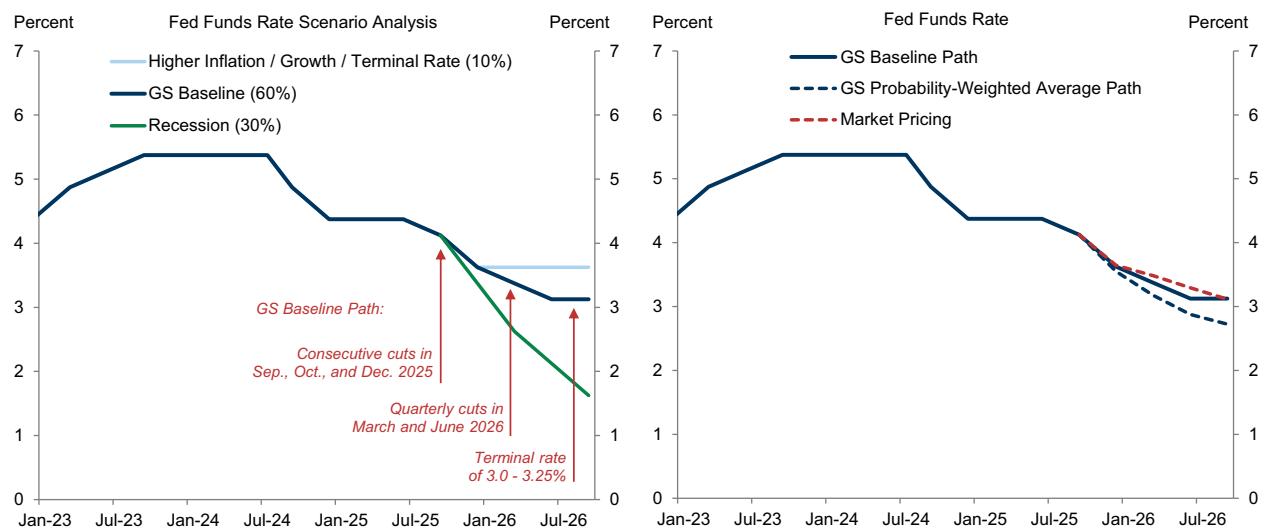
If the labor market does stabilize and inflation continues to fall to just over 2% as we expect, then the FOMC would likely shift from risk management mode to normalization mode next year. At that point, the key question for the Committee would be what the

appropriate terminal rate is.

Participants will likely have a range of views on the appropriate terminal rate, with some thinking that 3.5-3.75% is the right place to be and that no further cuts are necessary, while others might prefer to take the funds rate as low as 2.5-2.75%. It is hard to know how this debate would play out, but we think the best guess is that participants will meet in the middle by delivering two more 25bp cuts to 3-3.25%.

Because of our concerns about the labor market and subdued inflation forecast, we continue to see more downside than upside risk to the path of the funds rate over the next year. Exhibit 9 shows that on a probability-weighted basis, our Fed forecast remains more dovish than market pricing.

Exhibit 9: We Expect Two More 25bp Rate Cuts in 2026; Our Probability-Weighted Fed Forecast Is More Dovish Than Market Pricing



Source: Goldman Sachs Global Investment Research

David Mericle

The US Economic and Financial Outlook

(% change on previous period, annualized, except where noted)

	2022	2023	2024	2025	2026	2027	Q1	2025	Q2	Q3	Q4	Q1	2026	Q2	Q3	Q4
OUTPUT AND SPENDING	2022	2023	2024	2025	2026	2027	Q1	2025	Q2	Q3	Q4	Q1	2026	Q2	Q3	Q4
Real GDP	2.5	2.9	2.8	2.1	2.5	2.1	-0.6	3.8	3.5	1.6	3.1	2.0	2.0	2.0	2.0	2.0
Real GDP (annual=Q4/Q4, quarterly=yoyn)	1.3	3.4	2.4	2.1	2.3	2.1	2.0	2.1	2.1	2.1	3.0	2.6	2.2	2.3		
Consumer Expenditures	3.0	2.6	2.9	2.5	1.8	2.0	0.6	2.5	2.7	1.4	1.6	1.8	1.8	1.7		
Residential Fixed Investment	-8.1	-7.8	3.2	-1.5	-0.9	1.9	-1.0	-5.1	-1.6	-2.0	-2.0	1.0	2.0	2.0		
Business Fixed Investment	6.5	7.3	2.9	4.2	3.3	3.7	9.5	7.3	4.1	1.9	2.3	3.8	4.0	4.0		
Structures	3.5	16.7	1.1	-3.6	0.7	2.6	-3.1	-7.5	3.3	4.0	-2.0	1.0	2.0	2.0		
Equipment	2.8	2.9	3.5	8.0	3.2	3.4	21.3	8.5	4.7	0.6	2.0	4.0	4.0	4.0		
Intellectual Property Products	11.7	6.2	3.5	5.2	4.9	4.7	6.5	15.0	4.0	2.0	5.0	5.0	5.0	5.0		
Federal Government	-3.3	3.3	3.8	-1.2	1.7	0.9	-5.6	-5.3	3.0	-17.5	22.5	0.0	1.0	1.0		
State & Local Government	0.0	3.6	3.8	2.4	0.7	1.2	1.9	3.1	1.1	0.5	0.3	0.3	0.5	1.0		
Net Exports (\$bn, '17)	-1,024	-925	-1,033	-1,087	-903	-935	-1,381	-1,058	-994	-915	-893	-897	-906	-915		
Inventory Investment (\$bn, '17)	146	47	44	31	25	61	172	-18	-28	0	10	20	30	40		
Nominal GDP	9.8	6.7	5.3	4.8	5.0	4.0	2.9	6.0	6.4	4.6	5.8	4.0	3.9	3.7		
Industrial Production, Mfg.	0.4	-1.0	-1.0	1.3	2.8	3.0	4.0	2.5	3.4	1.9	2.9	2.9	2.9	2.9		
HOUSING MARKET																
Housing Starts (units, thous)	1,552	1,421	1,371	1,291	1,224	1,315	1,401	1,354	1,234	1,176	1,179	1,209	1,239	1,269		
New Home Sales (units, thous)	637	665	685	656	670	644	655	670	620	680	690	690	662	638		
Existing Home Sales (units, thous)	5,083	4,103	4,067	3,983	3,978	4,132	4,127	3,990	3,888	3,926	3,937	3,956	3,989	4,030		
Case-Shiller Home Prices (%oyoy)*	7.5	5.3	3.8	-0.2	0.7	2.2	3.9	2.4	1.5	-0.2	-0.4	0.4	0.6	0.7		
INFLATION (% ch, yr/yr)																
Consumer Price Index (CPI)**	6.4	3.3	2.9	2.7	2.1	2.1	2.7	2.5	2.9	2.8	2.5	2.7	2.4	2.2		
Core CPI **	5.7	3.9	3.2	2.9	2.2	2.2	3.1	2.8	3.1	3.0	2.8	2.8	2.5	2.2		
Core PCE** †	5.0	3.1	3.0	3.0	2.2	2.0	2.8	2.7	2.9	2.9	2.8	2.7	2.5	2.2		
LABOR MARKET																
Unemployment Rate (%)^	3.5	3.8	4.1	4.5	4.3	4.1	4.2	4.1	4.4	4.5	4.5	4.4	4.4	4.3		
U6 Underemployment Rate (%)^	6.6	7.2	7.5	8.2	7.8	7.5	7.9	7.7	8.1	8.2	8.2	8.1	8.0	7.8		
Payrolls (thous, monthly rate)	380	216	168	69	95	115	111	55	62	50	80	100	100	100		
Employment-Population Ratio (%)^	60.1	60.1	60.0	59.6	59.6	59.6	59.9	59.7	59.7	59.6	59.6	59.6	59.6	59.6		
Labor Force Participation Rate (%)^	62.3	62.5	62.5	62.4	62.3	62.1	62.5	62.3	62.4	62.4	62.4	62.3	62.3	62.3		
Average Hourly Earnings (%oyoy)	5.4	4.4	3.9	3.8	3.4	3.2	3.9	3.8	3.8	3.6	3.5	3.4	3.3	3.3		
GOVERNMENT FINANCE																
Federal Budget (FY, \$bn)	-1,376	-1,694	-1,833	-1,775	-2,000	-2,100	--	--	--	--	--	--	--	--	--	--
FINANCIAL INDICATORS																
FF Target Range (Bottom-Top, %)^	4.25-4.5	5.25-5.5	4.25-4.5	3.5-3.75	3-3.25	3-3.25	4.25-4.5	4.25-4.5	4-4.25	3.5-3.75	3.25-3.5	3-3.25	3-3.25	3-3.25		
10-Year Treasury Note^	3.88	3.88	4.58	4.20	4.20	4.25	4.23	4.24	4.16	4.20	4.20	4.20	4.20	4.20		
Euro (€/\$)^	1.07	1.11	1.04	1.19	1.25	1.25	1.08	1.18	1.17	1.19	1.23	1.23	1.24	1.25		
Yen (\$/¥)^	132	141	157	145	127	120	150	144	148	145	137	137	136	127		

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.

** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.

† PCE = Personal consumption expenditures. ^ Denotes end of period.

Note: Published figures in bold.

Source: Goldman Sachs Global Investment Research

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Disclosure Appendix

Reg AC

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