

The Fed cuts again but leans hawkish for December

The U.S. Federal Reserve delivered its second consecutive rate cut, lowering rates by 25 basis points as anticipated. Meanwhile, stronger economic data have prompted us to upgrade our 2025 growth forecast, creating compelling opportunities across emerging markets, senior loans and municipal bonds.

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KEY TAKEAWAYS

- The Fed cut interest rates by 25 basis points, with the target policy rate range now at 3.75%-4.00%.
- The Fed also announced the end of its balance sheet runoff, which will stabilize the size of its balance sheet moving forward. We do not expect major market or macroeconomic impacts from this change.
- In his press conference, Chair Powell leaned hawkish, pushing back against market pricing for a December rate cut that had approached 100%.
- Since the last FOMC meeting, we have upgraded our 2025 GDP forecast from 1.0% to 1.5%. This revision reflects better-than-expected economic data, slower tariff passthrough effects and robust business investment activity.
- We favor asset classes that may benefit from Fed rate cuts, including emerging markets debt, senior loans and municipal bonds.

WHAT HAPPENED?

The Federal Reserve cut interest rates for the second consecutive meeting, reducing the fed funds rate by 25 basis points (bps) to a new target range of 3.75%-4.00%. This decision was fully anticipated by the market and aligns with the Fed's previously published dotplot of rate expectations.

The policy statement did not have any substantive changes. However, Chair Powell leaned notably hawkish in his press conference. He indicated that “a further reduction in the policy rate at the December meeting is not a forgone conclusion. Far from it.” He went on to explain that “December is six weeks away, [and] we just don’t know what we’re going to get” in terms of economic data between now and then. If the government shutdown persists and there are no major data releases by the December meeting, Powell said that uncertainty “could be an argument in favor of caution about moving.”

Separately, the Fed also decided to end its policy of balance sheet runoff, effective 01 December. At that point, maturing Treasuries will be reinvested in new Treasury auctions, and maturing mortgage-backed securities will be reinvested in Treasury bills. This

will stabilize the level of bank reserves in the system and reduce the risk of dislocations in overnight lending markets moving forward, but it is unlikely to have a macroeconomic impact.

We continue to expect two additional rate cuts moving forward, totaling 50 bps of cuts through the middle of 2026. Though one of those cuts could occur at the December policy meeting, it will depend on the incoming data. Contingent on the end of the government shutdown, the Bureau of Labor Statistics could release three monthly jobs reports in quick succession before the December meeting. The signal about the labor market from those releases should determine the pace and path of near-term rate cuts.

ECONOMIC OUTLOOK BRIGHTENS DESPITE MIXED SIGNALS

Although economic growth has clearly slowed in 2025 compared to the stronger pace of 2023-24, the outlook has brightened. We have upgraded our full-year 2025 GDP growth forecast from 1.0% to 1.5% based on better recent data, and we maintain our expectation for a further rebound to 1.8% in 2026.

Since the last FOMC meeting, second quarter GDP growth was revised upward by 0.5 percentage points to an annualized rate of 3.8% quarter-over-quarter. Business investment provided meaningful support, driven by substantial spending on technology hardware and, to a lesser extent, software.

Despite continued softening in the labor market – with the unemployment rate rising to 4.3% – consumer spending has strengthened, particularly in the services sector. This dynamic was confirmed by business sentiment surveys, where the services sector gauge climbed above the corresponding manufacturing reading.

On the inflation front, core CPI prices decelerated in September to their slowest monthly increase since May at 0.2%. This moderation was driven primarily by slower shelter inflation, though core goods prices remain elevated. We expect tariffs to continue working through the supply chain, with their peak

impact on consumer prices occurring around year-end, when we forecast overall core inflation to reach 3.2% year-over-year.

WHAT DOES THIS MEAN FOR INVESTORS?

As the Fed continues its easing cycle, we are seeking opportunities in attractively valued fixed income asset classes that combine sound fundamentals with compelling yields.

Emerging markets (EM) debt offers a significant yield premium versus global peer averages – nearly 100 basis points on a ratings-adjusted basis. Spreads also appear favorable relative to other fixed income segments. Fundamentals remain solid, with EM countries maintaining lower leverage than developed markets and debt-to-GDP ratios that on average fall below those of G7 economies.

For investors concerned they may have missed the opportunity following two consecutive years of solid returns (with a third year looking likely), there is encouraging news. EM fund flows are only now beginning to turn positive after three straight years of outflows, signaling improving demand. If inflows continue gaining momentum as we anticipate, the EM rally still has considerable room to run.

Senior loans represent another compelling opportunity, as they are directly affected by Fed policy. When the Fed lowers the target fed funds rate, the risk-free rate of return declines. This rate – the theoretical return on an investment carrying zero risk of financial loss – serves as the baseline to which a credit spread is added to calculate senior loan yields. The relationship between Fed easing, the risk-free rate, and yields has led to the mistaken perception that senior loans cannot perform well in falling rate environments.

History tells a different story. Since 1997, loans have posted positive total returns in eight of the nine years when the Fed lowered rates. Their only negative year during a Fed easing cycle was 2008, when the global financial crisis drove all risk assets lower.

Lower interest rates improve fundamentals for loan issuers by reducing their interest expense, potentially leading to credit spread tightening. Although some recent economic data – notably labor market indicators – have weakened, corporate fundamentals remain broadly healthy for leveraged finance borrowers.

The three-year senior loan yield stands at 7.79% as of 27 October. Even with further Fed rate cuts, the starting yield for loans remains near its highest level in more than 15 years, offering compelling entry points.

Municipal bonds have rebounded impressively over the past two months after underperforming taxable fixed income assets by a wide margin for most of the year. The dominant headwind has been historically high supply, exceeding \$400 billion year-to-date through September. Supply in the first three quarters of 2025 had already surpassed the \$381 billion annual average seen over the previous decade.

Inflows have begun to accelerate, totaling over \$35 billion so far in 2025. We expect investor demand to continue rising given the current backdrop of elevated yields, healthy fundamentals, and the prospect of additional Fed rate cuts, which should push cash yields lower and help draw sidelined investors back into the market.

The municipal yield curve has nearly doubled in steepness since the start of 2025. The 1-to-30 year yield differential has expanded from 91 basis points to 170 basis points as of October 20. Investors are now being rewarded with higher yields as they move further out on the muni curve. For those open to lengthening duration and taking on credit risk, high yield municipals offer a tax-equivalent yield of 9.53% for investors in the top income tax bracket – one of the most compelling levels of income across the entire fixed income universe.

Finally, fundamentals for issuing municipalities remain strong. Revenue collections and reserves are near their highest levels in more than 40 years. Credit rating upgrades continue to exceed

downgrades, as they have over the past five years, and municipal defaults remain rare, isolated, and idiosyncratic.

For more information, please visit us at [nuveen.com](https://www.nuveen.com).

Endnotes

Sources

Federal Reserve Statement, October 2025.

Bloomberg, L.P and S&P Markit.

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