

Year-end Crossroads

Late-2025 rate cuts in the U.S. and UK contrast with an ECB pause, while markets price a soft landing into 2026

- The Fed extended its easing cycle with a further 25 bp cut in December, while the ECB held rates unchanged and the Bank of England delivered a year-end cut amid faster disinflation.
- Markets have leaned into a “soft landing together with lower yields” narrative, with U.S. equities at record highs at the end of 2025, a weaker dollar, and renewed appetite for precious metals.

United States: A third cut, but “data dependence” remains the anchor

At its 10 December meeting, the Federal Reserve cut the federal funds target range by 25 basis points to 3.50%–3.75%, extending the easing cycle into year-end. The decision reinforces the Fed’s intent to recalibrate policy as inflation pressures continue to cool and growth shows more balanced momentum, while keeping optionality via an explicitly data-dependent stance.

Markets interpreted the move as consistent with a gradual normalization path. Rates markets strengthened their “lower yields” bias into late December. 2-year Treasury yields fell to the mid-3% range by the end of 2025, reflecting confidence that the tightening phase has come to an end.

Beyond rate cuts, the Fed’s ongoing balance-sheet normalization remains an important, and often underappreciated, part of the policy mix. While quantitative tightening continues, more accommodative financial conditions and strong asset markets suggest that the effective stance of policy may be loosening faster than headline rates imply, raising the bar for aggressive further easing in early 2026 unless growth or labor data deteriorate meaningfully.

Euro Area: Steady hands at the ECB, with policy kept “unchanged” into 2026

In contrast to the Fed, the ECB kept its key rates unchanged in December, holding the deposit facility at 2.00% (MRO 2.15%, marginal lending 2.40%). The messaging remained consistent with a “wait-and-assess” posture: the disinflation process has progressed, but the Governing Council continues to emphasize meeting the inflation target sustainably—especially given lingering uncertainty around wages, fiscal policy, and the growth mix.

The Fed’s latest rate cut reinforces its intent to recalibrate policy, while keeping optionality via an explicitly data-dependent stance

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The policy divergence (Fed easing vs. ECB pause) has contributed to cross-asset positioning that favors duration exposure and selective risk-taking, while keeping currency hedging active as relative-rate expectations shift.

Holding rates steady has helped the ECB preserve policy credibility, but it also shifts attention back to fiscal dynamics and fragmentation risks within the Euro Area

For the ECB, holding rates steady has helped preserve policy credibility, but it also shifts attention back to fiscal dynamics and fragmentation risks within the Euro Area. With several governments entering 2026 with elevated deficits and tighter fiscal rules returning, the ECB's tolerance for market volatility will be tested, reinforcing the importance of tools like reinvestment flexibility and transmission protection alongside conventional rate policy.

Global markets: Soft-landing optimism, widening rotation, and late-year crosscurrents

Global markets finished the year with constructive risk sentiment despite thin holiday liquidity. In the U.S., equities climbed to record highs, with the S&P 500 approaching the 7,000 level and rotation broadening beyond mega-cap tech into financials, healthcare, transports and small caps—suggesting investors are increasingly willing to price a benign macro path into 2026.

In parallel, the U.S. dollar weakened late in the year as investors weighed the path of further Fed cuts and upcoming policy uncertainty, supporting commodity performance. Precious metals were the standout: gold and silver posted exceptionally strong year-to-date gains, supported by a mix of central-bank demand, ETF inflows and hedging against fiscal/monetary uncertainty.

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Overall, the late-2025 and early-2026 backdrop still looks like a “fragile equilibrium”. Markets are pricing easing and resilience, but remain exposed to confidence shocks (policy surprises, geopolitics, and pockets of credit stress) as the cycle transitions into 2026.