

Money Market Funds

To Neutral and Beyond

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Money market funds (MMFs) continued to attract strong inflows in 2025, approaching \$10 trillion of global assets under management,¹ even as global interest rates moved lower and began to normalize. Following two years of elevated policy rates and abundant cash balances, investors have maintained their preference for the liquidity, transparency and simplicity that MMFs provide. The year began with expectations that easing monetary policy might prompt a rotation toward longer-duration assets, yet persistent macro uncertainty and geopolitical tensions have reinforced the appeal of MMFs as a strategic component of portfolios.

Central banks around the world are dealing with a wider dispersion in growth, employment and inflation, which could potentially lead to a divergence in monetary policy. With that in mind, we believe money market assets will continue to trend higher in 2026 as investors grapple with volatility from unconventional policy out of Washington, D.C. and garner more clarity on macro factors while rates approach neutral.

In the United States, a supportive backdrop and procyclical policies mean that markets can begin to transition from global macro concerns of 2025 to micro, asset class specific stories. Morgan Stanley anticipates the U.S. will remain the main driver of the macro narrative, with GDP projected to grow by 1.3% in 2026,² supported by strong consumer and AI-related business spending, despite labor market and trade headwinds. Artificial Intelligence (AI) will remain a central theme, with AI-related spending supporting growth and driving productivity gains. Short-term credit markets experienced exceptionally tight spreads over the past 12 months; however, we expect spreads to widen marginally as issuance increases, supported by robust M&A pipelines and rising Tech/AI-related CapEx needs. Overall, continued demand for yield should absorb the additional supply, but credit selection is likely to become increasingly idiosyncratic as we move into the new year. Treasury bill supply is projected to remain elevated into the new year, which could contribute to volatility in funding markets. If volatility

AUTHOR

GLOBAL LIQUIDITY TEAM

¹ Source: Crane Data as of 15/12/2025

² Source: Morgan Stanley Research as of 5/12/2025

persists, the Federal Reserve may intervene through targeted open market operations, likely by expanding Treasury bill purchases.

Following the synchronized tightening of 2022–23 and the cautious easing through 2024–25, most major central banks now find themselves near neutral. Inflation has moderated but remains uneven at near 3% in the U.S., closer to 2% in the eurozone, and around 4% in the U.K., underscoring the growing divergence in domestic conditions.

Federal Reserve

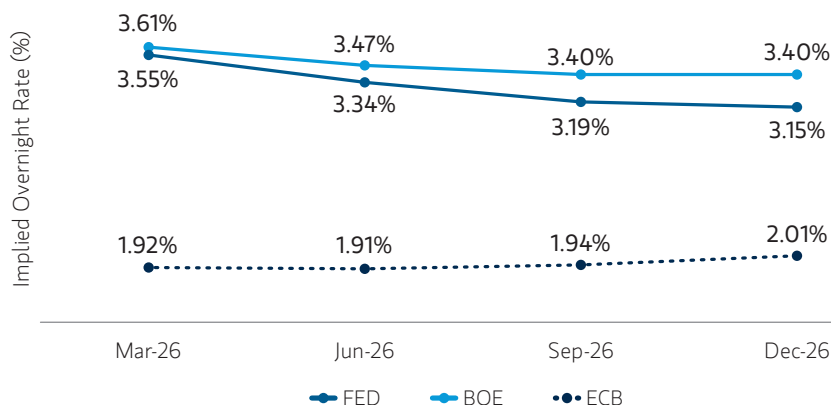
Federal Reserve Chair Jerome Powell has continued to emphasize a data-dependent and measured approach as the U.S. economy navigates a slower, but resilient, expansion. With inflation expected to gradually converge toward the Federal Reserve’s target, attention within the FOMC (Federal Open Market Committee) has turned to signs of softening in the labor market. A modest rise in the unemployment rate and slower wage growth have introduced uncertainty around the strength of the labor market, prompting policymakers to reassess the timing and extent of additional easing.

Markets initially expected a quicker path toward normalization, but steady consumer spending, strong fiscal support and tariff-related uncertainty have encouraged the Fed to proceed more cautiously. In addition, the neutral rate has slowly gravitated higher the last few years, sparking debate around where exactly the neutral rate should land. That said, policymakers seem to think it should lie between 3.00%-3.50%.

On 1st December, the Fed ceased its balance sheet run down, reinvesting mortgage-backed security (MBS) maturities into Treasury bills. The market will likely grapple with whether the end of quantitative tightening will immediately provide support to funding markets, or if

DISPLAY 1

Market Expectations for Implied Overnight Bank Rates



Source: Bloomberg, as of 11/12/2025

friction remains across year end. Settlement dates for Treasury supply will be closely watched for stress and Standing Repo Facility use.

The approaching conclusion of Powell’s term and possibility of new Fed leadership later in the year may introduce some additional uncertainty for investors.

While monetary policy is less restrictive today, there is still room for future rate cuts; in fact, the FOMC now anticipates one rate cut in 2026. We believe the Fed will take a careful and methodical approach to monetary policy decisions, ultimately lowering rates gradually until more clarity is gleaned on employment.

European Central Bank

With inflation pressures firmly receding in 2025, the ECB continued the process of removing the restrictiveness of monetary policy gradually through 2025, reducing its key deposit rate 100 basis points (bps) from 3% to 2%. The Governing Council has stated they believe 2% to be the neutral rate in the eurozone economy whereby monetary policy neither restricts nor stimulates the economy. As current CPI data is at the current 2% target, and medium-term inflation forecasts, as well as inflation expectations from surveys, are also at 2%, the ECB deems that they are

now in a “good place,” where the bar for any further change to monetary policy is prohibitively high.

Economic factors that could drive additional rate cuts include weaker growth, potentially caused by the U.S. administration’s higher tariff regime, which would weigh on exports and reduce overall activity. However, data in the latter part of the year suggested that growth in the eurozone was resilient in light of higher tariffs. In terms of upside risks, inflationary pressures could rise due to higher fiscal spend across many jurisdictions, particularly in Germany, as the release of the debt brake could potentially drive up prices. For now, the ECB is happy to sit and watch data develop and maintain monetary policy stable at 2%.

Bank of England

Views from the Monetary Policy Committee (MPC) have continued to be split on the risks around persistent underlying inflation and the perceived slack emerging in the economy. The MPC reduced interest rates from 4.75% to 3.75% in 2025, at a gradual pace of 25bps per quarter due to fears of persistent inflation. The U.K. saw inflation peak in September 2025 at 3.8% as food prices and services remain sticky. In addition, unemployment rose to 5% in a slowing labor market.

The majority of MPC members are concerned about household inflation expectations risking further second-round effects, with core goods and services inflation still high and with few signs of downward pressure from geopolitical factors. They prefer to see if the disinflation trend is sustainable in upcoming economic

prints before looking to cut further. The October inflation print of 3.6% is a step in the right direction and aligns with the remaining members, who believe the disinflation process is on track. As importantly, key data prints have undershot MPC expectations, resulting in lower inflation, weaker GDP and weaker wage growth than

in previous BoE forecasts. Looking ahead, focus will be on aggregate supply and demand dynamics and impacts from the Autumn Fiscal budget. The market expects the BoE to bring the base rate down to 3.5% by Q2 2026, given expectations that inflation pressures will continue to slowly subside.

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Italy: MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. The **Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. **France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain. **Germany:** MSIM FMIL Frankfurt Branch, Große Gallusstraße 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axeltorv2, 1609 Copenhagen V, Denmark.