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Fed Chair Jerome Powell TING SHEN/ BLOOMBERG NEWS

Trump Enters as Fed Is Shifting Its Focus

BY NICK TIMIRAOS

With its second consecutive interest-rate cut this year, the Federal Reserve is attempting to boost the odds of a soft landing. Whether it sticks the landing could shape exactly what kind of economy Donald Trump inherits.

If the Fed is fortunate, dialing back its past rate increases will allow the economy to continue growing steadily with the unemployment rate leveling off at a historically low level and inflation grinding back to the central bank's 2% goal.

If the economy slides into a recession under the weight of earlier increases, Trump would take office as President George W. Bush did in 2001, with the economy heading into a downturn. Alternatively, any resurgence in inflation could force the Fed to stop cutting rates, raising the odds that the economy faces a hard landing later in Trump's term.

Stable economy

"He's inheriting a stable economy, an economy with lots of possibility," said Glenn Hubbard, who was a top adviser to Bush. With the Fed cutting rates, "there's one less headwind."

The Fed began raising rates in 2022 at its fastest pace in four decades to combat inflation that had hit a 40-year high. It paused those hikes in the second half of 2023 and held rates at a two-decade high until September. So-called core inflation, which excludes volatile food and energy prices, stood at 2.7% in September, down from 5.6% two years ago.

Analysts on Wall Street are generally less worried about a recession than they were a few weeks ago. Bond yields have moved up sharply as investors anticipate fewer cuts than they did just seven weeks ago, when the Fed lowered its benchmark federal-funds rate by a half percentage point. The latest cut approved Thursday will bring the rate to a range between 4.5% and 4.75%, a level last seen in early 2023.

"Recession odds have gone down," said Steven Blitz, chief U.S. economist at GlobalData TS Lombard. Due in part to the Fed cutting rates with a solid economy, "the tailwind for Year One of the next president's economy is going to be great."

Blitz is among those who feared a few months ago that the Fed might hold rates at a high level for too long, putting pressure on vulnerable corners of the economy such as domestic banks and commercial real estate that might lead to a sharper slowdown in spending and hiring.

He said he now thinks the risks are tilted toward inflation proving to stay somewhat firmer than anticipated and running just above the Fed's 2% target over the coming year.

"Without cuts, the next president would be inheriting what we used to call a growth recession, with positive GDP growth and rising unemployment," said Blitz. Instead, he said the Fed may find itself in a few months forced to pause its rate cuts if solid growth tells policymakers that rates aren't as restrictive as they think.

Others see pockets of strength from high-income consumers who have continued to spend money, buoyed by lofty stock values and home prices, and strong demand for investment in new technologies such as generative artificial intelligence.

Jobs outlook

Optimists say fears about a labor-market slowdown have been oversold.

A swift jump in immigration over the past two years has allowed job vacancies to fall while making it somewhat harder to find work, leading to gentle increases in the unemployment rate that defy traditional patterns, said Marc Giannoni, chief U.S. economist at Barclays.

The economy is "as close as it gets to a soft landing," he said. "There is always the possibility that something breaks—the stock market falls abruptly, consumers retrench, and firms pause their hiring. But that is very hard to forecast and it's not in our baseline."

Others see any declarations of victory as premature and worry about a softening labor market.

Expectations that the economy will achieve a soft landing have led to higher borrowing costs for companies and households in recent weeks. The average 30-year mortgage rate, for example, jumped to 6.8% this week from 6.1% around the time of the Fed's first rate cut in September.

Mortgage rates in recent weeks are too high to produce a soft landing because they will lead to a further pullback in residential investment, said Peter Berezin, chief global strategist at BCA Research.

Despite healthy consumer spending, declining residential investment bears watching because that is the only component of economic output that typically shrinks in the run-up to a recession, said Berezin. Real-time measures of job openings also point to a continued slowdown in privatesector employment in the months ahead.

"Obviously, the faster and the more aggressively they cut rates, the less the risk that the economy will fall into recession by the end of this year or early next year, but they have to be cautious as well," he said. "If they cut too much proactively, the economy could overheat."

Longer-term interest rates could also rise if investors fear that Trump will be complacent about budget deficits that are at unprecedented levels for an economy that is expanding solidly during peacetime.

Moreover, if the economy does enter a downturn, there are good reasons to think the economy might not be as easy to stimulate with rate cuts as in past cycles, leaving monetary policy less potent.

On Thursday, Fed Chair Jerome Powell said he thought interest-rate policy was in a good position to deal with whatever the economy faces in the months ahead.