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Fed Rate Cut Remains on Track

A 2.6% increase in consumer prices is unlikely to derail move in December

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Consumer prices edged up in October after having recorded the slowest rate of growth in 3½ years in the previous month, a sign of how inflation continues to move lower on an uneven and bumpy path.

The latest report likely wasn't enough to derail an--other interest-rate cut from the Federal Reserve in December. But together with solid consumer spending and steady hiring, firmer inflation could kick off a bigger debate at officials' next meeting over whether to slow the pace of rate cuts early next year.

The Labor Department reported on Wednesday that consumer prices in October rose 2.6% from a year earlier. That marks a pickup from the previous month, when the consumer- price index was up 2.4%.

Core prices, which exclude food and energy items in an effort to better reflect inflation's underlying trend, were up 3.3%.

Both results matched the expectations of economists polled by The Wall Street Journal.

Investors had been preparing for an inflation reading higher than the consensus estimate, and they took Wednesday's report as good news. Traders increased their bets that Fed officials would cut rates by a quarter point at their next meeting in December, rather than standing pat.

Investors' positive response to the report might have been

driven in part by relief that President-elect Donald Trump and the Fed won't immediately be at loggerheads. Trump repeatedly pressed for lower rates during his first term. Economists view some of Trump's proposed policies, such as higher tariffs, as likely to push inflation higher.

The report is the first after an election that was characterized by Americans' frustration with inflation during President Biden's administration— consumer prices are now about 20% higher than they were when he came into office.

Voters around the world have punished leaders and ruling parties for high prices and inflation.

Even though inflation has been on a cooling trend, Trump will enter office at a delicate time for the economy, with the Fed aiming to lower interest rates and ensure the continued health of the economy without rekindling inflation.

"Inflation data on the hotter side could have led the market to start seeing Trump reflationary policy in a less favorable light," Evercore ISI strategists noted on Wednesday.

The Dow Jones Industrial Average and the S& P 500 edged up. The Nasdaq Composite was down slightly.

The pickup in overall inflation was in part because of tougher comparisons with a year earlier. But there were also some items that registered significant increases in prices in October. Prices for used cars and trucks, for example, rose a seasonally adjusted 2.7% from a month earlier, while airline fares rose 3.2%.

Energy prices were unchanged from a month ago, de--spite a decline in gasoline prices. That was because those lower prices at the pump were offset by increases in electricity and natural-gas prices.

The month-over-month in--crease in overall prices was a seasonally adjusted 0.2%. Core prices were up 0.3% on the month. Those results were also in line with expectations.

Before the inflation report, futures markets implied there was about a 60% chance the Fed would cut rates at its December meeting. After the report, that had risen to about 80%.

Despite some bumps along the way, inflation still looks as if it is in a cooling trend. In October 2023, overall consumer prices were up 3.2% from a year earlier. In June 2022, prices were up 9.1% from a year earlier, marking the steepest inflation since the early 1980s.

Moreover, there is still a degree of "catch-up inflation" in the data. For example, car insurers have to negotiate price increases with state regulators, so it takes a while for jumps in their costs to make their way into prices.

At a press conference last week, Fed Chair Jerome Powell hinted that the central bank was prepared for firmer-thananticipated readings, or "bumps."

But he sees residual stickiness for some prices as reflecting the lagged effects of earlier increases, rather than new sources of price pressure.

For example, rents continue to rise at a historically high clip in the CPI, but rent rises for new leases have been mild for over a year.

"That's just a catch-up problem. It's not really reflecting current inflationary pressures. It's reflecting past inflationary pressures," Powell said. "We're not declaring victory, obviously, but we feel like the story is very consistent with inflation continuing to come down on a bumpy path."

If Fed officials proceed with a December cut, the focus is likely to turn to what might prompt them to slow down interest-rate reductions next year. Several officials on Wednesday said they want to avoid taking rates down too low only to reverse course later.

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Most of them view the current level of short-term interest rates as restrictive, meaning that without more cuts the labor market could cool further than they like, and even put the economy at risk of recession.

Officials want to bring rates back to a more "neutral" setting that neither spurs nor slows growth, but they don't know where that is. Before the 2008-09 financial crisis, many thought a neutral rate might be about 4%, but after the crisis and an extremely sluggish recovery, economists and Fed officials concluded the neutral rate might be closer to 2%. St. Louis Fed President Alberto Musalem told reporters on Wednesday that the central bank could take its time moving rates down to a neutral setting. "The strength of the economy is likely to provide the space for there to be a gradual easing of policy with little urgency to try and find where the neutral rate may be," he said.

In a speech on Wednesday, Dallas Fed President Lorie Logan said she expected more rate cuts would be warranted, but she also said there were some hints that the Fed might be close to a neutral rate that has moved up in recent years. She compared the Fed's job with a ship's captain who has to avoid mistaking water for mud as the ship reaches the shore.

"In these uncertain but potentially very shallow waters, I believe it's best to proceed with caution," she said. 80%

The chance of a Fed interest-rate cut next month as implied by the futures markets

