



The Fed's Next Moves Are Anybody's Guess

Good economic data, and the coming Trump presidency, throw everything into doubt

Take the Federal Reserve's projections from September and throw them into the trash. The path forward for rates is now highly uncertain.

The Fed cut rates by a quarter point on Thursday, following a halfpoint cut in September. Markets are already dialing back bets that another reduction will follow in December. Futures prices now imply a roughly 25% chance that the Fed will leave rates unchanged at that meeting rather than cutting again, up from 14% a month ago.

Further out, the uncertainty is even greater. Take for instance Fed policymakers' longer-term economic projections released at their September meeting. These showed expectations on average that the target policy rate would be between 3.25% and 3.5% by the end of 2025, down from a range of 4.5% to 4.75% now. That represents a significant amount of easing still to come—perhaps one more quarterpoint cut in December and four next year.

But the chance that the Fed could cut rates by just a quarter point or less between now and June, for instance, stood at a not insignificant 16.9% as of Wednesday on the CME Group's FedWatch tool, compared with zero chance on the day of the September meeting.

When asked about the Fed's September projections at Thursday's press conference, Fed Chair Jerome Powell strongly suggested that economic conditions have improved since then. "In the main, the economic activity data have been stronger than expected," he said, citing jobs growth, retail sales and some recent revisions to a series of Bureau of Economic Analysis data.

That helps explain why a December rate cut could now be in doubt. As for next year, you can't talk about that without talking about President-elect Donald Trump.

Powell stressed that it takes a long time for fiscal policy changes such as tax cuts to work their way through Congress, and after that still more time for them to have an impact on the economy, which the Fed would have to react to.

Fair enough. But some policy changes don't necessarily need to go through a full legislative process, including the tariffs that Trump levied on Chinese goods in his prior administration and that he promises to increase significantly now.

Then there are changes in financial conditions that are already manifesting themselves in markets, including soaring stock prices and rising bond yields. These can begin to have impacts on the economy long before a tax bill becomes law.

Finally, the potential for political tensions between the Fed and the White House is another wild card to keep an eye on. This was underscored by Powell's terse, five-word answer when asked if the president has the power to fire or demote him or other senior Fed governors, which he repeated once for clarity: "Not permitted under the law."

The Fed has taken some of the pressure off markets with a cumulative reduction in rates of three quarters of a point. How much more relief will be coming, and when, is now very hard to forecast.

—Aaron Back

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Saturday, 11/09/2024 Page .B011

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