12-19-2024

ECONOMIC POLICY

Fed cuts rate by quarter-point

Central bank envisions fewer reductions next year; stock market dips

BY CHRISTOPHER RUGABER

THE ASSOCIATED PRESS

WASHINGTON>> The Federal Reserve cut its key interest rate Wednesday by a quarter-point — its third cut this year — but also signaled that it expects to reduce rates more slowly next year than it previously envisioned, mostly because of still-elevated inflation.

The Fed's 19 policymakers projected that they will cut their benchmark rate by a quarter-point just twice in 2025, down from their estimate in September of four rate cuts. Their new projections suggest that consumers may not enjoy much lower rates next year for mortgages, auto loans, credit cards and other forms of borrowing. *

The central bank's expectation of just two rate cuts in 2025 rattled Wall Street, sending stock prices plummeting in the worst day for the market in four months. The Dow Jones Industrial Average closed down more than 1,100 points, roughly 2.5%. The Nasdaq composite was hit worse: It sank about 3.5% Wednesday. Higher interest rates can slow business expansion.

Speaking at a news conference, Chairman Jerome Powell underscored that policymakers are slowing their rate reductions as their benchmark rate nears a level that policymakers refer to as "neutral" — the level that is thought to neither spur nor hinder the economy.

Wednesday's projections suggest that the policymakers think they may be close to that level. Their benchmark rate stands at 4.3% after the latest rate cut, which followed a steep half-point reduction in September and a quarter-point cut last month.

"I think that a slower pace of (rate) cuts really reflects both the higher inflation readings we've had this year and the expectations that inflation will be higher" in 2025, Powell said. "We're closer to the neutral rate, which is another reason to be cautious about further moves."

Blerina Uruci, chief economist at T. Rowe Price, said the tone of Powell's news conference was surprisingly "hawkish," meaning that it seemed to favor maintaining relatively high rates. *

Uruci noted that Powell said the Fed's decision Wednesday to reduce its benchmark rate by a quarter-point was a "closer call," indicating that there was opposition to the move. Indeed, four officials supported keeping rates unchanged Wednesday, according to the projections. Not all 19 policymakers have a vote at each meeting. One — Beth Hammack, head of the Federal Reserve Bank of Cleveland — voted against the rate cut because she favored keeping rates unchanged.

"The committee might be quite divided at this point," Uruci said. "And we have a growing hawkish contingent."

At his news conference, Powell acknowledged that at least some Fed officials have begun to assess the potential effects of President-elect Donald Trump's policies on the economy and inflation. The Fed chairman noted that some policymakers think that since the election, the future path of inflation has become harder to gauge.

Trump's threats to impose tariffs on all imports and to engage in mass deportations of migrants could worsen inflation next year.

"It's kind of common-sense thinking that when the path is uncertain, you go a little bit slower," Powell said. "It's not unlike driving on a foggy night or walking into a dark room with furniture. Just slow down."

This year's Fed rate reductions have marked a reversal after more than two years of high rates, which largely helped tame inflation but also made borrowing painfully expensive for American consumers.

But now, the Fed is facing a variety of challenges as it seeks to complete a "soft landing" for the economy, whereby high rates manage to curb inflation without causing a recession. Chief among them is that inflation remains sticky: According to the Fed's preferred gauge, annual "core" inflation, which excludes the most volatile categories, was 2.8% in October. That is still persistently above the central bank's 2% target.

At the same time, the economy is growing briskly, which suggests that higher rates haven't much restrained the economy. As a result, some economists — and some Fed officials — have argued that borrowing rates shouldn't be lowered much more for fear of overheating the economy and reigniting inflation.On the other hand, the pace of hiring has cooled significantly since 2024 began, a potential worry because one of the Fed's mandates is to achieve maximum employment.

"We don't think we need further cooling in the labor market to get inflation below 2%," Powell said at his news conference.

The unemployment rate, while still low at 4.2%, has risen nearly a full percentage point in the past two years. Concern over rising unemployment contributed to the Fed's decision in September to cut its key rate by a larger-than-usual half-point.

Asked why the central bank envisions any rate cuts in 2025 given still-elevated inflation, Powell noted that the Fed's latest projections "have core inflation coming down to 2.5% next year."

"That would be significant progress," he said. "We'd be seeing meaningful progress to get inflation down to that level."

The Fed chairman added: "We and most other forecasters still feel that we are on track to get down to 2%. It might take a year or two from here."

Trump has proposed a range of tax cuts — on Social Security benefits, tipped income and overtime income — as well as a scaling-back of regulations. Collectively, these moves could stimulate growth. At the same time, Trump has threatened to impose a variety of tariffs and to seek mass deportations of migrants, which could accelerate inflation.

Powell acknowledged that Fed officials are seeking "to understand ways tariffs can affect inflation and the economy and how to think about that."

The Fed's uncertainty about the economy's future path was underscored by the quarterly economic projections the Fed issued Wednesday. The policymakers now expect overall inflation, as measured by their preferred gauge, to rise slightly from 2.3% now to 2.5% by the end of 2025. That is far below its peak of 7.2% in June 2022.

Even so, the prospect of slightly higher inflation makes it harder for the Fed to reduce borrowing costs because high interest rates are its principal weapon against inflation.

"From here, it's a new phase," Powell said, "and we're going to be cautious about new cuts."