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Fed likely to slow its interest rate cuts

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WASHINGTON >> Americans hoping for lower borrowing costs for homes, credit cards and cars may be disappointed after this week's Federal Reserve meeting. The Fed's policymakers are likely to signal fewer interest rate cuts next year than were previously expected.

The officials are set to reduce their benchmark rate, which affects many consumer and business loans, by a quarter-point to about 4.3% when their meeting ends Wednesday. At that level, the rate would be a full point below the four-decade high it reached in July 2023. The policymakers had kept their key rate at its peak for more than a year to try to quell inflation, until slashing the rate by a half-point in September and a quarter-point last month.

The problem is that while inflation has dropped far below its peak of 9.1% in mid-2022, it remains stubbornly above the Fed's 2% target. As a result, the Fed, led by Chair Jerome Powell, is expected Wednesday to signal a shift to a more gradual approach to rate cuts in 2025. Economists say that after cutting rates for three straight meetings, the central bank will likely do so at every other gathering, or possibly even less often than that.

"We're on the cusp of a transition to them not cutting every meeting," said David Wilcox, a former senior Fed official who is an economist with Bloomberg Economics and the Peterson Institute for International Economics. "They're going to slow the tempo of cuts."

The economy has fared better than officials expected it would as recently as September. And inflation pressures have proved more persistent. The presidential election added a wild card, too: President-elect Donald Trump has promised to enact policies — from much higher taxes on imports to mass deportations of people living illegally in the United States — that most economists say threaten to accelerate inflation.

"Growth is definitely stronger than we thought, and inflation is coming in a little higher," Powell said recently. "So the good news is, we can afford to be a little more cautious" as the Fed's officials seek to lower rates to what they consider a "neutral" level — one that neither spurs nor restricts growth.

On Wednesday, the policymakers will also issue their quarterly projections for growth, inflation, unemployment and their benchmark interest rate over the next three years. In September, they had collectively envisioned that they'd cut rates four times next year. Economists now expect just two or three Fed rate cuts in 2025. Wall Street traders foresee even fewer: Just two cuts, according to futures prices.

Fewer rate cuts by the Fed would mean that households and businesses would continue to face loan rates, notably for home mortgages, that would far exceed their levels before inflation began surging more than three years ago.

Some economists question whether the Fed even needs to cut this week. Inflation, excluding volatile food and energy costs, has been stuck at an annual rate of about 2.8% since March. A year ago, the policymakers had forecast that that figure would have fallen to 2.4% by now and that they'd have cut their key rate by three-quarters of a point. Instead, inflation has become stuck at a higher level, yet the Fed after Wednesday's meeting will likely have lowered its benchmark rate by a cumulative full point.

Fed officials, including Powell, have said they still foresee inflation heading lower, however slowly, while their key rate is still high enough to restrain growth. As a result, reducing rates this week is more akin to letting up on a brake than stepping on an accelerator.

The potential for major changes to tax, spending and immigration policies under Trump is another reason for the Fed to take a more cautious approach. Former Fed economists say the central bank's staff has likely begun factoring the effects of Trump's proposed corporate tax cuts into their economic analyses, but not his proposed tariffs or deportations, because those two policies are too difficult to assess without details.

Tara Sinclair, an economist at George Washington University who is a former Treasury Department official, suggested that the uncertainty surrounding whether Trump's policy changes will keep inflation elevated — and necessitating higher rates — could also lead the Fed to cut rates more gradually, if at all.

"It seems easier to explain not cutting than to find themselves in a position where they would have to raise rates in this political environment," Sinclair said.

Powell has said the Fed is seeking to lower its rate to the so-called "neutral" level. Yet there is wide disagreement among the policymakers about how high that rate is. Many economists peg it at 3% to 3.5%. Some economists think it could be higher.

And Richard Clarida, a former vice chair of the Fed who is a managing director at PIMCO, said that if inflation becomes stuck above the Fed's target level, then the policymakers will likely keep rates above the neutral level.

During the July-September quarter, the economy expanded at a solid 2.8% annual rate. On Tuesday, the government will report the November retail sales figures, which are expected to show healthy consumer demand.

"There doesn't seem to be any sign of weakness emerging overall," said David Beckworth, a senior fellow at the Mercatus Center at George Mason University. "I don't see in my mind the justification for rate cuts."