THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: (609) 529 -1300
www.EconomicOutlookGroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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The Fed Cut Rates Again Even Though Inflation Is Not In Retreat

That press conference by Fed Chairman was quite a show. There was a pinch of amusement to see Jerome Powell stand behind the podium and labour to rationalize the Fed's decision to proceed with a third straight rate cut even though (a) the Summary of Economic Projections shows headline inflation moving higher next year, and (b) achieving the 2% target will take longer, perhaps not until the end of 2027. In contrast, the oddest forecast was that real GDP growth will drop back from 2.5% this year to 2.1% in 2025, despite the expansive fiscal policies to be implemented next year by the Trump Administration.

Practically speaking, I believe the Fed has effectively given up its goal of getting inflation back to 2% any time soon. Indeed, the latest FOMC statement removed the previous reassuring phrase from September's release, which noted *"The Committee has gained greater confidence that inflation is moving sustainably toward 2% target…"* Well, that sentence is now gone! — and with good reason. It's hard to dispute the fact inflation has veered off course. (Powell did hint we might actually see a lower PCE inflation print for November when that report is released on Friday, but I suspect this retreat may be short-lived.)

Frankly, short of a recession, it will be nearly impossible to get inflation back on its righteous path to 2% the next year or two. That is because Powell and his colleagues are about to face a new set of obstacles that threaten to thwart their goal. If you look ahead and consider President-elect Trump's firm commitment to slash taxes, curb immigration and launch an arsenal of import duties the next 12 months, how can there be *ANY* confidence inflation will

crawl back even close to the Fed's target. There's not of stick of gum that can hold price increases to 2% under such circumstances.

If the Fed's goal here was to slip in one more quarter-point cut before the next Administration takes office, then such a step does not come without real risks. First, this reduction was not warranted or urgently needed and may backfire to fuel more inflation. Second, it could erode the Fed's credibility as the nation's primary guardian against inflation. Third, given the current political climate, any subsequent monetary tightening that *commences after Trump takes office* could be construed by his loyalists as an effort by Powell and his colleagues to undermine the President's agenda.

Powell is aware Trump's second term in office could become problematic for setting monetary policy. No matter how many times Powell seeks to assure financial markets and global central bankers that politics will play no role when deliberating on interest rates, the reality is policymakers at the Fed now must function against the backdrop of a President who will not shy away from publicly criticizing the agency if he disapproves of their decisions. And if those rebukes by Trump and his advisers persist throughout the year, one has to ask if there's a risk it will puncture the long-held belief in Congress that the US central bank should operate independently of politics.

For now, the year ends with the Fed bringing the overnight rate down to 4.25% - 4.50%, the lowest in nearly two years. It's very unclear how many more --- or whether there will be any --- rate cuts in 2025. What we can say is the drum roll now begins leading to the next Fed meeting, which takes place only days after Trump takes office. From that moment on, the entire political and economic dynamics will change in Washington --- and we have to brace ourselves for that.