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ECONOMIC TALKING POINTS
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November's rate cut was an easy call.
But Trump's victory makes another reduction problematic for the Fed.

With the election over, the real work now begins on what a second Presidential term with Donald Trump means for U.S. monetary policy.

During the campaign, Trump showered virtually every constituency with lucrative pledges to gain their favor, including promises to end taxes on tips, overtime, social security benefits. Trump even vowed to lift the SALT deduction cap. Corporate taxes would also drop from the current 21% rate – already the lowest since 1939 – to 15% for firms that make products in the US. Moreover, to protect US industries and jobs from foreign competition, Trump eagerly talked of expanding tariffs on goods coming in from all countries, with special emphasis on imports from Mexico, Canada, Europe, and especially China.

Then there was this not so subtle warning from Trump's closest advisors that the Federal Reserve's days of enjoying political independence are numbered. They (and Trump himself) believe that as President with a large electoral mandate, he should have a greater say in setting interest rate policy.

Take a moment to think about all this.

If you stand back and view the totality of the changes coming in a second Trump term, it feels like we're about to enter into uncharted era with a profoundly different set of economic rules. It's not so much that things will be "different" the next four years, it's that the fundamental structure of the economy "won't be the same." There's more than a nuanced difference between these two.

What does it all mean in practical terms?

To begin with, economists will need to recast their forecast models if they are to have any chance at providing reasonably accurate projections on the path of the business cycle the next four years.

My central message to clients at this juncture should be to invest in being agile, nimble and resilient so they can better confront both the unusual set of economic policies coming and a world that will face perhaps even greater geopolitical risks next year.

As for today's events, we view the Federal Reserve's 25 basis point rate cut, to a range of 4.50% - 4.75%, an easy call. Its favorite inflation metric, the PCE chain price index, has slid to 2.1% rate over the past 12 months level (more accurately 2.09%). Core inflation, however, still remains above the Fed's 2.0%, with the most recent print at 2.7% The more wildly followed CPI has largely paralleled these disinflationary trends.

Today's action, however, still keeps the fed funds rate in restrictive territory. Clearly the Fed has chosen to proceed cautiously in lowering interest rate. **So what may they do next?**

Prior to the election, I felt confident policymakers would approve another quarter-point cut in December. That now appears less likely. Much will depend on changes in inflation expectations between now and then. The FOMC next gathers on December 17 and 18. Before that meeting, we will get three more inflation prints (CPI on Nov. 13 and Dec.11; PCE prices on Nov. 27), and one employment report (Dec. 6).

Frankly, I foresee the winds of inflation picking up in the coming weeks in anticipation that Trump's promises to expand tariffs, slash taxes and restrict immigration will all materialize in 2025.

Certainly the forward-looking financial markets wasted no time in their reaction to Trump's win. The major stock indexes rocketed higher in the belief that lower taxes and less regulatory supervision will translate into higher profits.

In contrast, the bond market sold off yesterday driving market yields higher out of fear that massive deficits, higher import duties and a tighter labor market would re-ignite inflation pressures, and that this would prompt the Fed to abruptly terminate any further monetary easing. (Let's face it, if Americans believe they would no longer be taxed on tips or overtime next year, they may well ramp up spending this year!)

I therefore see the chance of any further rate cut dropping below 50% in December and probably throughout 2025. There is simply a growing risk that an expansive fiscal policy in combination with higher tariffs will unleash another round of inflation.