Comerica Economic Alert

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Fed Cuts by a Quarter Percent but Signals Less Confidence that Inflation Will Slow

- **The Fed cut the federal funds rate a quarter percent at the November decision as expected.**
- **However, their policy statement signaled a bit less confidence that inflation will keep slowing.**
- **Inflation expectations priced into the bond market have risen since the election. If those expectations are realized, the Fed will cut rates less in the rest of 2024 and in 2025 than expected pre-election.**

As virtually assured, the Fed lowered the federal funds target a quarter percent to a range of 4.50% to 4.75% at the November 7 decision, two days after the election. The Fed continues to reduce the size of their balance sheet by running off up to $35 billion per month in mortgage-backed securities, and up to $25 billion per month in Treasuries. They actually ran off about $42 billion of their securities portfolio in October.

The Fed made modest changes to its policy statement in November that seem to indicate less confidence that inflation is slowing. Where the previous statement framed the September rate cut as appropriate "in light of the progress on inflation and the balance of risks," the current statement simply frames the cut as "in support of [the Fed's] goals." Also, the latest statement removed the September phrase, "The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent," keeping the second half of the justification for lower rates unchanged, "The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance." Chair Powell soft-pedalled that change in the press conference following the decision, explaining that the September statement indicated that inflation had hit the threshold for the Fed to pivot to cuts, but the Fed isn't still thinking of "confidence" as a precondition for further cuts. Methinks the gentleman doth protest… quite a bit. Finally, where the prior statement read "Job gains have slowed," the current statement reads, "Since earlier in the year, labor market conditions have generally eased." The Fed did not release an updated Dot Plot. They publish those quarterly, and the last one was in September. The next Dot Plot will be published in December.

In short, the Fed followed through with the cut signaled at the September decision, but was a little less adamant about the case for additional rate cuts in December and into 2025. Powell did state that the Fed is still "on a path toward a more neutral stance." But neutral is a theoretical idea, not a specific level.

The stock market's post-election surge is a sign of animal spirits being unleashed in anticipation of a return to tax cuts, deregulation, and tariff increases. In the bond market, long-term yields have risen post-election, with investors pricing in expectations for higher inflation over the next few years than they anticipated pre-election. If these expectations for higher inflation are realized, it will slow the pace of rate cuts next year. On the other hand, the market might be surprised again if the Democrats outperform in the undecided races for Congress and secure enough seats to limit the president-elect's ambitions.

President-elect Trump is likely to pressure the Fed to cut interest rates more aggressively, like he did during his first term, but at least over the next year it will have little effect on the trajectory of interest rates. The Fed system is structured to insulate rate decisions from pressure from the White House. After Fed Chair Powell's term expires in 2026, President-elect Trump will have an opening to appoint a new Fed chair who is more sympathetic to his calls for lower interest rates.