

Wall Street celebrates Fed interest rate “pivot”

Nick Beams

13 December 2023

Wall Street celebrated yesterday’s meeting of the US Federal Reserve which has been characterized as a “pivot” from a restrictive monetary policy, as it indicated interest rate cuts will start next year, possibly as early as March.

The Dow closed at over 37,000, a record high, and the other major indexes, the S&P 500 and the tech based NASDAQ, reached their highest levels in almost a year. The upsurge continued a trend which began after the November Fed meeting when the market began to anticipate rate cuts some time next year.

The same trend was reflected in the bond market with the yield on the 10-year Treasury, which was near 5 percent earlier in the year, falling to just above 4 percent with predictions that it could soon go below that level.

The swing of almost 100 basis points in a market that in “normal” times only shifts by relatively small amounts is an indication of the large movement of money which has pushed up the price of bonds. (Yields and bond prices have an inverse relationship.)

At the shorter end of the market, the yield on the two-year Treasury note recorded its biggest daily decline since the collapse of Silicon Valley Bank in March.

After the November Fed meeting, chair Jerome Powell sought to temper market expectations of rate cuts by adopting what was regarded as a somewhat “hawkish” tone in his press conference and in subsequent comments.

Just two weeks ago, in a major speech just before the blackout period, which precedes Fed meetings, he pushed back against market expectations.

“It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease,” he said.

That tone was gone at his press conference following

yesterday’s meeting with speculation about when a rate cut would be made set off by Powell’s remarks.

They were reinforced by the summary of economic projections submitted by members of the Fed’s policy-making body, the so-called “dot plot,” which showed interest rates coming down by around three quarters of a percentage point from their present level of between 5.25 and 5.5 percent.

The aggregation of the individual “dot plot” predictions showed Fed officials expected the funds rate to be between 4.5 and 4.75 percent by the end of next year, falling further in 2025.

There was a significant change in the statement by the Federal Open Market Committee which announced the decision to keep interest rates on hold.

It said that in “determining the extent any additional firming that may be appropriate to return inflation to 2 percent over time” the committee would consider the cumulative effect of past tightening.

The difference was the insertion of the word “any” into the wording of the previous statement.

Asked about the change at his press conference, Powell said it reflected the view that the Fed rate was “likely at or near its peak for this tightening cycle.” He said officials “do not view it is likely to be appropriate to raise interest rates further” before adding the pro forma declaration that “neither do they want to take the possibility off the table.”

All this was music to the ears of the stock market which rose steadily during the press conference.

It also took great heart from the statement by Powell that the Fed would start to cut rates before inflation reached its target level of 2 percent. The estimates by Fed officials for core inflation, measured by the personal consumption index, are for inflation of 2.4 percent in 2024, falling to 2.2 percent in 2025. The

median projections for these years in September were 2.6 percent and 2.3 percent respectively.

Powell said the Fed would not wait until 2 percent was reached because “you’d want to be reducing restriction on the economy well before” that point “so you don’t overshoot.”

Having been castigated for not raising rates soon enough at the start of the inflation surge in 2021, Powell was keen to indicate to the markets that the Fed would not fall behind the curve as inflation started to come down, and that if interest rates were kept too high it could possibly lead to a recession.

“We’re aware of the risk that we would hang on too long,” he said. “We know that’s a risk and we’re very focused on not making that mistake.”

Powell said the Fed was proceeding “carefully” and while it was too early to declare victory and indicate directly that the Fed was making a pivot, all his remarks went in that direction.

He said officials were looking at when they might lower rates and that “begins to come into view, and clearly it’s a topic of discussion.”

However, despite the jubilation on Wall Street, there are warnings that the pivot in interest policy may indicate fear of a recession. A significant factor is the impact of higher rates on companies which borrowed at very low interest rates with the resumption of quantitative easing at the start of the pandemic, but which now have to refinance under conditions of much higher rates.

Commercial property is one of the areas most affected along with start-up companies that have been floated with large amounts of borrowed money based on speculation that they could be “the next big thing.”

On the economic outlook, Powell pointed to a significant slowdown.

“Recent indicators suggest that the growth of economic activity has slowed substantially from the outsized pace seen in the third quarter,” he said.

Activity in the housing sector had “flattened out” and was “well below the levels of a year ago,” reflecting the effect of higher mortgage rates, and higher interest rates also appeared to be “weighing on business fixed investment.”

Overall, he said, Fed officials expected the economy to grow by only 1.4 percent next year with the unemployment rate expected to rise from its current

level of 3.7 percent to 4.1 percent at the end of next year.

He said wage rises had been gradually “cooling off” but were running “a bit above what would be consistent with 2 percent inflation over a long period of time.”

The prospect of interest rate cuts might be expected to provide a boost to the economy. But as some analysts have pointed out, it could have a perverse effect as investors postpone decisions to borrow to make new investments now because they anticipate they will be able to get better terms in the near future.



To contact the WSWS and the
Socialist Equality Party visit:

wsws.org/contact