Fed cuts interest rates amid market frenzy

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As expected by financial markets, the US Federal Reserve cut its base interest rate by 0.25 percentage points at its meeting on Wednesday but indicated that a further rate cut in December—also widely anticipated—was not a "foregone conclusion."

Wall Street, which had been looking forward to an assurance that the Fed was on a downward path of cheaper money, helping to propel it to still greater heights, fell when that was not forthcoming.

In his prepared remarks, Fed chair Jerome Powell said there were "strongly differing views about how to proceed in December. A further reduction in the policy rate at the December meeting is not a foregone conclusion—far from it. Policy is not on a preset course."

He emphasised this issue in his press conference. "I always say that it's a fact that we don't make decisions in advance. But I'm saying something in addition here."

The "far from it" phrase was described by one economist cited by the *Financial Times* (FT) as "heavily loaded" and "intended to send a signal."

Another factor appears to have been the lack of data available to the Fed because of the government shutdown. "What do you do when you're driving in a fog? You slow down," Powell said, indicating that there was a "possibility" that the lack of data could influence the debate on what to do in December.

The "strongly differing views" referred to by Powell were reflected in yesterday's decision. Trump's latest appointee to the Fed board, Stephen Miran, who backs the president's demand for major rate cuts, voted for a cut of half a percentage point. But the Kansas City Fed president Jeffrey Schmid called for the rate to remain on hold.

In his prepared remarks, Powell noted that in the near term "risks to inflation are tilted to the upside and risks to employment to the downside—a challenging situation" and there was no "risk-free path" for policy.

He said that while inflation had come down from the highs of 2022, it remained "somewhat elevated" relative to the Fed's goal of 2 percent and inflation in the price of goods had picked up with higher tariffs pushing up prices in some categories. He claimed there was a "reasonable case" that the tariff effect would be a one-time shift, but it was "also possible" the inflationary effects "could be more persistent."

The increase in the downside risks to employment was cited as the justification for the rate cut even as inflation persisted. But the rate reduction will do virtually nothing to boost the real economy.

Since the Fed meeting in September, there have been a swath of job cuts in key sections of industry. The employment placement firm Challenger, Gray & Christmas has said that employers have announced almost a million job cuts so far this year.

Major firms are carrying out a purge. Amazon is to cut 14,000 corporate positions this year, with more to come in 2026, and UPS has already axed 48,000 positions so far this year.

The rate cut will do nothing to halt the job slaughter. Its only impact will be to inflate the stock market as Wall Street demands cheaper money to sustain the ongoing frenzy.

FT columnist Brooke Masters this week described a recent conference she attended on asset-backed securities as resembling scenes from the movie The Big Short, "which depicted the lunacy of the mortgage-backed securities market right before the 2008 crash."

The instability of the market is expressed in the violent movements in the prices of high-tech stocks this year, as outlined in a report published in the FT this week. It said that individual stocks had gained or lost $100 billion in market capitalization in a single day 119 times so far this year, the highest level on record.

According to Bank of America, this year has already exceeded the record number in 2024 of what is called "fragility events" in big tech stocks when prices move outside their usual range, with large-cap tech stocks moving "10, 20, 30 percent in a day" in the kind of price movements that used to be rare.

The biggest upward mover has been the AI chipmaker Nvidia, which this week became the first $5 trillion company by market capitalization, just three months after it passed the $4 trillion market.

Its share price has risen by 90 percent in the past six months alone to the extent that the company has a market value greater than the main stock indexes of Germany, France, and Italy combined. Just three years ago, before OpenAI launched ChatGPT in late 2022, Nvidia, which produced chips for video games, was valued at $400 billion.

But the kind of violent downside movement that can take place was demonstrated in after-hours trading on Wednesday when $155 billion was wiped off the shares of Meta (the owner of Facebook) over market concerns about the extent of its capital spending on AI.

The growing instability of the financial system was highlighted in a report from the International Monetary Fund earlier this month.

It said that "valuation models show risk asset prices well above fundamentals, raising the risk of sharp corrections" and that "markets appear complacent as the ground shifts."

There were also indications from the Fed in yesterday's decisions that it is concerned about possible liquidity problems arising in financial markets as it announced the conclusion of its financial asset reduction program from the beginning of December.

Since June 2022, the Fed has reduced its holdings of US Treasuries and mortgage-backed securities—purchased during the period of quantitative easing—in a process known as quantitative tightening.

But the withdrawal of the Fed has the effect of tightening the money markets, in particular, the very-short-term repo market, which plays a decisive role in the highly leveraged mechanisms of the financial system.

The Fed is anxious to avoid the experience of 2019 when an attempt to reduce its asset holdings saw overnight rates, normally at low levels, shoot up to as high as 10 percent.

Pointing to just one of the issues that could set off financial turbulence, Diane Swonk, chief economist at KPMG US, said: "The biggest issue driving the Fed's thinking is the fear of a liquidity shock."