2 firm inflation prints just made the Fed's 2025 rate cut path a lot 'murkier'

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October inflation readings out this week have shown little progress toward the Fed's 2% inflation target, putting into question how deeply the Federal Reserve will cut interest rates in 2025.

On Wednesday, the "core" Consumer Price Index (CPI), which strips out the more volatile costs of food and gas, showed prices increased 3.3% for the third consecutive month during October. Then, on Thursday, the "core" Producer Price Index (PPI) revealed prices increased by 3.1% in October, up from 2.8% the month prior and above economist expectations for a 3% increase.

Taken together, the readings are adding to an overall picture of persistent, sticky inflation within the economy. Economists don't see the data changing the Fed's outlook come December. And markets agree with the CME FedWatch Tool currently placing a nearly 80% chance the Fed cuts rates by 25 basis points at its December meeting.

But the lack of recent progress on the inflation front could prompt the Fed to adjust its Summary of Economic Projections (SEP), which had forecast the central bank would cut interest rates four times, or by one percentage point in total, throughout 2025.

"PPI won’t decisively alter the Fed’s easing bias, but it makes charting the policy outlook murkier," Nationwide financial market economist Oren Klachkin wrote in a note to clients today. "We anticipate 75 [basis points] of cumulative Fed easing in 2025, but risks seem to be tilting toward a more gradual pace of easing."

"Their bias is toward cutting, but they'll probably have to have to go at a slower pace next year," Wolfe Research chief economist Stephanie Roth told Yahoo Finance (video above).

Markets have quickly shifted over the past two months to reflect this sentiment. On Sept. 18, when the Fed slashed rates by half a percentage point, markets had projected the Fed would finish 2025 with a federal funds rate around 3%. Now, the market is pricing in about 80 fewer basis points of easing next year.

This speculation has also prompted a large increase in bond yields over the past month. The 10-year Treasury yield (^TNX) has added about 80 basis points since the Fed's first rate cut in September. But that in itself hasn't proven to be a headwind for the stock market rally, as all three indexes are within striking distance of new record highs. Investors have attributed the market's resilience to stronger-than-expected economic data flowing in as bond yields rise.

"The reason it hasn't hit the stock market is very simply because if the yield is rising, partly because growth is going to be stronger, that effect is going to be stronger on the stock market," Bridgewater Associates co-chief investment officer Karen Karniol-Tambour said at the Yahoo Finance Invest conference.

At his most recent press conference on Nov. 7, Fed Chair Jerome Powell said inflation continues to come down on a "bumpy path" but declined to provide forward guidance on the Fed's path.

"We don't know the right pace, and we don't know exactly where the destination [of rates] is," Powell said. "So the point is to find that, to find the right pace and the right destination as we go. And I think there's a fair amount of uncertainty about that. "

But economists are taking hints from recent trends within the inflation prints. The three-month annualized rate of core inflation moved from 3.1% last month to 3.6% after the October CPI release. This underscores the recent lack of progress toward the Fed's 2% goal. Add the potential inflationary economic policies expected from President-elect Donald Trump, and the picture becomes even more uncertain.

"The inflation data over the past few months have not shown much additional progress, and the election outcome has raised new questions about the path ahead for price growth," Wells Fargo senior economist Sarah House wrote in a note to clients. "We think the time is fast approaching when the FOMC will signal that the pace of rate cuts will slow further, perhaps to an every-other-meeting pace starting in 2025."

Economists use the data from CPI and PPI to project a reading from the "core" Personal Consumption Expenditures (PCE) index, the Fed's preferred inflation gauge. Bank of America US economist Stephen Juneau believes that release, due out at the end of November, will show core prices rose 2.8% in October, up from 2.7% in September.

"If our forecast proves correct, it will mark two consecutive uncomfortably high prints as the Fed seeks to return inflation to its 2% target," Juneau wrote in a note to clients on Thursday.

He added this doesn't mean markets should "panic." Some of the factors driving inflation higher in October, like financial services and airfares, aren't expected to last. Additionally, inflation expectations remain low, and the labor market no longer appears to be a cause of concern on the inflation front.

Still, Juneau, like other economists, argues the recent data shows "the risk appears to be tilting toward a shallower cutting cycle given resilient [economic] activity and stubborn inflation."

Federal Reserve Board Chairman Jerome Powell speaks during a news conference at the Federal Reserve in Washington, Thursday, Nov. 7, 2024. (AP Photo/Mark Schiefelbein) · ASSOCIATED PRESS

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