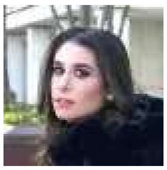
The Fed made a slow pivot in 2023. It faces pressure to move faster in 2024.



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What a difference a year makes for the Federal Reserve.

The central bank entered 2023 having raised interest rates at the fastest pace since the 1980s as part of an aggressive campaign to cool red-hot inflation.

Now, as the year draws to a close, that campaign appears to be all but over.

The Fed last raised rates in July to a 22-year high. After holding rates steady at their third consecutive meeting this month, Fed officials predicted they would likely pivot to cutting rates three times in 2024.

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Even Fed Chair Jerome Powell, after months of sounding hawkish, turned slightly dovish at his last press conference of the year while keeping all options open.

"You see that people are not writing down rate hikes," Powell said last Wednesday. "That's us thinking that we have done enough but not feeling that really strongly confidently and not wanting to take the possibility of a rate hike off the table."

"Nonetheless, it's not the base case anymore."

Federal Reserve Board Chair Jerome Powell at a news conference last Wednesday. (AP Photo/Alex Brandon) (ASSOCIATED PRESS)

The debate in 2024 will likely be about when cuts can begin and whether the Fed will be as aggressive as markets expect.

Some Fed officials have urged patience in recent days, saying that it was "premature" to talk about a rate cut as early as March and that the markets had gotten "ahead" of the central bank by betting on cuts early in 2024.

But one of these officials also emphasized it was in fact appropriate to start discussing cuts given the progress made by the central bank this year.

Inflation falls

The reason for the Fed's long, slow pivot in 2023 was simple: Inflation fell closer and closer to its target of 2%.

The Fed's preferred reading of "core" inflation, which strips out volatile food and energy prices, stood at 3.5% for the month of October, down from 3.7% in September and 4.3% in June. That puts the reading lower than what Fed officials had predicted for the end of the year.

When the year started, both the Fed and inflation were in much different places. In January, core inflation was 5.6%, and the Fed had just completed some eye-popping tightening measures — including a 50-basis-point hike in December 2022 and 75-basis-point hikes in the summer and fall of 2022.

But Powell was already indicating that same month that progress had been made.

"We can now say for the first time that the disinflationary process has started," Powell said in January.

What the Fed then decided to do as the year evolved was to slow the pace of its hikes, giving its tightening a chance to filter through the US economy while it evaluated the pace of inflation.

Rates went up by a quarter percentage point on Feb. 1 and then by quarter-point increments in March and May, defying some predictions that a regional banking crisis that roiled the financial world during that time might stop the Fed from hiking further.

The Fed then paused at its June meeting before raising rates for the last time this year in July, settling at a 22-year high of 5.25% to 5.5%.

Warnings

The second half of the year offered an extended standoff between the Fed and markets.

Investors were increasingly eager for the central bank to indicate the rate-hiking campaign was over, but Fed officials were careful to say repeatedly that they needed to see more progress on inflation before they would be ready to stop raising rates.

Powell himself offered several warnings that investors should not presume the hikes were done. One came in August, as [Fed officials decamped to an annual symposium](#) in Jackson Hole, Wyo.

Fed Chair Jerome Powell, left, at Jackson Hole, Wyo., in August with European Central Bank President Christine Lagarde, right, and Bank of Japan Governor Kazuo Ueda, center. (Photo by Natalie Behring/Getty Images) (Natalie Behring via Getty Images)

"At last year's Jackson Hole symposium, I delivered a brief, direct message. My remarks this year will be a bit longer, but the message is the same: It is the Fed's job to bring inflation down to our 2% goal, and we will do so," Powell said in August.

As late as Dec. 1, Powell warned against assuming the Fed was finished raising rates.

"It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease," Powell said in a speech at Spelman College.

Powell's pivot

Then the central bank shifted course last week, taking many by surprise. Not only did the interest rate-setting committee pencil in three rate cuts for 2024, but Powell acknowledged that the central bank was likely at the peak of the current rate-hiking cycle.

Powell also said at his press conference that cuts will be "a topic for us looking ahead" and acknowledged the subject had been a topic of conversation at the December meeting.

A trader works, as a screen displays a news conference by Federal Reserve Board Chairman Jerome Powell last Wednesday. REUTERS/Brendan McDermid (Reuters / Reuters)

The markets rallied, cheering a return to cuts in 2024. Investors, which had been pricing in four rate cuts for next year going into the December meeting, boosted those bets to five. And they are now predicting the central bank will begin to start these cuts in March.

It is also clear, however, that the decision will not be a straightforward one and will hinge on data. While the median projection for next year is three cuts, predictions from individual Fed members vary, according to a "dot plot" released by the Fed last week.

Two members see holding rates at current levels, five see two cuts next year, six see three cuts, and four see four cuts next year.

There was more evidence of this divergence among Fed officials in the days after the last meeting. In media interviews, some Fed officials began pushing back on the market’s bullish reaction while others acknowledged possible cuts were part of the current discussion.

New York Fed president John Williams made it clear that he felt it would be premature to talk about a rate cut in March, while Chicago Fed president Austan Goolsbee said he was confused by the market’s response.

New York Federal Reserve President John Williams. (Photo by Rob Kim/Getty Images) (Rob Kim via Getty Images)

Cleveland Fed president Loretta Mester added that markets had gotten "a little bit ahead" of the central bank.

Other officials, however, have been willing to acknowledge that cuts are on the table if inflation keeps tumbling. One was San Francisco Fed president Mary Daly, who said it was appropriate to begin the rate-cut discussion given the progress on inflation.

If inflation continues to drop, the Fed's benchmark rate would still be restrictive even with three cuts, she told The Wall Street Journal.

Atlanta Fed president Raphael Bostic also predicted cuts, but in the second half of 2024.

What could determine how quickly or how much the Fed will cut is whether the US economy falls into a recession or not. Some think the Fed won’t cut rates three times unless a recession appears.

Powell made it clear last week that the economy could still move in surprising directions in 2024.

"Nobody is declaring victory," he said. "That would be premature."