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After the Fed's Rate Cut, Why Are Rates Higher?

Treasuries have risen in the wake of the central bank's late-2024 cuts. What gives?

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Key Points

- Historically, rate-cutting cycles have been associated with falling US Treasury rates. But not this time.
- A combination of a robust economy and uncertainty surrounding the policies of the Trump administration have re-ignited inflation risks.
- After having engineered a 100-bp rate cut between September and December of 2024, it's no surprise that the rate-cutting cycle is on hold for the time being.

With great fanfare last September, the Federal Reserve (Fed) announced a 50-basis-point (bps) cut in its federal funds rate—a move intended as a signal to investors that the long battle against inflation had apparently been won. For good measure, the September 18 cut was followed by 25-bps cuts in November and December.

Historically, rate-cutting cycles have been associated with falling US Treasury rates. But not this time. Since that initial September cut, Treasury rates have climbed steadily, with the US 10-year Treasury rising over 100 bps higher as of mid-January 2025.

Many investors might be wondering why long-term rates have surged despite the Fed rate cuts. But several key factors have set this rate-cutting cycle apart from prior ones.

Factor #1: No Economic Crisis to Avert

Historically, when the Fed has been actively cutting rates, it's accompanied by a slowing economy—or worse, a crisis (**FIGURE 1**). While there are other instances of rate cuts in that 25-year span (the Fed cut 75 bps from July 2019 to January 2020), the pace of those cuts was gradual, and the Fed wasn't necessarily attempting to prevent an economic disaster.

FIGURE 1: During Economic Crises, the Fed Rapidly Cuts Rates
Three Events That Prompted the Fed to Cut its Federal Funds Rate by 100 bps

Crisis Event	Key Rate	Start (%)	End (%)
COVID-19 2/28/20-4/30/20	Federal Funds Rate	1.75	0.25
	10-Year Treasury Rate	1.15	0.64
Global Financial Crisis 11/30/07-1/31/08	Federal Funds Rate	4.25	3.00
	10-Year Treasury Rate	3.94	3.60
Dotcom Bust 11/30/00-1/31/01	Federal Funds Rate	6.50	5.50
	10-Year Treasury Rate	5.47	5.11

Source: Hartford Funds.

Factor #2: Continued Strong Economic Data

At the present time, the economy seems to be firing on all cylinders:

- Over two million jobs were created in 2024
- December unemployment rate of 4.1% vs. longer-term averages closer to 6%
- GDP is expected to come in between 2.8-3.0% for 2024, consistent with the 3% average since 2000
- Consumer spending continues to remain strong, with retail sales up 3.8% in November[1]
- Personal Income up 2.64% year-over-year in November 2024[2]

[1] US Census Bureau.

[2] YCharts.

Clearly, these numbers suggest no need for the Fed to cut rates. Low unemployment, strong consumer spending, and higher incomes are generally a recipe to keep rates higher or, at a minimum, not to see them drop.

Factor #3: Inflation Fears Rekindling

The Fed has made tremendous strides in reining in inflation, from its peak of 9.1% in June 2022 back to 2.7% in November 2024. That said, "the last mile is often the hardest," as the saying goes. Lately, the Consumer Price Index (CPI)[3] has been moving sideways, more or less. Core CPI (excluding food and energy) has been stuck at 3.2-3.3% for the past six months.

Meanwhile, just as US Treasury rates were bottoming out in the fall of 2024, the US presidential election was coming into sharper focus, with neither party saying much to address the potentially inflationary risks of rising federal deficits. Ultimately, Donald Trump won the presidency, and the Republican party swept the Senate and the House.

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While the Republican margins are narrow, one-party control of both legislative houses makes it theoretically easier for the president to get key parts of his agenda passed. Many of Trump's policies are intended to be pro-growth (e.g., deregulation and tax cuts) on top of an already strong economy. In addition, the implementation of new tariffs, as well as proposals to expand deportation of immigrants, have many investors worried about inflation once more.

Finally, many new policy proposals could directly impact the US debt balance, which stood at $36 trillion at year end.[4] Estimates of future debt levels have ranged from an added $3 trillion to $7 trillion over the next few years in the absence of drastic changes to spending—which may significantly raise the price the US government pays on newly issued debt.

While the impact of any policies won't be fully known for some time, the market is trying to project a range of outcomes. As a result, 10-year Treasuries rose 30 bps since the election through year end and an additional 50 bps as of January 10.

Why Cut Rates at All?

Investors should keep in mind that the Fed's recent hiking cycle took place with unprecedented speed. The federal funds rate went from zero to 5.50% in the span of 18 months—the fastest upward move since the 1980s. Inflation had reached unacceptably high levels in June 2022, and the Fed was aggressively hiking to get it back to a more comfortable level.

As the inflation rate gradually declined toward its target rate of 2%, the Fed remained cautiously aware of the risk of staying overly restrictive for too long. Keeping its dual mandate of price stability and full employment in mind, Fed policymakers were comfortable taking their foot off the gas last September—especially when they saw some weakness in labor markets.

But after having engineered a 100-bps rate cut between September and December of 2024, Fed policymakers have been signaling an awareness of inflationary risks ahead. It's no surprise that the rate-cutting cycle is on hold for the time being.

Conclusion

The Fed's recent cutting cycle should be viewed from the lens of an overly aggressive Fed downshifting to a more neutral policy. Some investors may have been caught by surprise as rates ticked higher following the Fed cuts, but, in light of continued strong economic data and fresh concerns about re-inflation, a higher-rate environment starts to make sense.

[3] The Consumer Price Index (CPI) is a measure of change in consumer prices as determined by the US Bureau of Labor Statistics; [4] National Debt Clock, Peter G. Peterson Foundation.

Your financial professional can help prepare your portfolio for a changing rate environment.

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