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SHUTDOWN DELAYS DATA

Fed's policy path looks more treacherous

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The Federal Reserve has wagered since August that it could afford to lower interest rates even as inflation picked back up for two crucial reasons. Price pressures from President Donald Trump's tariffs were likely to be temporary, and a weakening labor market would help to keep inflation in check as companies hesitated to make their products more expensive and wage growth stayed subdued.

The potential pitfalls of this strategy were clear from the start. Federal Reserve Chair Jerome Powell readily admitted that the approach was hazardous after unveiling it at the central bank's annual conference in Jackson, Wyoming.

Cutting interest rates too quickly could inadvertently stoke inflation, while moving too slowly could tip the economy into a downturn. As Powell put it in September — when the Fed lowered interest rates for the first time this year — the central bank faced "no risk-free path."

The government shutdown, which is entering its fifth week, has made that path all the more treacherous. The federal workers who collect and report economic data on inflation, the labor market, wages and a range of other metrics are no longer performing that work, obscuring officials' view of the economy at a moment when divisions over the policy outlook have sharpened.

The Fed is still poised to lower interest rates another quarter of a percentage point on Wednesday to a new range of 3.75% to 4%. But it will be much harder for the central bank to feel confident about what to do next without its most reliable sources of data in hand.

"The lack of official government sector data is a big impediment to having a clear take on where the economy is," said Seth Carpenter, a former Fed economist who is now at Morgan Stanley. "I think it makes them more confused, it makes it more uncertain and it forces a deeper debate about risks."

The lapse in funding, which is now one of the longest ever, has left the central bank devoid of any of the official government statistics that its policymakers see as the "gold standard" for economic data. The government did not release its October jobs report, which the Fed relies on to understand the trajectory of the labor market, and will not release the one for November. The only exception to the data lapse came last week when the Bureau of Labor Statistics published the consumer price index report for September. The release, which was published more than a week late, was pulled together to meet a deadline to adjust Social Security benefits for inflation. That report provided some relief, with price pressure being less intense than feared. But it is likely to be the last inflation report for a while if lawmakers do not soon reach a deal to reopen the government.

Alternative measures for tracking prices, spending and hiring exist, including surveys and anecdotes collected by policymakers across the 12 regional Fed banks. But those fall far short in terms of reliability and consistency over longer stretches of time. Private-sector data can help fill some gaps, but access is not always a given.

ADP, a payroll services company, for example, recently stopped providing the Fed with weekly data on roughly 20% of the country's private workforce that the central bank had for years tracked.

Lacking a complete picture of the labor market is particularly hazardous for the Fed given that it is the cornerstone of many officials' view that they do not need to be overly concerned about inflation even though it has run well above the central bank's 2% target for several years.

What was clear before the shutdown was that the labor market was cooling off. Monthly jobs growth had slowed significantly, and the unemployment rate, while relatively stable, had edged slightly higher.

Companies had also been posting fewer job openings, and the number of Americans willingly leaving their positions had plateaued. Part of that reflected a pullback in demand for new hires as companies turned more cautious about expansion plans, or

sought to reduce costs to offset rising expenses from Trump's tariffs. - Note

The slowdown is also likely to reflect a pullback in the supply of available workers in the wake of Trump's immigration crackdown. What has resulted is a labor market suspended in a "curious balance," according to Powell. That, he warns, makes it susceptible to a more severe slump.

So far, that has not happened. Some companies, like Target and General Motors, have laid off workers, but the number of Americans filing for unemployment benefits remains low by historical standards. Consumer spending, which accounts for roughly 70% of the \$23 trillion economy, has also held up, even though it is primarily driven by wealthy Americans.

If the cracks in the economy's foundation start to deepen, the Fed's decision to lower interest rates to a more neutral setting that neither speeds up growth nor slows it down will look prudent. But if that foundation stays sturdy, the Fed could face a bigger inflation problem than it had planned for.

"The Fed better be right that labor demand is slowing significantly, because if that isn't the case and we still have upward pressure on inflation, then cutting rates now is going to be a mistake," said Torsten Slok, chief economist at Apollo Global Management. "It's playing with fire to allow inflation to be too high above the target for an extended period."

Some officials at the Fed appear more concerned about that risk than others, spawning a range of views about how much more to lower interest rates in the coming months.

What has complicated the decision further is that policymakers have different perspectives on what exactly constitutes a neutral policy setting. Some believe interest rates are more or less at that level, while others think the central bank still has a ways to go until interest rates are no longer restraining economic activity.

While officials are not getting the economic data that would typically help to bridge those gaps, the shutdown has, in some ways, narrowed the scope of potential policy actions for the Fed to take in the interim.

As of September, most officials were on board for two more quarter-point cuts this year, so there is likely to be a high bar to deviate from that course.

The standard thinking is also that the shutdown will shave between 0.1 and 0.2 percentage points off annual growth in economic output for each week it drags on. And this time around, the Trump administration has threatened to lay off workers and withhold back pay once the government reopens. The prospects of a bigger, more permanent hit to growth only serve to bolster the case for interest rate reductions.

At the same time, a larger half-point cut seems unlikely. For policymakers to coalesce around that, they need concrete proof that the labor market is quickly crumbling. The government data blackout will make that harder to amass.

"Doing nothing is the same as doing something," said Eric Winograd, an economist at the investment firm AllianceBernstein. "All else equal, the lack of official data argues for them to be more cautious rather than more aggressive."

After Wednesday's cut, Winograd expects the Fed to again lower borrowing costs a quarter of a percentage point in December and to continue to make consecutive reductions in 2026 until interest rates reach a range of 2.5% to 2.75%.

But for other economists, the Fed's ability to cut interest rates next year is far more constrained given an expectation that growth will soon speed back up.

Uncertainty around Trump's tariffs and other economic policies is expected to have receded by then. - Note

And many Americans are poised to receive bigger tax refunds because of provisions in the tax and spending bill Trump signed into law over the summer.

The legislation eliminated taxes on tips and overtime for certain workers as well as provided larger credits for some families with children. Big benefit cuts, which could see millions of people lose Medicaid and food stamps in the coming years, do not kick in until after the midterm elections in November next year.

"There's pretty substantial consumer stimulus that's going to kick in," said Donald Rissmiller, chief economist at Strategas, a research firm. "It's pretty clear we should have substantial tail winds by February." *Note*

What worries Rissmiller most is not the Fed's cutting interest rates now — which he believes is warranted — but failing to change course if the economy gathers steam again. *Note*

