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Fed Upheaval Sows New Rate Uncertainty

BY MATT GROSSMAN

Weeks before what is likely to be the Federal Reserve's first interest-rate cut of the year, an unprecedented effort by President Trump to reshape the central bank is scrambling the dynamics on its policy committee.

In an Aug. 22 speech, Fed Chair Jerome Powell opened the door to a rate cut at the Fed's Sept. 16–17 meeting to cushion a weaker labor market. While a quarter-point reduction from the current 4.25% to 4.5% target range still looks all but assured, the breadth of support for that cut among Fed officials, and what comes after, have been thrown into doubt.

Trump has moved to fire Fed governor Lisa Cook over allegations of mortgage fraud, the first time a president has tried to dismiss a governor in the central bank's 111-year history.

Cook sued to block her removal, and initial arguments in Washington, D.C., federal district court Friday left it unclear whether Cook was still serving or would be able to vote at the September meeting.

The court fight over Cook's position strains internal Fed unity. Cook named Powell a defendant in her suit because she wants a judge to rule that he can't bar her from the Fed. Neither Powell nor the Fed has taken a position on the case. In court Friday, the Fed asked only that the judge, Jia Cobb, rule quickly, "to remove the existing cloud of uncertainty."

Interest rates are set by the Federal Open Market Committee, composed of a board of seven governors in Washington nominated by the president and confirmed by the Senate, and five presidents of the 12 regional reserve banks on a rotating basis.

Besides Cook, the governors consist of Powell and two Biden administration appointees who, like Cook, consistently vote with him, and two governors appointed by Trump in his first term, both of whom in July dissented in favor of a rate cut. Trump has nominated Stephen Miran, a close adviser who has also backed rate cuts, to an open seat on the board.

Miran's confirmation hearing before the Senate Banking Committee is set for Thursday. If the full Senate confirms him quickly enough, he could join the Fed in time for the September meeting, meaning at least three Trump-aligned governors strongly backing the president's demand for rate cuts.

If courts rule that Cook can be fired, Trump has told advisers he would move quickly to nominate her successor, which would give his appointees a four-to-three majority on the board. That confirmation would be difficult to accomplish before the September meeting, but Cook's absence alone could leave the board evenly split between three Trump appointees, two Biden appointees and Powell.

While support for at least a quarter-point cut has built across the FOMC, there are skeptics on both sides. "Inflation remains too high, and therefore policy should remain modestly restrictive," Kansas City Fed President Jeffrey Schmid said earlier this month. Meanwhile, some analysts anticipate that Michelle Bowman or Christopher Waller—both appointed by Trump—could press for a half-point cut. Waller, however, in a speech in Miami Thursday, backed a quarter-point cut unless the economy weakens substantially.

"I would not be surprised if on an ongoing basis here, we get dissents quite regularly," said Matthew Luzzetti, Deutsche Bank's chief U.S. economist.

High-profile dissents could sow confusion among investors trying to discern who will control the path of rates over coming months: Powell or the growing contingent of Trump appointees.

The pressure on the Fed from the White House and Cook's case have put enormous weight on Powell.

"Powell is going to be trying to keep the upcoming meetings as ringfenced as possible from all the pressures and questions floating around the Fed institutionally," said Krishna Guha, vice chairman at Evercore ISI.

Through July, most Fed officials were broadly hesitant to cut interest rates, though they assessed that rates were high enough to lean against economic growth.

At the Fed's annual Jackson Hole conference, Powell said his perception of the risks has shifted. Unemployment has stayed modest, but after seismic downward revisions to job creation landed in early August, the labor market now appears weaker. Further risks to the labor market help make the case for a coming rate adjustment, Powell said.

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