Powell Guides Modest Easing With Low Conviction

- The overall communications were less dovish than they could have been…
- ...with a maximum of 50bps in cuts signalled…
- ...and heavy conditionality around even that amount of easing...
- ...amidst no change in balance sheet guidance…
- ...and relatively minor changes to forecasts and statement language…
- ….leaving one to ponder whether markets were truly listening throughout

This was about the lowest conviction delivery of a potential rate cut or cuts that one could have imagined. The entire suite of communications is enshrouded by heavy conditionality, but **it was worth waiting to listen to the press conference in order to get the full picture because that was when the conditionality of it all was made clearer**. In my view, the market reaction didn't necessarily hear as much of the heavy conditionality that surrounded the cut prospects as could have been the case, especially during Powell's press conference. The overall suite of communications was not as dovish as it might have been or than was priced going in, such that the further rally in short rates on the headlines appears overdone. I think the reaction to price in three cuts this year and more than four by the end of next year was overdone on the back of the overall messaging here.

First I'll review the changes and then come back to Powell's significantly milque toast guidance.

- Against some expectations, **the Fed left its policy rate range unchanged** at 2.25–2.5%. This reflects a lack of urgency by contrast to some market voices into the meeting with about a one-in-four chance of a cut priced for today;
- **The median projection unweighted toward voting FOMC members points toward no rate cut this year and only one cut next year followed by a hike in 2021. The longer run neutral rate was revised down** by 25bps to 2.5% for the second downward revision since December. That's a far cry from the nearly full percentage point of easing priced by the end of next year and most of three cuts priced by the end of this year going in.
- **The dispersion of the dots, however, puts seven voices in favour of two cuts this year and one in favour of a single cut for eight cut voices in total against eight holds and one hike.** During the press conference, Powell may have indicated that his dot was likely in the two cut camp when he said developments prompted "a number of us to write down rate cuts" and "a number of them have not." Thus, the power-weighted dots indicate easing.
- **The updated dot plot set a floor for the potential amount of easing at -50bps** from here. The lowest of the dots is clustered around this range over the forecast period. **That is less than fed funds futures had priced.**
- **Balance sheet policy was left unchanged as expected.** There were no references to expediting plans to end run-off earlier than September and certainly no QE4 references. The final question in the press conference was on this topic and Powell said that balance sheet run-off is "very close to the end of its life" which is September, and "If we do provide accommodation, we'll certainly keep in mind what we said earlier this year to always adapt to our objectives." There was no hint at a discussion on balance sheet policy during the meeting.
- **Forecasts were subjected to relatively modest changes.** Changes are noted below, but the main takeaway is that either they demonstrate a lack of

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How the Dots Shifted

(March # estimates, June # estimates)

	2018	2019	2020	Longer Run
1.875	0, 7	0, 7	0, 5	0,
2	0, 0	0, 0	0, 0	0, 0
2.125	0, 1	0, 2	0, 2	0,
2.25	0, 0	0, 0	0, 0	0, 1
2.375	11, 8	7, 5	5, 5	, 0
2.5	0, 0	0, 0	0, 0	0, 8
2.625	4, 1	4, 2	5, 3	,
2.75	0, 0	0, 0	0, 0	4, 3
2.875	2, 0	3, 0	4, 1	, 0
3	0, 0	0, 0	0, 0	4, 2
3.125	0, 0	2, 1	1, 1	, 0
3.25	0, 0	0, 0	0, 0	1, 2
3.375	0, 0	1, 0	1, 0	, 0
3.5	0, 0	0, 0	0, 0	1, 0
3.625	0, 0	0, 0	1, 0	0, 0
Medians	2.4, 2.4	2.6, 2.1	2.6, 2.4	2.8, 2.5

conviction toward serious downside risks, or cautious optimism for now, or that this has little to do with the base case fundamentals per se. I think it's primarily the latter and will come back to this such that **one should not be tempted to suggest that the FOMC's base case macro numbers don't support easing.**

- **Growth forecasts were minimally changed.** GDP is left intact at 2.1% this year, revised up a tick to 2% next year and left unchanged at 1.8% in 2021 and 1.9% for the longer run neutral rate.
- **Inflation projections were minimally changed.** Core PCE was revised down two-tenths to 1.8% this year, one tenth to 1.9% next year, and unchanged at 2.0% in 2021. Is the Phillips curve dead? Even with potential easing, core inflation was revised down but modest easing could guard against otherwise sharper downward revisions.
- **The unemployment rate was revised a tick lower in every period** to 3.6% this year, 3.7% in 2020, 3.8% in 2021 and 4.2% in the longer run.

Statement language was changed in a less dovish manner than could have easily been the case.

- **"patient" was deleted as expected** and replaced by conditional language by referencing that " **the Committee will closely monitor" conditions**
- core narrative guidance was left intact: "**The Committee continues to view** sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes"
- while forecasts were changed very little on balance, the statement flags that **'uncertainties about this outlook have increased."** Hence, while the base case was unchanged, there is less conviction around it and the rate cut guidance can be justified with little change in base case forecasts by taking our insurance against downside risks.
- **they are looking through nonfarm** and still reference words like "strong" and "low" for the state of labour markets and the unemployment rate.
- **Economic activity was downgraded** as rising at a "moderate" rather than previously "solid" rate. That's largely just a reflection of what we already knew about the Q1–Q2 transition.
- **Inflation is still described as "running below 2 percent" which is unchanged.**
- **the reference to market-based measures of inflation expectations was downgraded** to "have declined" from "have remained low"

Key takeaways from Powell's press conference included the following:

- Why the somewhat changed outlook? Powell argues (rightly in my view) that crosscurrents had been improving in the data and trade policy discussions into the April 30th–May 1st meeting but since deteriorated.
- **When asked if they considered a rate cut today, the answer was "there was not much support for cutting rates at this meeting"** That's clear in that only Bullard dissented in favour of an immediate cut.
- When asked why they kept their powder dry, Powell said "we are going to be monitoring the crosscurrents but we'd like to see more going forward," and "we'd like to see if these risks materialize" or "add more to the downside" and "the committee wanted to see more" and "some of these developments have been of recent vintage" such that "we'll be learning more" quite soon. ***This applies heavy conditionality to those among the dots that are guiding easing at this juncture and that should serve as a clear warning that easing is not assured.*** One combination that could push this off is if nonfarm rebounds, Trump and Xi make some progress next week at the G20, core inflation gradually rises over H2 and global market risks stabilize. That's a tall, but not impossible order.
- On the breadth of opinion, **Powell said 'many" see accommodation**, which is not "most" or certainly "all" in the Fed's language and again note the conditionality attached to the guidance. He also noted "The support for the policy statement we took was quite broad."
- On whether the Fed could cut 50 in one fell swoop and act faster this time, Powell said "We haven't engaged in this yet. It depends heavily on incoming data and developments and the evolving risk picture." ***That sounds like it sets a high bar to go -50bps in one shot and requires sharply negative developments.***
- When asked if a deal with China could remove rate cut risk, Powell said "We're not looking at any one thing" and "we're not exclusively focused upon one event or one piece of data. We have incoming data in the US that has been solid."

Please see the accompanying statement comparison that follows. The original statement is here and the revised projections and dot plot are available here.

RELEASE DATE: JUNE 19, 2019

Information received since the Federal Open Market Committee met in May indicates that the labor market remains strong and that economic activity is rising at a ***moderate*** rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although growth of household spending appears to have picked up from earlier in the year, indicators of business fixed investment have been soft. On a 12-month basis, overall inflation and inflation for items other than food and energy ***are running below 2 percent***. ***Market-based measures of inflation compensation have declined***; survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, ***but uncertainties about this outlook have increased.*** In light of these uncertainties and muted inflation pressures, ***the Committee will closely monitor*** the implications of incoming information for the economic outlook and ***will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective***.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren. ***Voting against the action was James Bullard***, who preferred at this meeting to lower the target range for the federal funds rate by 25 basis points.

RELEASE DATE: MAY 1, 2019

Information received since the Federal Open Market Committee met in March indicates that the labor market remains strong and that economic activity rose at a ***solid*** rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Growth of household spending and business fixed investment slowed in the first quarter. On a 12-month basis, overall inflation and inflation for items other than food and energy have ***declined and are running below 2 percent.*** On balance, market-based ***measures of inflation compensation have remained low*** in recent months, and survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, ***the Committee will be patient*** as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

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