Fed Cuts, Markets Debate Less Dovish Guidance

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- Fed cuts by 25bps as expected
- The bias suggests a pause, if not done...
- ...but the statement and presser conflicted
- Markets largely shrugged it all off
- There should remain material probability of future easing

The Federal Reserve signaled that it may pause its rate cut path if it hasn't entirely finished its easing campaign. That message was delivered more clearly in Chair Powell's press conference than in the statement itself, but still not stridently so. The tendency to deliver materially different messages in the statement versus the press conference is an ongoing point of frustration in terms of Fed communications and creates the impression the Chair doesn't have the full support of the committee that signed off on the statement. Nevertheless, the degree of conditionality upon the absence of material surprises to the FOMC's expectations should maintain non-zero market probabilities in favour of additional easing.

The net effect on markets had the two year Treasury yield shaking off the total suite of communications and actually rallying a touch. Fed funds futures pricing for additional rate cuts moved lower, but the contracts still price a full cut by next summer. The 10 year Treasury rallied by 2–3bps. The USD very slightly appreciated. Stocks slightly rallied. This market reaction could be a function of prior movements that priced in a little less accommodative stance, position covering, the absence of stronger guidance that easing is over, and market doubts that the all-clear has been sounded.

The FOMC statement took the first step toward this outcome. It did so by altering—not removing—the reference to "appropriate" policy in such fashion as to recraft it in a less action-oriented sense. Previously they said:

> "As the Committee contemplates the future path of the target range for the federal funds rate, it will continue to 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."

Now the statement says:

> "The Committee will continue to monitor the implications of incoming information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate."

There were two dissenters this time instead of three. I wouldn't make anything of that. The two who dissented were the same ones who preferred not to cut all along (Rosengren, George). This time, however, Bullard did not dissent but that's likely immaterial. He dissented in September in favour of a single 50bps cut and his dot was likely among the ones that expected 50bps in total remaining cuts over the duration of the year. Instead of getting that in one front-loaded cut in September, Bullard was appeased by two cuts that were spread across two meetings.

There were no other material statement changes. The description of current conditions in the opening paragraph was left intact. The conditionality and overall data dependence surrounding future rate moves was also left unchanged. Please see the attached statement comparison.

The press conference spiced it up a bit when Powell said the following:

- “Monetary policy is in a good place.”
- “The committee views the current stance of monetary policy as likely to remain appropriate.”
- “We will respond accordingly if things change”
- “A material reassessment of our outlook would be required to change the suitability of the current policy stance.”

Those words imply that the Fed is done as long as developments don’t sharply surprise their outlook. They feel they have taken out enough insurance. It nevertheless would have been much clearer to markets had the statement said “The committee views the current stance of monetary policy as likely to remain appropriate but will respond accordingly if things change” rather than the awkward mixed messages delivered by the FOMC consensus statement that simply watered down “appropriate” language.

Nevertheless, the Fed still says policy is not on a preset course and the overall communications avoided strident references to this simply being a midcycle adjustment. The door to future easing is a little narrower but not shut.

I thought a good question in the press conference related to whether the Fed is overly reactionary to trade headlines. Powell noted that progress toward a ‘phase one” US-China trade deal and lowered risk of a hard Brexit outcome were among the reasons for today’s bias shift. When pressed, however, he also said it’s about more than just trade.

We’ll see. If phase one is a dud or begets nothing thereafter then the Fed might have a renewed communications issue on its hands at that point. Prejudging US-China trade negotiations and British politics has been a losing proposition. Also note that while perceived improvements were cited, greater risk surrounding USMCA ratification was shrugged off, and there was zero mention of other material risks like the mid-November decision on auto tariffs and the need for another Continuing Resolution to fund the government past November 21st. Further, it’s questionable timing to signal less appetite for further accommodation in Q4 when there are still year-end funding demands ahead and when dollar demand usually drives hedging costs and basis higher.

When asked if the next movement would eventually be toward a rate hike that would be consistent with past unwinds of temporary bouts of modest easing, Powell stipulated that it would take a sustained move upward in inflation that he doesn’t foresee such that “We’re not thinking about raising rates right now.”

RELEASE DATE: OCTOBER 30, 2019

Information received since the Federal Open Market Committee met in September indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending has been rising at a strong pace, business fixed investment and exports ***remain weak***. 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 remain low; 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 light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 1-1/2 to 1-3/4 percent. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain. ***The Committee will continue to monitor the implications of incoming information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate.***

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; James Bullard; Richard H. Clarida; Charles L. Evans; and Randal K. Quarles. **Voting against this action were: Esther L. George and Eric S. Rosengren**, who preferred at this meeting to maintain the target range at 1-3/4 percent to 2 percent.

RELEASE DATE: SEPTEMBER 18, 2019

Information received since the Federal Open Market Committee met in July indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending has been rising at a strong pace, business fixed investment and exports ***have weakened.*** 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 remain low; 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 light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 1-3/4 to 2 percent. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain. ***As the Committee contemplates the future path of the target range for the federal funds rate, it will continue to 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.***

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