SIGN ON THE “DOT”TED LINE

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Although the money and bond markets appear to be “chomping at the bit” for a rate cut, expectations for such action at the just-completed FOMC meeting were low. Rather, the focus was on whether the policy makers would be making any changes to their Federal Funds’ Rate projections, or blue dots, for the remainder of this year and 2020. So, did the Federal Reserve (Fed) sign on the “dot”ted line?

To end the suspense, yes, the Fed did make an adjustment to its prior forecast from March. Three months ago (an eternity from today’s vantage point), the policy makers were forecasting no action for this year, but they actually had a rate *hike* for 2020. While their 2019 outlook remains the same, the Fed not only took the rate increase off the table for next year but has now moved into rate cut territory.

Remember, four times per year, the Fed provides these blue dots following a scheduled policy meeting. As we have seen through the first half of 2019, the policy makers’ outlook can definitely change. In a data-dependent mode, a flexible Fed should not come as too big of a surprise. However, the only problem is that monetary policy uncertainty can definitely create its own uncertainties and volatility in the financial markets. There is no doubt that bond investors have witnessed this phenomenon firsthand of late–the month of May’s plunging U.S. Treasury (UST) yields are still a fresh backdrop in everyone’s mind.

Let’s get back to a data-dependent Fed for a minute, because this will more than likely hold the key for the overall money and bond market setting–not only for the remainder of this year but for 2020 as well. As I mentioned in the intro, prior to today’s FOMC meeting, these markets have made it very clear that their expectation is for rate cuts to begin sooner rather than later. While Fed Funds Futures did not necessarily point to an actual move at the June convocation, they certainly anticipated one at the July FOMC meeting, with more to follow.

Conclusion

Even if the Fed stands ready to “act as appropriate” and potentially cut rates if developments change, the money and bond markets may be setting themselves up for some disappointment on the timing side of the equation. In my experience as a Fed watcher over the years, while the blue dots can shift around, an actual policy move tends to have more lead time. In other words, the FOMC will be more deliberate in its decision-making progress as compared to the markets’ own expectations. So, while the bond market’s focus on the blue dots helps shape the U.S. Treasury landscape, as we have seen already, it doesn’t necessarily mean the Fed’s voting members actually follow through on them.

Unless otherwise stated, data source is Bloomberg, as of June 14, 2019.

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DEFINITIONS

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Blue dots : the midpoint target range/level of the FOMC participants’ projections for the future Federal Funds Rate.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.