FED WATCH: THIRD TIME'S A CHARM?

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10/30/2019

Once again, as widely expected, the Federal Reserve (Fed) voted to cut rates at its October FOMC meeting. This marks the Fed's third consecutive quarter-point reduction and places the new federal funds target in the 1.50% to 1.75% range. The question that now comes to mind is whether the third time's a charm.

Heading into this latest convocation, there was little doubt the Fed had become divided over future policy decisions. This fractured state was on display at the September FOMC meeting—the minutes for that gathering highlighted how some members favored more aggressive rate cuts, while others wanted no cuts at all. Thus, heading into this latest policy meeting, it would have been no surprise to see the markets reveal some uncertainty regarding the potential outcome. Interestingly, this was not the case at all. As of this writing fed funds futures pegged the probability of a rate cut at 90% prior to the meeting and still was pricing in an additional two rate cuts for 2020.

The dynamics for the U.S. economic outlook have shifted to some degree since the Fed started cutting rates back in late July. The one constant has been the labor force setting, as the backdrop remains solid, with the unemployment rate at 50-year lows and weekly jobless claims remaining at historically low levels. Admittedly, nonfarm payroll growth has edged lower, but the other measure of new job creation, civilian employment, has been rather robust. Manufacturing and investment data do reveal a weakening state (by-products of trade uncertainty) and global growth is still mired in the doldrums. However, the lower rate setting engendered by the Fed and the plunge in Treasury yields this year, do appear to be bearing some fruit in interest-sensitive sectors such as consumer spending and housing. In addition, the yield curve has recently un-inverted, perhaps providing a less ominous growth path. Finally, if implemented, "Phase 1" of a U.S.-China trade agreement is in the works.

Conclusion

So, where does the Fed go from here? While the policymakers are certainly in data-dependent mode, I believe the voting members would like to sit back and observe how their three consecutive rate cuts play out. By the way, the last time the Fed was in insurance-mode, or making a "mid-cycle adjustment to policy", back in 1998, the policymakers also cut rates by a quarter-point at three consecutive meetings and then went to the sidelines. Certainly, given the apparent division in policy views, this seems to be the more likely path now as well, unless of course, upcoming economic data takes a turn for the worse. Against this backdrop, the Fed could be done for 2019, and may prove to disappoint market expectations for next year. This is where "Fed communication" comes into play to bridge the divide.

Unless otherwise stated, data source is Bloomberg, 10/25/19.

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