Split Fed Cuts Another 25

A divided FOMC announced another 25 basis point cut in the fed funds rate, bringing the lower band of the overnight target range down from 2.00% to 1.75%. This move was widely expected, although the Kansas City and Boston Fed Presidents dissented again, preferring to keep rates unchanged, while the St Louis Fed President thought a 50 basis point cut was more appropriate. The official statement, released immediately after the meeting, showed committee members believe household spending has been rising at a strong pace, although business fixed investment and exports have weakened.

The new “dot plot” indicates no more cuts this year …although it's close. Five committee members thought today’s cut was unnecessary, five expect no additional cuts this year and seven expect one more cut this year. The median rate projection for 2020 at 1.90% is the same as 2019, indicating that Fed members expect/believe/hope they’ll be sidelined during the election year.

The FOMC also lowered Interest on Excess Reserves (IOER), or the rate paid to banks by the Fed on excess reserves, by 30 basis points to 1.70% in an effort to coax more dollars into the repo market …which has had recent liquidity issues.

In the press conference that followed, Fed Chairman Powell again referred to the cut as “insurance against downside risks.” When asked if today’s move is a mid-cycle adjustment, Powell responded that more extensive cuts may be needed if the economy weakens further.

Other notable highlights from the press conference include:

- Powell blames weakness in business investment squarely on trade policy. He mentioned trade multiple times.
- Powell believes inflationary pressure will remain muted, and expects the job market to remain strong. (Note: These are the dual mandates of the FOMC …and both are being achieved.)
- Powell indicated future decisions will be data dependent, on a “meeting by meeting” basis.
- Powell said it’s possible the Fed could resume asset purchases (quantitative easing) “sooner than we thought.”
- Powell characterized the current period as “a time of difficult judgements.”
- Powell characterized households as being “in very strong shape.”

Please see disclosure on page 2.
Bond yields rose and the DOW plunged about 170 points before staging a recovery. The dollar strengthened again, which isn’t what you’d normally expect to see after a rate cut. But, in all fairness, the U.S. economy is still stronger than the vast majority of developed countries and our yields are still considerably higher. A strong currency is the result of a relatively strong economy. Looking back, the Fed might have gotten more bang for the buck if they’d cut 50 basis points all at once in July. Then again, the markets might have devoured the gift and clamored for more. If the economy is as strong as the President and the Fed Chairman both believe, the argument for further easing is hard to make …which is reflected in a split Fed decision and a flat dot plot.

President Trump wasted no time in tweeting his displeasure with what he sees as an inadequate move and a weak Fed.

Trump is blaming the Fed, while Powell has made it clear it’s all about trade. If a trade agreement can be reached in October, the Fed should be done. If the trade war escalates further, the Fed may be forced to rescue the economy.

As Powell said, decisions will be made on a meeting-by-meeting basis. Investors would like more clarity, but…this is a time of difficult judgements.

Market Indications as of 3:00 P.M. Central Time

DOW: Up 36 to 27,147 (HIGH: 27,399)
NASDAQ: Down 9 to 8,177 (HIGH: 8,330)
S&P 500: Down 1 to 3,004 (HIGH: 3,026)
1-Yr T-bill: current yield 1.87%; opening yield 1.85%
2-Yr T-note: current yield 1.75%; opening yield 1.73%
5-Yr T-note: current yield 1.67%; opening yield 1.66%
10-Yr T-note: current yield 1.79%; opening yield 1.80%
30-Yr T-bond: current yield 2.25%; opening yield 2.27%