FOMC Cuts the Fed Funds Rate, Signals Pause

As the day began, fed funds futures were implying 95% odds the Fed would cut the target rate another 25 basis points following the conclusion of today’s Federal Open Market Committee (FOMC) meeting. Indeed, the Fed obliged this afternoon as the FOMC announced its third 25 bps rate cut of the year, taking the fed funds target down to a range of 1.50% to 1.75%. Markets were much more concerned with what the Fed might say, how they would characterize the economy, and what hints they might provide about the future path of interest rates. On this front, the FOMC seems to have threaded the needle with a balanced statement that was just what the market expected. The FOMC noted the health of the labor market, where “job gains have been solid…and the unemployment rate has remained low,” as well as the strength of consumers as “household spending has been rising at a strong pace.” They also acknowledged that “business fixed investment and exports remain weak” and that core inflation was “running below 2 percent.” The official statement included some important differences in the outlook for interest rates. In September, 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…”

Today’s statement tweaked this language, saying:

“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.”

The change from “act as appropriate” to “assesses the appropriate path” suggests the Fed is less inclined to continue cutting rates and likely to take a pause to wait and see how things evolve. During his post-meeting press conference, Chair Powell reminded us that monetary policy acts with a significant lag and thus the rate cuts already made have yet to fully work their way through the economy. This is another reason to expect the Fed to take more of a wait and see approach. Nothing in the Fed’s statement or Chair Powell’s comments thus far have deviated too far from expectations. Bond yields have risen slightly as the Fed’s outlook now leans more positive and the chances for additional rate cuts this year have diminished.

Positive Progress on Trade
This past weekend, the U.S. and China signaled significant progress had been made in writing up the details of what is being called Phase 1 of a trade deal. Details remain light, but initial reports claim the planned 25% to 30% increase on $250 billion of goods will be averted, although apparently the 25% tariff will remain. It’s unclear whether the 10% tariffs on $160 billion of consumer goods due to take effect on December 1st will still happen. China will buy more agricultural goods and pork, and perhaps make commitments on natural gas and aircraft. Some progress on intellectual property rights and a mechanism of enforcement and dispute resolution are also likely. Much remains to be seen, but these developments certainly appear positive. Equity markets cheered the news as the S&P 500 surged to a new record high on Monday.
Brexit Deadline Extended
In Europe, the Brexit fiasco continues and confusion abounds. However, the United Kingdom will apparently not crash out of the European Union with no deal at the October 31st deadline. The EU has granted an extension to January 31st to allow more time for Parliament to approve the deal reached with Prime Minister Johnson last week. In the meantime, the U.K. will hold an election in December, the outcome of which will determine where it goes from here, at least that is the hope. No one really knows for sure.

Consumers Drive Third Quarter GDP Growth
This morning brought the initial print on third quarter GDP which advanced at a +1.9% annualized pace, down from +2.0% in the second quarter and +3.1% in the first. The result was better than the +1.6% median estimate in Bloomberg’s survey, but the sharp slowing from earlier this year reinforces the view of a deteriorating economy deserving of easier Fed policy. Early guestimates for Q4 are lower still. The mighty consumer continues to be the driving force behind the economy as personal consumption grew +2.9% while business fixed investment contracted for a second straight quarter, falling -3.0% in Q3 after a -1.0% decline in Q2. Other positive contributors included government spending, up +2.0%, and residential fixed income, up +5.1% as declining mortgage rates support housing. Inventories were essentially flat. The Q3 GDP report mostly corroborates what we already knew, businesses are retrenching while consumers plow ahead.

This week has already been packed with tons of important news and data, and we still have more to come. Tomorrow brings personal income and spending data, and the September read on the Fed’s preferred inflation measure, core PCE. The busy week wraps up with Friday’s employment report and ISM manufacturing survey data. Stay tuned.

Market Indications as of 2:35 P.M. Central Time
DOW Up 100 to 27,175 (HIGH: 27,359)
NASDAQ Up 30 to 8,307 (HIGH 8,330)
S&P 500 Up 8 to 3,045 *New Record High*
1-Yr T-bill current yield 1.56%; opening yield 1.57%
2-Yr T-note current yield 1.60%; opening yield 1.64%
5-Yr T-note current yield 1.61%; opening yield 1.66%
10-Yr T-note current yield 1.78%; opening yield 1.84%
30-Yr T-bond current yield 2.26%; opening yield 2.33%