July FOMC Meeting: A "Mid-Cycle Adjustment" – Now What?

- The FOMC lowered the Fed funds rate target range by 25 basis points, with the mid-point of the target range now at 2.125 percent
- The FOMC voted to end the run-off of the Fed balance sheet on August 1, two months earlier than had been scheduled

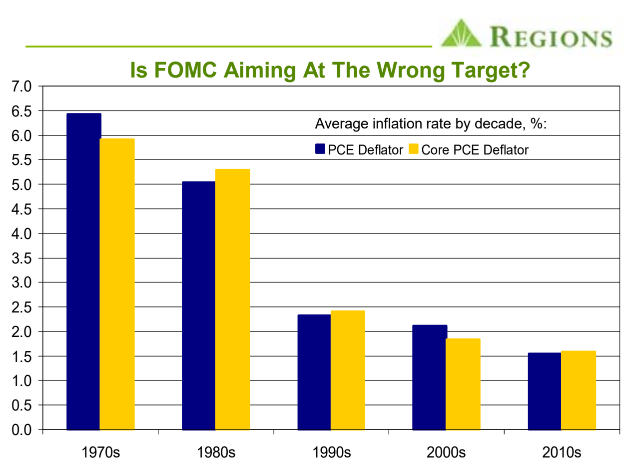
As was widely expected, the FOMC cut the Fed funds rate target range by 25 basis points at the conclusion of their two-day meeting, which puts the mid-point of the target range at 2.125 percent. The Committee also opted to end the run-off of the Fed balance sheet on August 1, two months earlier than had been scheduled. The rate cut came despite no change in the Committee's assessment of current economic conditions and despite the overall tone of the economic data having improved since they effectively telegraphed this rate cut at their June meeting. Downside risks, global in nature, to the FOMC's growth outlook and muted inflation pressures are cited as factors behind the rate cut. While the post-meeting policy statement offered no hints of future policy moves, it did repeat the by-now familiar pledge to "act as appropriate to sustain the expansion." There were two dissents to the vote to cut the funds rate, with Boston Fed President Rosengren and Kansas City Fed President George preferring no change in the funds rate.

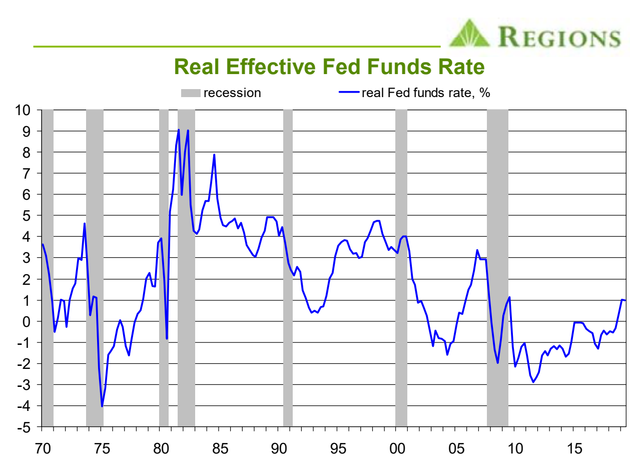
With one minor exception, the assessment of current economic conditions is identical to that offered in June. Economic growth is again characterized as "moderate," with "solid" job gains and faster growth in consumer spending, while growth of business fixed investment is again characterized as "soft." The sole change is the Committee noting that market-based measures of inflation compensation "remain low," after the June statement noted they had declined.

Given that the assessment of current economic conditions has not changed and given that rising downside risks to the outlook were also cited in the June post-meeting policy statement, it is reasonable to ask why the funds rate was cut today and not at the June meeting. Be that as it may, we're still waiting for a clear explanation of why a rate cut is warranted at all. Some, including Chairman Powell in his post-meeting press conference, argue that a rate cut will help "boost" inflation, an argument we find lacking. Inflation, not just here in the U.S. but globally, has been and remains less attuned to monetary policy than had been the case in the past. Instead, a prolonged period of decelerating inflation, which we illustrate in our first chart below, has been driven by three factors – globalization, technology, and demographics. A lower Fed funds rate won't change this. Some, including Chairman Powell in his post-meeting press conference, characterize this as an "insurance cut," a concept we can most charitably describe as curious. The downside risks facing the economy have nothing to do with either the price or the availability of credit, but instead mainly reflect ongoing uncertainty over trade policy, which has weighed on business sentiment, and in turn business investment, both here and abroad. We have yet to hear a plausible explanation of how Fed funds rate cuts offer any insurance against a worst-case outcome of trade disputes.

Chairman Powell also cited a third rationale for a rate cut – that it would provide support for the economy. We're skeptical of this argument, and will again note that the cost of capital is not the issue, and we think it unlikely that market interest rates, having already fallen considerably, will react much to this rate cut. An alternative argument for the rate cut is that the FOMC has to, for want of a better term, keep pace with foreign central banks who are adding further monetary accommodation. In such an environment, the FOMC standing pat effectively equivalent to them becoming tighter, which has implications for U.S. inflation and U.S. exports that are at odds with the FOMC's objectives. We are sympathetic to this argument, but worry about potentially bad outcomes from the FOMC following foreign central banks down what has been, and will likely remain, a fruitless path. Chairman Powell, however, did not touch on this argument in his post-meeting press conference.

Perhaps the most interesting comment Chairman Powell made in his post-meeting press conference is that "we are thinking of it (i.e., the rate cut) as a mid-cycle adjustment to policy." This is distinctly at odds with what was in essence the start of a prolonged easing cycle priced into the markets prior to today's decision, as evidenced by the reaction in the markets as Chairman Powell spoke. One can argue that if the FOMC's assessment of "neutral" is lower now than has been the case in the past, at least one more rate cut may be in the offing, but this would still leave the FOMC stopping well short of where the markets had anticipated.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com