FOMC COMMENTARY

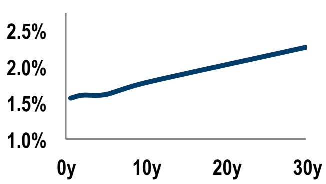
JANNEY INVESTMENT STRATEGY GROUP

MISSION ACCOMPLISHED?

October 30, 2019

- The Federal Reserve cut its target for overnight rates by 25bps to a range of 1.50 – 1.75%, the third consecutive rate cut
- This is the first cut of the sequence in which odds of a subsequent meeting cut were <50%, giving the Fed an opening to pause
- Today's statement ended the cutting bias with elimination of "sustain the expansion" language, making it slightly hawkish
- Despite the language change, interest rate markets held on to a rally, signaling skepticism that this is the cycle's last cut

Treas.	2.15PM	1.45PM	Chg.
3mo	1.59	1.59	+0.00
2yr	1.63	1.61	+0.01
5yr	1.64	1.63	+0.01
10yr	1.79	1.80	-(0.01)
30yr	2.28	2.29	-(0.01)
3m/2s	4	3	+1
2s/10s	16	19	-(2)
2s/30s	66	68	-(2)



The Federal Reserve Open Market Committee today reduced their target for overnight interest rates by a third 25bps to a range of 1.50% to 1.75%, completing the Greenspan-esque "three insurance cuts" cycle. What is unique about this pre-Halloween rate slash is that, in comparison to the last two, the markets are pricing much lower odds of subsequent cuts. On the day before both the July and Sept FOMC meetings, we had more than 50% odds of a cut priced in at the next meeting; as of yesterday's close, we had a mere 20% chance of a December cut. If the Fed wants an opening to pause in its current cutting process, today is about as good as the Central Bank is going to get. Mission accomplished?

Once again, the economic picture between last FOMC meeting and this one is as mixed as a bag of Almond Joy and Reese's. On the Almond Joy hand (coconut in chocolate—really?), the ISM manufacturing index, a classic leading indicator of the business economy, printed a second month below the 50 mark. Similarly, core durable goods orders measures deteriorated, bringing the contraction in orders to two consecutive months. On the Reese's hand (peanut butter, now that's what I'm talking about), consumer spending has remained resilient, aided by still-strong income gains and only modest sentiment disruptions from trade tensions. The sum of these backward-looking economic metrics came through in this morning's 3Q GDP release, which noted real final sales to domestic purchasers, a measure of "core" GDP, grew at a +2.0% rate. In other words, growth is right around trend, despite headwinds. If there is one clear signal of still-significant economic risks, it is evident in inflation expectations. Inflation expectations are the one area that present obvious downside policy risk, and FOMC doves have been quick to latch onto that metric in the past. Ten-year TIPS breakevens are today at 1.60%, while the five-year forward breakeven--one of the Fed's preferred long run inflation metrics--is hovering below 1.70%, far shy of the Fed's 2% target.

The statement accompanying today's rate cut announcement was more about exorcising the ghosts of FOMC statements past than staking a completely new position. The September statement included a mere 14 word changes (including prepositions and articles, but excluding the voter rolls), while the July statement featured 80 (including rate cut rationale and the early end of quantitative tightening). At least as far as the statement goes, fewer textual changes imply persistence, while more changes imply a directional policy shift. This time around, the magic number is 52 word changes. Easily the most significant of these changes was the Fed's decision to drop the phrase "act as appropriate to sustain the expansion," and replace it with "assess the appropriate path," a much more mild formulation that hints a pause in cuts is more likely than a continuation. The cutting bias is gone, replaced with a tentative hope. Whether the markets price more cuts from here is truly a function of intermediate-term economic expectations. Our own thesis remains, however, that market plumbing fragilities will ultimately force the Fed to cut rates further in 2020.

Rates markets came into today's in full bullish costume, but briefly faced some headwinds in the moments after the statement release, before ultimately settling down slightly stronger than pre-release levels. The yield curve flattened considerably, however, with the 2s/10s spread contracting more than 2bps in 15 minutes. Frequent readers know that we consider 2s/10s the best evidence of whether a FOMC policy decision is "working." While the Permanent Open Market Operations' T-bill purchases helped steepen 2s/10s, the evidence so far today suggests the Fed has not yet done enough to stimulate economic growth in the face of ever-present late-cycle headwinds. Spooky.

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FEDERAL RESERVE press release

- Virtually no change in economic language

Information received since the Federal Open Market Committee met in September indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending has been rising at a strong pace, business fixed investment and exports remain weak. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed.

- Fed no longer working to "sustain the expansion," only "assess[ing] the appropriate path," a shift away from clear cutting bias; more cuts contingent upon economic change

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 1-1/2 to 1-3/4 percent. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain. 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.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

- George and Rosengren dissented hawkishly

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; and Randal K. Quarles. Voting against this action were: Esther L. George and Eric S. Rosengren, who preferred at this meeting to maintain the target range at 1-3/4 percent to 2 percent.

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