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Fed Removes *"Patient,"* Opening Door for Future Rate Cut

As expected, the Fed opted to keep rates unchanged at the latest June FOMC meeting. At the same time, the Committee softened the tone of the statement to signal an increased willingness to provide additional accommodation, *if needed*. While still relatively positive on the domestic front, the Committee specifically noted growing uncertainty stemming from conditions abroad, particularly international trade relations, that could warrant a rate reduction sooner than later.

While hardly a concession to the market's plea for an immediate rate reduction, a more dovish-leaning sentiment in the statement coupled with a downward revision to the Committee's projection for rates offered welcome reprieve to policymakers fearing the Fed would continue to dig in its heels against an eventual – and needed – rate cut to support growth and inflation. Still, taken at face value, the Fed has simply vowed to *"monitor"* the data closely and *"react"* accordingly, offering little confidence, let alone specifics, that a rate reduction is coming potentially as soon as market participants would hope or expect.

Less "Patient"

As expected, the Fed opted to leave the Federal funds target unchanged in a range of 2.25% to 2.50% in Wednesday's policy announcement. Although, also as predicted, the Fed offered a noticeably softer tone in the accompanying statement, opening the door for a potential rate reduction in the coming months. Dropping the reoccurring reference to the Fed being *"patient,"* the statement supposed the Committee is prepared to act to sustain the expansion amid intensifying trade tensions. While a far cry from a commitment to lower rates within months, let alone weeks, a removal of the lingering pledge to remain on the sideline without a qualifying replacement signals at least an increased preparedness to act with further accommodation, *if deemed necessary*.

"Uncertainties about this outlook have increased," the June Federal Open Market statement read. *"In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion."*

Reiterating a data-dependent stance, the Committee, however, offered little in the way of details in terms of timing for the highly anticipated reduction in rates. The statement was void of any reference to next month, near-term, or even by the end of the year. In fact, during the press conference, the Chairman suggested the Committee is increasingly poised to "*react*" to the data, suggesting members, while not opposed to the cycle's first rate cut, are still taking somewhat of a wait-and-see approach as opposed to gearing up for a preemptive move as early as next month. The former pathway, of course, risks extending the timeline before a rate cut is realized versus an imminent policy adjustment as the market is expecting.

"We want to see and we want to react to developments and trends that are sustained and genuine."

\- Federal Reserve Chairman Jerome Powell, June 19th FOMC Press Conference

Despite ample evidence arguably supporting the need for lower rates, if policymakers don't yet feel the data warrants a rate reduction, it could still be some time before the majority of the Committee is convinced a rate cut is the appropriate "*reaction.*" With only six weeks before the July meeting, September may be the earliest opportunity for a policy change, appropriately coinciding with a termination of right-sizing the balance sheet. Although, a further deterioration in the data would no doubt expedite the timeline for further accommodation, as the Committee has vowed to closely monitor economic developments.

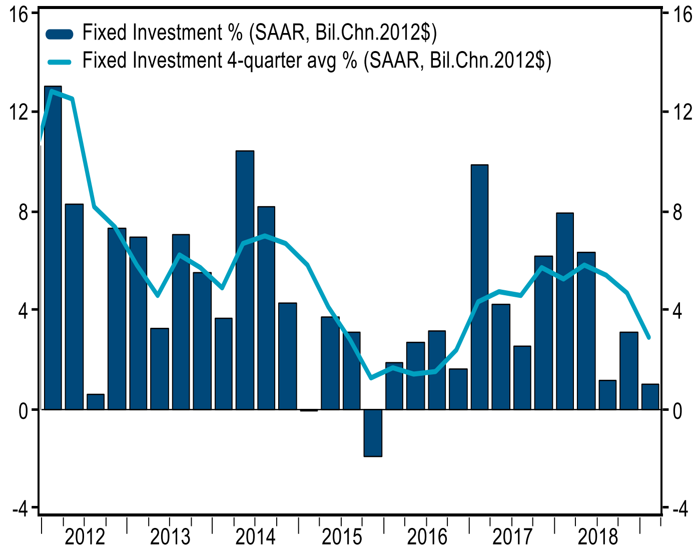
Uneven Footing

Despite evidence of weakness bubbling underneath the surface, the majority of Fed officials have stood vehemently opposed to the idea of rate cuts anytime soon. Even amid the recent escalation in trade tensions with China and Mexico, and while acknowledging elevated uncertainties for investors and businesses, several Fed members have dismissed the need for near-term action, championing the current state of the economy as well as expectations for continued solid growth and improving levels of inflation. Not for a lack of evidence in the data, up until now, the softer state of economic affairs has simply been masked by policymakers' perpetual – and theoretical – objection to unwinding policy.

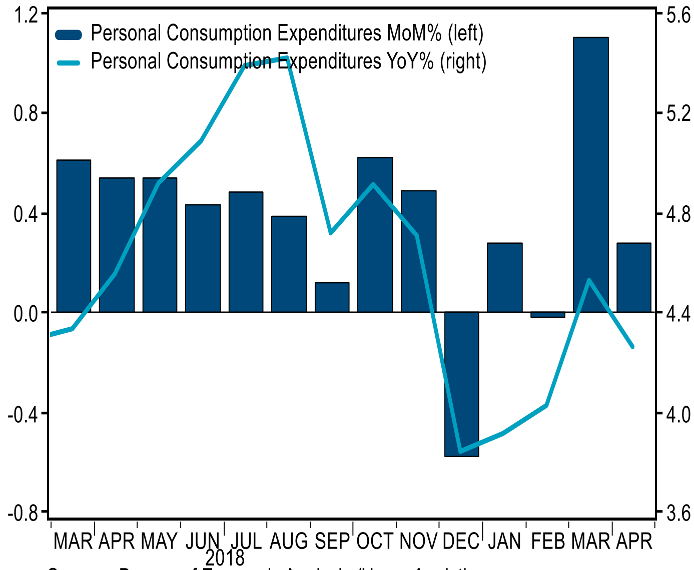
The latest round of U.S data, however, has been far from robust, and rather uneven at best. With further deterioration in business investment and confidence, a slowdown in manufacturing and increased volatility in the consumer sector, coupled with international uncertainty and waning price pressures, it has no doubt become increasingly difficult for even the more hawkish-leaning members to ignore the mounting indications of fundamental weakness.

As a result, in the June FOMC statement, the Committee tempered its assessment of the economy; to the market's relief, policymakers acknowledged the increased evidence of waning momentum both domestically and globally, conditions which could warrant a rate reduction. Downgrading the characterization of topline growth from *"solid"* in May to *"moderate"* in this week's communication, officials also noted the imbalance in the data as *"growth of household spending appears to have picked up from earlier in the year,"* while indicators of business fixed investment *"have been soft."* Noting the unemployment rate has still *"remained low,"* the statement also repeated that the labor market *"remains strong."*

Aside from uneven domestic fundamentals, however, the Committee furthermore underscored the mounting level of uncertainty stemming from international policy and geo-political issues along with a *"muted"* level of inflation.



Source: Bureau of Economic Analysis /Haver Analytics



Source: Bureau of Economic Analysis /Haver Analytics

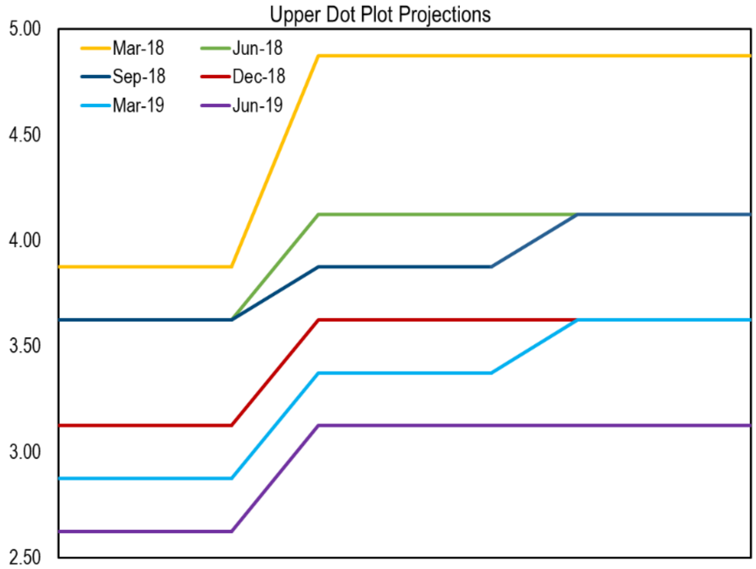
Lower Dots in the Dot Plot

Since the start of the year, Committee members have largely stood by their policy decision last December to raise the Federal funds rate to 2.50%. Furthermore, with rates at a presumed "*neutral*" level, policymakers have been steadfast in their outlook that rates would likely remain unchanged throughout 2019, if not longer. In fact, according to the May FOMC meeting minutes, there was zero conversation regarding the possibility of rate cuts, but rather only a discussion of potentially further rate *hikes*.

This month, not only was there a discussion of rate cuts, but one Fed member voted for an immediate reduction of the Federal funds target range. In other words, while the Committee ultimately opted to hold policy steady, the vote was not unanimous; St. Louis Federal Resave President James Bullard dissented in favor of a quarter-point rate cut, marking the first dissent of Powell's tenure as Chairman.

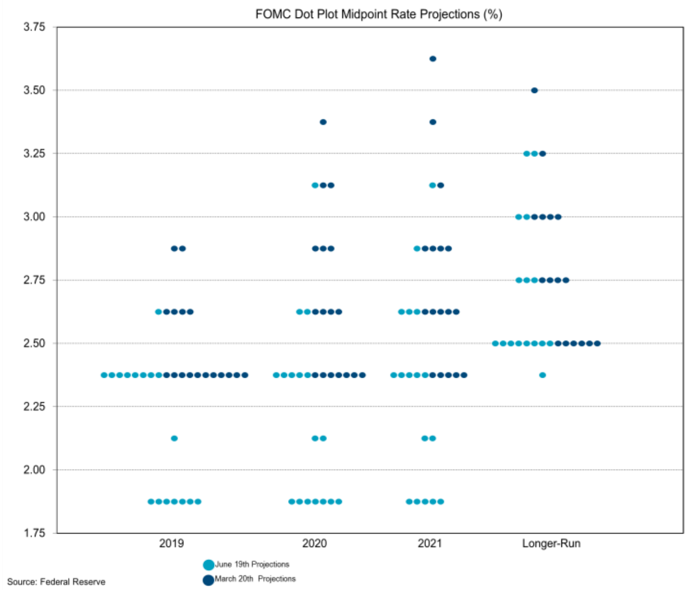
Earlier this month, Bullard suggested the Fed may be *forced* to cut rates – and soon – as a result of lingering low inflation as well as the economic threat posed from ongoing trade battles with China and now Mexico. Speaking to the Union League of Chicago on June 3rd, Bullard said the current trade conflicts are not easily solved and will weigh on business investment and add downward pressure to the broader economy which has already lost momentum since last year.

Such dovish-leaning comments represent a rising faction at the Fed that have grown less convinced of both sustained 2% growth and a near-term reversal of inflation pressures back to the Committee's 2% objective. In fact, as Vice Chairman Richard Clarida pointed out in earlier comments this month, inflation has failed to reach the Committee's target for the better part of the past decade, despite the Committee's longstanding optimism for stronger price pressures. And yet, many policy members still generally remain confident – as they always do – that inflation will revert back to the Fed's longer-run objective. Thus, with both the headline and core PCE continuing to trend to the downside and a number of policymakers aware of the ensuing weakness in the domestic economy, the latest *"dots"* reflect at least some Fed members forecasting increased accommodation by year-end.



Source: Federal Reserve

As expected, policymakers were starkly divided in regards to the expected pathway for rates – and the economy – going forward. Eight of the seventeen members now anticipate at least one rate cut by the end of the year, a clear contrast to the March dot plot which showed no Committee members anticipated a rate cut in the coming year. Another eight members see rates remaining unchanged in 2019, and still one member continues to forecast a rate hike. According to the updated quarterly forecasts as displayed in the dot plot, the median forecast for rates remained at 2.375% in 2019, but fell from 2.625% to 2.125% in 2020.



Other specifics from the Summary of Economic Projections showed slight downward adjustments to the Committee's forecast for inflation and unemployment, while expectations for topline growth pushed slightly higher. The median projection for 2019 GDP growth was unchanged at 2.1% and revised up by one-tenth of a percentage point to 2% in 2020. The 2021 forecast was unchanged at 1.8%. Furthermore, the median unemployment rate forecasts for 2019 through 2021 were all lowered by a tenth of a percentage point to 3.6%, 3.7% and 3.8%, respectively. Inflation forecasts, meanwhile, were revised down from 1.8% to 1.5% for the current year. By 2020, however, headline and core inflation are both projected to rise 1.9%, just shy of the Committee's longer-run target.

June 19th FOMC Summary of Economic Projections (SEP)

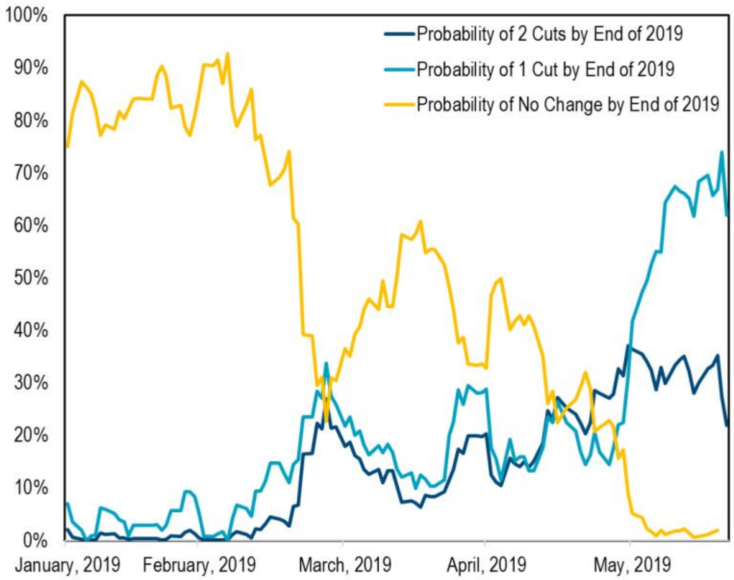
Percent

Variable	Median[1]				Central tendency[2]				Range[3]			
	2019	2020	2021	Longer run	2019	2020	2021	Longer run	2019	2020	2021	Longer run
Change in real GDP	2.1	2.0	1.8	1.9	2.0 – 2.2	1.8 – 2.2	1.8 – 2.0	1.8 – 2.0	2.0 – 2.4	1.5 – 2.3	1.5 – 2.1	1.7 – 2.1
March projection	2.1	1.9	1.8	1.9	1.9 – 2.2	1.8 – 2.0	1.7 – 2.0	1.8 – 2.0	1.6 – 2.4	1.7 – 2.2	1.5 – 2.2	1.7 – 2.2
Unemployment rate	3.6	3.7	3.8	4.2	3.6 – 3.7	3.5 – 3.9	3.6 – 4.0	4.0 – 4.4	3.5 – 3.8	3.3 – 4.0	3.3 – 4.2	3.6 – 4.5
March projection	3.7	3.8	3.9	4.3	3.6 – 3.8	3.6 – 3.9	3.7 – 4.1	4.1 – 4.5	3.5 – 4.0	3.4 – 4.1	3.4 – 4.2	4.0 – 4.6
PCE inflation	1.5	1.9	2.0	2.0	1.5 – 1.6	1.9 – 2.0	2.0 – 2.1	2.0	1.4 – 1.7	1.8 – 2.1	1.9 – 2.2	2.0
March projection	1.8	2.0	2.0	2.0	1.8 – 1.9	2.0 – 2.1	2.0 – 2.1	2.0	1.6 – 2.1	1.9 – 2.2	2.0 – 2.2	2.0
Core PCE inflation[4]	1.8	1.9	2.0		1.7 – 1.8	1.9 – 2.0	2.0 – 2.1		1.4 – 1.8	1.8 – 2.1	1.8 – 2.2	
March projection	2.0	2.0	2.0		1.9 – 2.0	2.0 – 2.1	2.0 – 2.1		1.8 – 2.2	1.8 – 2.2	1.9 – 2.2	
Memo: Projected appropriate policy path												
Federal funds rate	2.4	2.1	2.4	2.5	1.9 – 2.4	1.9 – 2.4	1.9 – 2.6	2.5 – 3.0	1.9 – 2.6	1.9 – 3.1	1.9 – 3.1	2.4 – 3.3
March projection	2.4	2.6	2.6	2.8	2.4 – 2.6	2.4 – 2.9	2.4 – 2.9	2.5 – 3.0	2.4 – 2.9	2.4 – 3.4	2.4 – 3.6	2.5 – 3.5

Source: Federal Reserve

Market Expectations

For some time, the market – via a partially inverted curve – has been calling for a rate cut, if not two, in short order, growing the divide between market expectations and expectations of policymakers. While falling short of cowing to market – or political – pressures to cut rates just yet, the removal of *"patient"* from the statement coupled with a downward revision to a number of *"dots"* suggest at least an acknowledgment of the weakness bubbling underneath the surface, supporting the notion that policy has moved beyond neutral to become restrictive. While the Fed was hardly expected to capitulate to investors' call for lower rates at this week's meeting, expectations remain elevated for near-term action. According to *Bloomberg*, the market anticipates at least one rate cut by the end of the year with near certainty.



Source: Bloomberg

Up until now, the Fed has been relatively firm in its opposition to a potential rate reduction with policy still seen as appropriate. With the Fed increasingly digging in its heels, such stubbornness had market participants concerned the Fed would be willing to force the economy into recession before taking action. The June statement, however, should offer a welcome reprieve, as the Committee has clearly indicated an increased readiness to take action should growth and inflation continue to disappoint.

That being said, without a clear calendar-specific guideline and quantitative tightening still underway behind the scenes as the Committee unwinds the balance sheet, the Fed is likely to take in another month or two – or more – of data before moving forward with a policy adjustment. Remember, monetary policy is made and adjusted to support long-run fundamentals of maximum output and production, it is not intended to soften the day-to-day volatility stemming from political rhetoric – or tweets – or market unease. With policy projections still relatively positive, a gentler sentiment suggests the Fed is ready and willing to take action, but policymakers may not yet read the same sense of immediacy as the market.

-Lindsey Piegza, Ph.D., Chief Economist

Glossary

FOMC – Federal Open Market Committee
GDP – Gross Domestic Product
MoM – Month over Month
PCE – Personal Consumption Expenditures
SAAR – Seasonally Adjusted Average Rate
SEP – Summary of Economic Projections
YoY – Year over Year