Fed Goes Big

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Whether or not the Federal Reserve's policy setting Federal Open Market Committee would cut its overnight fed funds target rate today was not in doubt. The Fed had made it abundantly clear they would. The minutes from the last FOMC meeting on July 31st noted, "The vast majority observed that, if the data continued to come in about as expected, it would likely be appropriate to ease policy at the next meeting." Chair Powell, speaking at the annual Jackson Hole symposium on August 23rd stated in no uncertain terms, "The time has come for policy to adjust." While it has been clear the FOMC would cut rates today, the size of the rate cut, either 25 basis points or 50, had been hotly debated. A week ago, the tug-of-war favored 25 bps, but early this week the 50 bps camp gained the upper hand. Just prior to today's announcement, fed funds futures were almost evenly split, pricing in an implied 40 bps decline. The uncertainty over the size of the cut was unusual and told us markets would have to reprice one way or the other. It also complicates the Fed's job of communicating its decision and makes the new Summary of Economic Projections (SEP), the dot plot, and Chair Powell's post meeting press conference critically important.

Cutting to the chase, this afternoon, the FOMC put the matter to rest, trimming its target overnight rate by 50 basis points to a range of 4.75% to 5.00%. It very likely won't be the last. The new dot plot projects a year-end target of 4.375% (the mid-point of a 4.25% to 4.50% range), implying 25 basis point cuts at each of the two remaining meetings this year. For 2025, the projection suggests an additional 100 bps of reduction, taking the target to 3.375%. Another important point is that the longer run target has climbed over the last two meetings from 2.50% in March to 2.875% now, indicating the Fed sees a higher neutral rate.

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In the official statement, the Committee said they had "greater confidence that inflation is moving sustainably toward 2 percent, and judges that the risks to achieving its employment and inflation goals are roughly in balance." Despite noting its goals as "roughly in balance," the Committee certainly seems to be more concerned about the employment side, stating, "In light of the progress on inflation and the balance of risks, the Committee decided to lower the target…" by a half percentage point.

During his press conference, Chair Powell reiterated many of the same old points about data dependency and the path of rates not being on a preset course. Notably, he did not use the word "accommodative," emphasizing that the FOMC had decided to "recalibrate" by reducing "the degree of policy restraint" and that policy was moving to a more "neutral stance." Chair Powell returned to this "recalibrate" theme several times during the Q&A.

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This strikes us as an important characterization for several reasons. One, it tells us the Fed believes policy is currently too restrictive and will remain at least somewhat restrictive for a while longer, which the Fed believes is appropriate given that inflation remains above their target. Two, it tells us the Fed's concern about employment is growing. As Chair

Powell noted during his press conference, their hope is to get inflation back to the 2% target without the pain of a significant rise in unemployment. Indeed, the Summary of Economic Projections has the unemployment rate climbing only slightly, to 4.4% next year (from 4.2% today) while core PCE inflation falls to 2.2% next year and 2% in 2026. Finally, if the Fed hopes to get policy back to a neutral stance, and if they believe the long-run neutral rate is 2.875%, there is room to cut another two full percentage points to get to their estimate of neutral. It does beg the question, if the economy happens to slip into recession, how low would rates need to go to become accommodative?

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Reaction in financial markets, as expected, has been volatile. Bonds initially rallied with the two-year T-note dropping 10 bps from 3.64% to 3.54% immediately following the announcement. But as the news is digested and as the press conference wraps up, the rally has faded and the two-year yield now stands at 3.61%, just slightly above yesterday's close. Further out the curve, yields have climbed with the 10-year up 5bps to 3.70%. Stocks are mixed.

Market Indications as of 2:47 P.M. Central Time

DOW	Down -122 to 41,485 (HIGH: 41,622)
NASDAQ	Down -31 to 17,597 (HIGH: 18,647)
S&P 500	Up 19 to 5,656 (HIGH: 5,667)
1-Yr T-bill	current yield 3.97%; opening yield 3.99%
2-Yr T-note	current yield 3.62%; opening yield 3.60%
3-Yr T-note	current yield 3.48%; opening yield 3.46%
5-Yr T-note	current yield 3.48%; opening yield 3.43%
10-Yr T-note	current yield 3.70%; opening yield 3.64%
30-Yr T-bond	current yield 4.03%; opening yield 3.95%

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