Economics & Strategy

DBS Flash

Fed cuts with 3 dissents and funding challenges

US/Economics/Monetary policy/rates/FX

Group Research   September 19, 2019

Taimur Baig, Chief Economist
taimurbaig@dbs.com

Please direct distribution queries to Violet Lee
+65 68785281 violetleeyh@dbs.com

- *A rate cut with little concern about the outlook left the market dissatisfied.*
- *Steps to improve repo operations could be followed by resumption of asset purchases.*
- *Considerable tension in Fed decision-making is apparent.*
- *Short of a major re-escalation in trade war, Chair Powell may find it hard to build the case for another cut this year.*

A neutral cut?

A highly-expected policy rate cut delivered with little enthusiasm or conviction; that's the way we will characterise today's FOMC's decision. In addition to cutting the Fed funds target rate by 25bps to 1.75-2.00%, the FOMC implemented a few liquidity measures: interest rate paid on required and excess reserve (IOER) balances was eased to 1.80%; interest rate paid on required and excess reserve balances were also set at 20bps below the top of the target range for the federal funds rate. The combined impact of the policy rate cut and the change in IOER formula led to an effective cut of 30bps for reverse repo operations. The aim of these measures is to increase trading in the federal funds market at rates well within the FOMC's target range, something that not been the case lately, necessitating open market operations.

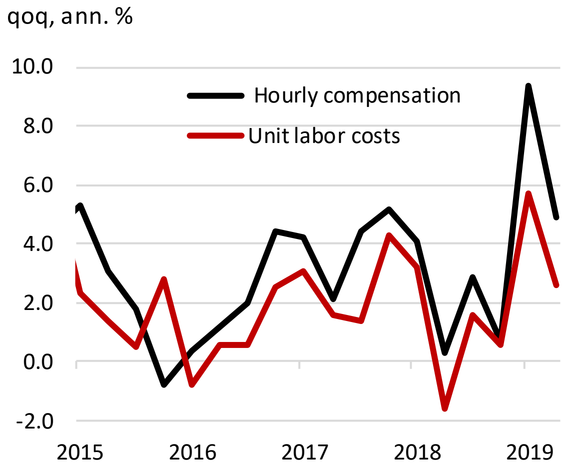
FOMC members are finding it hard to find consensus. Today's decision was characterised by 3 dissents, with James Bullard voting for a 50bps cut and Esther George and Eric Rosengren voting for a pause. Given such diverging views, it is not surprising that the median dot plot signals no further cuts in 2019.

Chair Powell came across as very neutral in the press conference, which was a source of disappointment for the market doves, perhaps explaining why asset markets took little away from the meeting's outcome. Mr. Powell's reluctance to confirm that the Fed continues to have an easing bias was another likely source of disappointment for the market.

Given the ongoing pressure on funding rates and sizeable open market operations carried out by the New York Fed this week, attention is shifting to the effectiveness of the Fed's monetary operations. We think that the Fed may well be heading toward resuming treasury purchases to maintain a stable balance of excess reserves. Chair Powell however stressed that recent money market tightness did not have macroeconomic significance.

FOMC members are still by and large optimistic about the outlook. The risks that led to policy easing are considered to be largely external; indeed, Chair Powell attributed weakness in exports and investment to trade war, and did not find anything to worry about as far as jobs growth was concerned.

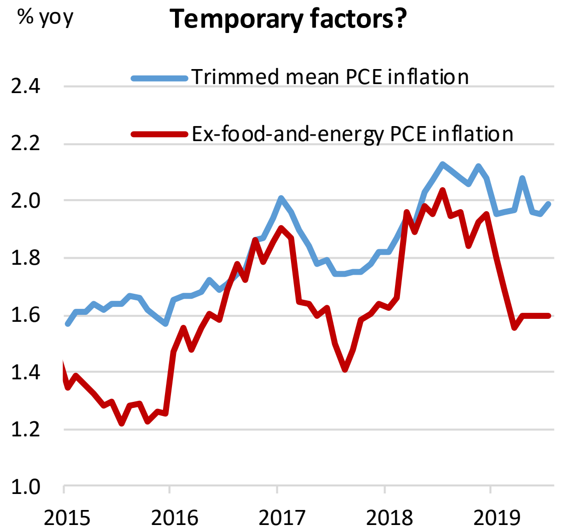
Wages and labour costs are rising



Sources: Bureau of Labour Statistics, DBS

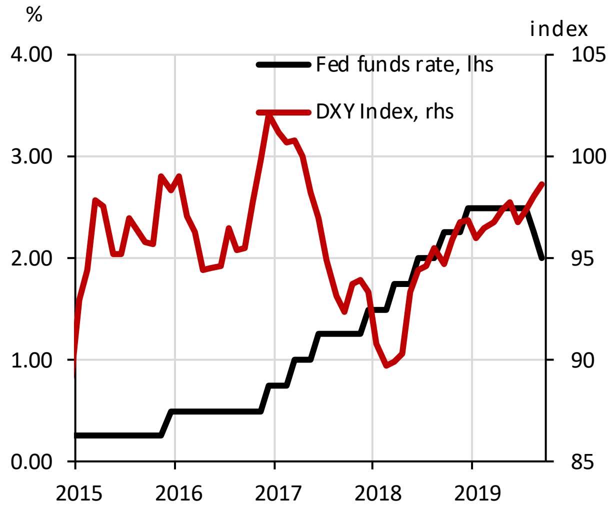
Looking at the latest dataflow on wages, labour costs, jobs, core inflation, industrial production, and currencies, we frankly find little to justify today's rate cut. We also don't see the market's expectation of another cut this year as highly plausible, given the tension among the FOMC's voting members. Unless US-China relationships nose dive in the coming months, or the US economy shows some sudden loss of momentum, the Fed will remain on the sideline this year, in our view, regardless of President Trump's highly antagonistic tweets.

Temporary factors?



Sources: Dallas Federa;l Reserve, DBS

Dollar index vs. Fed funds rate



Sources: CEIC, DBS

Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Chang Wei Liang
Strategist
+65 6878-2072 weiliangchang@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21-2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying, CFA
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Duncan Tan
FX and Rates Strategist - Asean
+65 6878-2140 duncantan@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).