Central Banks

Fed Fans

El País (Spain)

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Being a fan of the US central bank may not be strictly necessary, but closely following its monetary policy certainly is. The US may no longer boast the world's largest economy, but it is the country that issues the dollar — the global currency for reserves (accounting for around two-thirds of central bank reserves globally) and still the principal benchmark for international trade and financial asset issues around the world.

Last week's decision came as no surprise to BBVA Research. As expected, rates were cut by 25 bp, bringing the benchmark range to 1.75–2%, with no major changes in the assessment of the US economic landscape: no inflationary pressure, low unemployment and activity growing at moderate rates. The Fed believes that the global situation—with uncertainty over the governance of international trade and activity slowing in Europe and China—is weakening exports and investment.

While this landscape persists, so will the diversity of the solutions being put forward as the most appropriate. Some members of the FOMC (the Federal Open Market Committee, which defines the Fed's monetary policy) do not think that the interest rate should have been lowered, while others think that it should have been lowered further — by 50 bp instead of 25. The FOMC is also divided on the subject of cuts expected at upcoming meetings: a growing portion of its members agrees that a further cut is necessary, with seven members projecting an additional cut of 25 bp in 2019, and eight projecting one in 2020. Meanwhile, five believe that rates should return to where they were before this week's cut by the end of the year. The fact that monetary policy suggestions are so different within the same committee is testament to the uncertainty in the economic landscape.

In our view, it would be reasonable to assume that the July and September cuts are sufficient for now, and the economy must be allowed to absorb their effects before any additional cuts are enforced to bring the benchmark range to 1.5–1.75% in the first quarter of next year. However, in a situation where the development of trade policy (dis)agreements and monetary policy are so closely linked, as stated by the Fed itself, another cut may even come sooner — a cut before the end of the year is not beyond the realms of possibility.

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