Central Banks

FOMC Meeting: October 29th-30th

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October 30, 2019

For the third time this year, the Fed lowered the target range of federal funds rate 25bp to 1.5-1.75% without significant changes to their outlook on the labor market or inflation. The only changes to the statement regarding the outlook were on the committee's view on business fixed investment and exports, which they revised from "have weakened" to "remain weak". Contrary to their assessment of incoming data, the statement had a nontrivial change to the forward guidance. In addition to removing "sustain the expansion", a phrase that had been closely associated with the "mid-cycle" insurance cuts, the committee also decided to change "will act as appropriate" to the committee will assess "the appropriate path of the target range of the federal funds rate."

On the balance sheet, in an effort to disentangle "technical" adjustments of the balance sheet with changes in policy accommodation, there was no change in the committee's strategy to replenish reserves in the financial sector. While the level of reserves prior to the volatility in September ($1.45Tr) were given as reasonable targets for the exercise, we still maintain that the committee will continue looking into alternatives to outright bond purchases such as liquidity and capital requirements, regulatory guidance, standing repo facility, and the presence of regime changes in reserve preferences.

While the subtleties of the change in the statement left some doubt about additional rate cuts in 2019, the press conference and Q&A seemed the confirm the committee intends to pause after today's meeting. In fact, in the opening statement, the Chairman laid out a much more upbeat assessment of global conditions and the committee's risk assessment, even suggesting that the current stance of monetary policy was "likely to remain appropriate" if incoming data was in line with current conditions.

To deviate from the current stance of policy it would likely take, what the Chairman reiterated multiple times as "material reassessment of our outlook", suggesting that based on our view of the conditions in the 4Q19, a December rate is off the table. Moreover, the Chairman noted the risks to the U.S. economy were moving in a "positive" direction on account of the phase 1 handshake agreement between the U.S. and China and lower probability of a hard Brexit. While none of the questions pinned the Chairman to a measurable definition of material, the subtext suggested that the bar was rather high, meaning that small bouts of volatility would fall short of the threshold needed to cut rates again in December.

Chart 1. **Fed Funds Futures & BBVA Baseline, % effective**

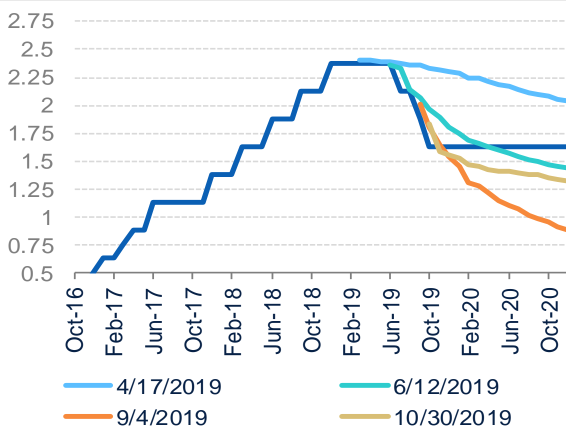
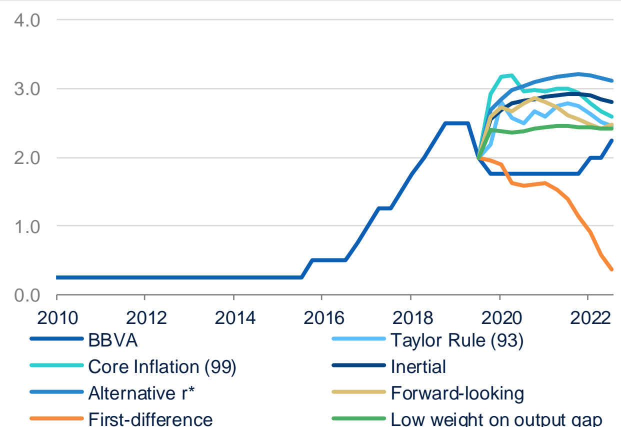


Chart 2. **Monetary Policy Rules, Fed Funds % upper bound**



Source: BBVA Research, CLE Fed & Bloomberg

Bottom Line

Based on the outcome of the October meeting, we do not expect the Fed will lower rates again in December, keeping with the Greenspan “mid-cycle” precedent of three insurance cuts, then a pause. That being said, global uncertainty, while lower, remains high at a time when many developed and emerging market economies have built up fragilities and have limited capacity for policy responses. As a result, there is a chance that the Fed could resume cutting rates in 2020. Although, as we view it, this would likely involve the realization of their risk scenario —a U.S. recession– implying a return to the zero lower bound.

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