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Economics Group

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FOMC Signals Rate Cuts Ahead

The FOMC acknowledges that uncertainties about the outlook have increased. We concur with the seven committee members that think rates will be 50 bps lower at the end of the year.

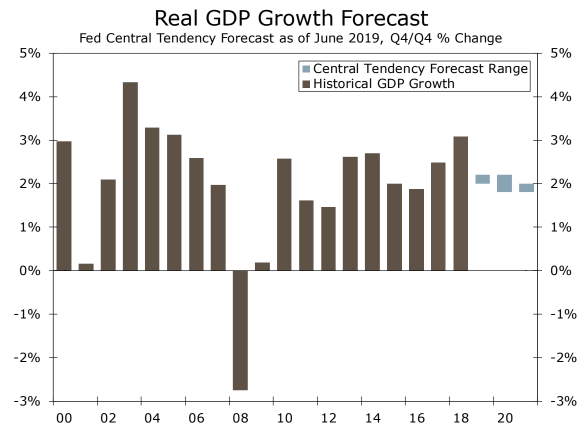
FOMC Keeps Rates Unchanged But Sends a Dovish Message

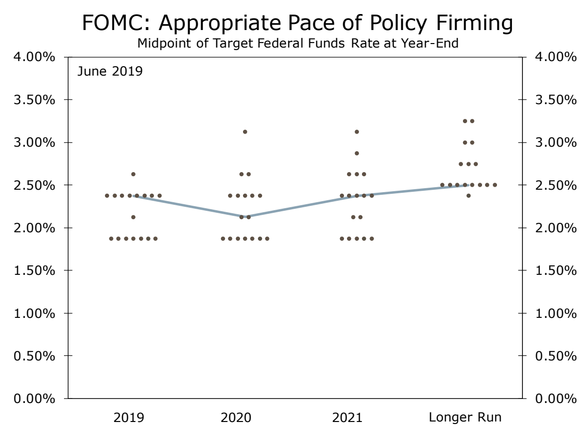
As widely expected, the Federal Open Market Committee (FOMC) decided at its meeting today to leave its target range for the federal funds rate unchanged between 2.25% and 2.50%. That said, the committee indicated that it could be easing policy in the not-too-distant future. For starters, the FOMC downgraded its assessment of the economy. At the last FOMC meeting in early May, the committee stated that "economic activity rose at a *solid* rate." Now it says that "economic activity is rising at a *moderate* rate."

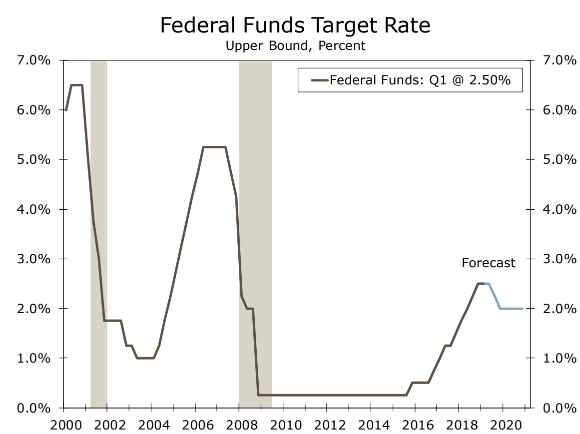
There were no major changes to the Fed's GDP growth projections for the next few years relative to the forecast that was released after the March FOMC meeting (top chart). However, the FOMC acknowledged in today's statement that "uncertainties to this outlook have increased." It also noted that inflationary pressures are "muted." Furthermore, the committee dropped the word "patient" from its statement. Many observers had surmised that "patient" meant that the FOMC would be on hold for some time as it analyzed incoming data. The committee now says that it "will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion." We interpret this sentence as signaling that the Fed will cut rates at the first sign of trouble.

There were also important changes to the so-called "dot plot." In March, none of the 17 FOMC members looked for rates to be lower at the end of 2019. The dot plot that was released today indicated that one committee member looks for rates to be 25 bps lower by the end of the year, and seven members expect that rates will be 50 bps lower at the end of 2019 (middle chart). The change in the dot plot reinforces our view that the Fed indeed will be cutting rates soon.

In that regard, we expect that the FOMC will cut its target range for the fed funds rate 25 bps at its next meeting on July 31 (bottom chart). We also look for another 25 bps rate cut in the fourth quarter, probably at the October 30 meeting. As we discussed in our most recent *Monthly Economic Outlook*, the continued undershoot of inflation below the Fed's target and the relative lack of conventional "ammunition" argue for more accommodative monetary policy in an environment of uncertainty. As we also noted, our overall macroeconomic forecast is predicated on the assumption that uncertainty related to trade policy continues to linger. If, however, President Trump and Chinese President Xi agree to a trade deal next week at the G-20 that eliminates the tariffs that both countries have levied on the other side, then the need to cut rates may dissipate. On the other hand, however, if negotiations completely break down and the United States levies tariffs on the remaining $300 billion worth of Chinese imports, then the FOMC may need to cut rates more than 50 bps. Stayed tuned.







Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

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