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FED DELIVERS ON MARKET EXPECTATIONS

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This is Christian Brobst. I'm here with Chuck Carmody again to discuss this afternoon's FOMC meeting and the following statement and press conference with Chair [Jerome] Powell.

Q: *In what was arguably one of the most important Fed meetings in recent years, do you feel the Fed lived up to the market's expectations today?*

A: Yes. I feel like the Fed was able to live up to the market's high expectations coming into this meeting. The market was expecting a double shift from the Fed, which included lower economic projections and no rate cut at this meeting.

From everything I've seen, Chair Powell and the Fed were able to meet these high expectations. A couple of highlights from the meeting included the following. The economic outlook was tempered as the wording "solid" was replaced with "moderate." One surprise from the statement was the committee referring to survey-based inflation measures as "little changed." The reason this is surprising is that we saw last week the U of M [University of Michigan] survey data came in at an all-time low.

Other interesting points from the statement included the dot plot, which showed eight members of the committee expecting a rate cut this year. And, finally, we had our first dissenter of Chair Powell's term as Fed Chairman, with [James] Bullard dissenting in favor of a 25-basis point rate cut.

Q: *So, the changes in the dot plots and the inflation expectation in this set indicate a material shift in the Fed's outlook for the economy. Are there specific data points that you would point to over the last month or two that might have influenced the updated dots?*

A: I think it's important that we go through each of the Fed's mandates and look at the data along each line. First off, inflation—as I just mentioned, the U of M inflation expectation survey came in at 2.2%, which was an all-time low. If you look further at CPI, the last data point we have there was at 2%. That had peaked at 2.4% back in July of '18, so that continues to come down. And then, arguably the most popular inflation measure the Fed looks at, core PCE [Personal Consumption Expenditures], which is currently at 1.6% year over year, had peaked at 2% back in

2018. If you want to look at market-based inflation data, breakevens are back to levels we had last seen in 2016, so those also continue to come down.

Moving on to the employment situation, employment data figures remain relatively strong, although May was relatively weak looking at the non-farm payroll number. Typically, what the Fed does is look at a three-month moving average, which currently stands at around 163,000 jobs created per month, which is still a relatively strong number. The unemployment rate is at 3.6%, and on the weaker side we've got average hourly earnings, which disappointed last month.

Q: *Seems like recently we've seen some impact of the trade war creeping into economic data. Where would you expect to see this kind of impact moving forward?*

A: The most obvious place we're seeing the implications of the trade war play out is in the manufacturing data. If you look at the U.S. manufacturing PMI [Purchasing Managers' Index] data—that came in at 50.5 last month. Going back to January of this year, that had peaked at 54.9. If you look at it on a more global scale, the JP Morgan global manufacturing PMI currently stands at 49.8, and that's been steadily declining since the beginning of 2018. So, as the trade war plays out, I would expect the manufacturing data to be the place where you see that most obviously.

Q: *Chuck, could you take one second and just talk briefly about the demarcation line in PMI data of 50 and what above and below means?*

A: Typically, when we see data points above 50, that indicates expansion; as the data moves below 50, that indicates things are contracting and it's typically a sign of weakness.

Q: *Great, thanks. So our largest focus here is clearly on domestic policy and the Federal Reserve, but we don't operate in a vacuum and it's hard to ignore some of the commentary this week from ECB President [Mario] Draghi. Do you expect the extraordinary dovishness in the eurozone to have any kind of spillover effects?*

A: I don't know if there's necessarily going to be spillover effects, but as we know well by this point the global economy is highly integrated. And what we're seeing in Europe flowed through into what we saw today from Chairman Powell. Draghi came out and said yesterday that additional stimulus will be required if the outlook doesn't improve. And you saw an immediate rally in eurozone government bonds that quickly spilled into the U.S. government bond market.

Further stories have indicated that all options are on the table for the ECB, including rate cuts, additional QE and changes to their guidance. So, I think we'll continue to see that story play out. From everything I've read, it looks like you will most likely see a policy change in September from the ECB, although it's possible in July. It should also be noted that Draghi's term will expire in November and we'll have a new head of the ECB.

Q: *Is there any chance that very weak data in the coming weeks could prompt an inter-meeting cut, in the pattern of Alan Greenspan in the early 2000s?*

A: Well, I think that's unlikely at this point, but it's certainly possible that we could see something like that. If you look at the probabilities around a rate cut post- Fed meeting today, we now have a 100% probability of a July cut priced in. In fact, there's a greater than 20% chance that we get a 50-basis point cut in July. So, while I think it's unlikely that we would have an inter-meeting cut—and I think it would take some extraordinary data and/or news to provoke something like that—it's certainly possible.

All right, Chuck. Thanks very much for your time. I appreciate your insights as always. As unlikely as it might be, if there is an inter-meeting Fed action we will send out an update on the podcast. Otherwise, keep a close eye on the data in coming weeks and you'll hear back from us again on July 31st.

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