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The Fed's Interest Rate Dilemma

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The Federal Reserve has been on quite a journey over the last year. A year ago, the Fed was intent to tighten monetary policy. They were raising rates and they were shrinking our balance sheet.

Today, we're really seeing the opposite reaction, both from rates and the size of the balance sheet.

So, what's the Fed's dilemma? What's their problem? We really have two economies here in the United States. We have companies that compete with China or companies that compete with Amazon, and they, for the most part, are under pressure. They need some help from lower rates. And you can add to that industries or companies that sell to China, given the trade talks, and the disruptions that are occurring there. So, that part of the economy would really benefit from lower rates.

You've got the rest of the economy, though—think about the FANG stocks, think about healthcare, think about industries that really have nothing to do with Amazon, with China, or global trade. They're doing really very, very well, and the Fed has a dilemma. They are trying to set one interest rate to serve all those different constituencies.

Now, at the same time—and this was part of the big pivot last year—the Fed was only looking at the United States and, again, the United States is doing very well compared to the rest of the world, so we could take, in their opinion, higher rates. Now, they're realizing that the one rate that works for the United States is problematic for the rest of the world.

So, the Fed is really in this tug of war between industries that need help and industries that don't, between geographic regions that are seeing tightening financial conditions and regions that don't.

I think they're navigating it fairly well—they've cut rates twice this year and there's another rate cut priced in by the end of the year. In addition to that, they have provided more liquidity into the system, and that liquidity has actually already seen some positive effects. They've done two things: they've provided support to the repo market—I don't think that's QE (Quantitative Easing); I think the press got that wrong. That's independent of quantitative easing. But, in addition to that, they have started to increase their balance sheet. I think they're going to be increasing it almost $500 billion. That clearly is quantitative easing, even though they're not saying it.

We think the Fed is navigating this tug of war fairly well, and the rates will continue to come down.

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