

## MUCH ADO ABOUT ALMOST NOTHING?

As expected, the Fed cut rates by 25 basis points. Markets were disappointed. That says a lot - about the market.

As expected, the U.S. Federal Reserve (the Fed) lowered key rates by 25 basis points (bps) to a target corridor of 2.00%-2.25% at its July Federal Open-Market Committee (FOMC) meeting. The move was so well anticipated, that it garners little additional comment. Additionally, the Fed will not reduce its balance sheet any further from August onwards, two months earlier than had previously been indicated, but in line with our expectations.

Interestingly, two of the governors voted against a change and none voted for more than a 25 basis point cut. The latter was certainly a disappointment for many market participants; this probably says more about the market than about the Fed.

In recent weeks, there has been plenty of speculation about the ultimate justification for an interest-rate move and the associated "forward guidance." The Fed's original idea appears to have been to insure economic growth against negative influences resulting from trade wars and weakening global activity. In recent weeks, however, the argument shifted towards lower interest rates being more appropriate because of structural changes to the U.S. economy. The latter would have been a far more favorable interpretation for equity markets and other risky assets.

In the end, there was something for everyone at the press conference. Jerome Powell described the interest-rate move as merely an insurance against external factors, that

is, an adjustment of monetary policy that would not be unusual in the middle of the cycle. In principle, all economic data and global developments would continue to be closely monitored. Clearly, Powell seemed to be trying hard to preempt criticism that the Fed had caved in the face of political pressure. In the process, he also conveyed to the markets that further easing might be moderate and is by no means guaranteed. No wonder the markets were underwhelmed.

A bit of historical perspective might help: The last time the Fed cut its main interest rate was back in December 2008. President-elect Barack Obama was still in the process of putting together his cabinet. Negative interest rates were still a concept even economic-policy wonks dismissed as little more than an interesting theoretical possibility. From our perspective, the current cut is perhaps best understood as an insurance against such an outcome.

## GLOSSARY

### Federal Open Market Committee (FOMC)

The **Federal Open Market Committee (FOMC)** is the committee that oversees the open-market operations (purchases and sales of securities that are intended to steer interest rates and market liquidity) of the U.S. Federal Reserve.

### Basis point

One **basis point** equals 1/100 of a percentage point.

### U.S. Federal Reserve (Fed)

The **U.S. Federal Reserve**, often referred to as "**the Fed**", is the central bank of the United States.

### Forward Guidance

**Forward Guidance** is an indication by a central bank to the likely course of future monetary policy.

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