US Federal Reserve signals readiness for interest rate cut

By Nick Beams
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The US Federal Reserve made no change to its base interest rate at the conclusion of its two-day policy meeting yesterday, but indicated it is prepared to make cuts later this year, citing increased "uncertainties" in the economic outlook in the US and globally.

The outcome was in line with financial market expectations. The major Wall Street indexes showed small rises for the day on the back of the decision and the language used in the statement of the policy-making Federal Open Market Committee (FOMC) that accompanied it.

In his press conference, Fed chairman Jerome Powell gave a clear indication that rate cuts were on the table later this year, pointing to what he called "significant changes" in the FOMC statement from previous months.

From the beginning of the year, he said, the Fed had used the word "patient," in assessing the need for any policy changes. That word had been removed from the latest statement.

"In light of increased uncertainties and muted inflation pressures, we now emphasize that the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion," he said.

The Fed revised down its assessment of the state of the US economy, saying activity was rising at a "moderate rate" rather than the "solid rate" of expansion it noted in May. The FOMC statement said that while household spending appeared to have picked up from earlier in the year, "indicators of business fixed investment have been soft."

Powell said at the Fed meeting on May 1 the continued "patient stance seemed appropriate" and there was no strong case for adjusting the rate, but since then crosscurrents had re-emerged. The major development was the Trump administration's escalation of the trade war against China.

At the previous Fed meeting the general expectation was that China and the US were on course to sign a trade deal. But within five days, that scenario was overturned when Trump claimed China was backtracking on previous commitments and threatened to impose a 25 percent tariff on an additional $300 billion worth of Chinese goods.

Since then negotiations have come to a virtual standstill. The new tariff hikes are expected to come into effect in July unless a last-minute change occurs as a result of the meeting between Trump and Chinese President Xi Jinping at the G20 summit meeting in Japan at the end of this month.

Among the other crosscurrents, Powell cited concerns about the strength of global growth, a fall in business confidence and the deterioration of risk sentiment in financial markets—a reference to the fall in yields on long-term bonds in the US and globally.

The decision to hold the rate steady was not unanimous. One member of the 10 who have votes on the 17-member FOMC—James Bullard, president of the St Louis Fed—indicated he wanted an immediate rate cut of 0.25 percentage points. It was the first time since Powell's appointment as Fed chair in February 2018 that the FOMC decision has not been unanimous.

While the nine other voting members decided to hold rates, they are moving in the same direction as Bullard.

Powell said though the baseline remained favourable, the question was whether the uncertainties would continue to weigh on the outlook. "Many FOMC participants now see that the case for a somewhat more accommodative policy has strengthened."

The Fed decision has broadly met market

expectations, at least for now, but whether it satisfies Trump remains to be seen. He has called for a rate cut of at least 1 percent, claiming that the Wall Street's Dow Jones index would be up by 10,000 points from its present level were it not for the Fed's "disruptive" actions.

On Tuesday, Trump again raised the possibility of removing Powell from his position. Asked about this threat at his press conference, Powell said the law was clear that he had a four-year term and "I fully expect to serve it."

The boosting of the stock market is going to be a central theme of Trump's re-election campaign. In a Twitter post at the weekend, he predicted "market crash the likes of which has not been seen before" if he were not returned in 2020.

The issue of interest rates and monetary policy could also become a feature of the economic warfare being waged by the Trump administration against US economic rivals.

Earlier this week, the president of the European Central Bank, Mario Draghi, indicated that the bank could provide a new stimulus to European financial markets in light of "lingering softness" in the European economy and persistently low inflation.

Speaking at the ECB's annual conference in Sintra, Portugal, Draghi repeated earlier remarks that the central bank had "considerable headroom" to launch an expansion of its €2.6 trillion quantitative easing program.

His remarks sent the value of the euro down against the dollar, bringing a furious response from Trump.

"Mario Draghi just announced more stimulus to come, which immediately dropped the euro against the dollar, making it unfairly easier for them to compete against the USA," he wrote on Twitter. "They have been getting away with this for years, along with China and others."

Trump also noted that Draghi's remarks had lifted European share markets. "German DAX way up due to stimulus remarks from Mario Draghi. Very unfair to the United States."

Draghi hit back saying the ECB was simply meeting its mandate, defined as lifting inflation close to, but below 2 percent. "We are ready to use all the instruments that are necessary to fulfil this mandate and we can't target the exchange rate," he stated.

Trump's remarks indicate that the US is set to harden its attitude to the European Union in ongoing trade negotiations. The US is threatening that auto tariffs of 25 percent, which would heavily impact on Germany, will be imposed if Brussels does not meet its demands, particularly on the opening of European markets for US agricultural exports.

Key members of the Trump administration, including White House trade adviser Peter Navarro, have expressed the view that European exporters, most notably Germany, have benefited to the detriment of the US from a low value of the euro.

The increase in economic conflicts between the major powers has raised concerns about whether, in the event of another financial crisis, there would be the same level of cooperation that existed in response to the global crisis of 2008.

In an interview with the *Financial Times* this week, Benoît Coeuré, a member of the executive board of the ECB, said the fall in bond yields was sending a "quite alarming" message and painting a "very bleak" picture of the global economy.

These warnings were underscored by new data which showed the value of negative-yielding bonds around the world had reached a new record high of $12.5 trillion. This indicates nervousness about the state of the global economy is rising in financial markets, and investors are seeking safety. A negative yield indicates that bond purchasers would make a loss if they held it to maturity.

Coeuré, who is a leading contender for the post of ECB president when Draghi steps down in October, said the kind of coordinated measures seen in 2008 would be "more difficult to achieve today."

"Global co-operation is eroding. The capacity of global policymakers to deal with shocks to the global economy today is today much less than it was previously," he warned.