

Opinion | 1 August 2019

## Fed's Powell delivers "hawkish cut"

Dollar rallies, the curve flattens, stocks sell. There's more coming, but not much, so don't hold your breath.



Source: Shutterstock

# 2.0-2.25%

**New Fed funds range**

Down 25bp

As expected

### Powell does what he needed to do...

Before you read my brief and personal thoughts on last night's Fed move, [here is the more detailed and insightful official house view from James Knightley](#).

It may not have pleased the US President, he has been tweeting again, but I think Jerome Powell can regard last night's Fed decision as good progress towards the goal of stabilizing the US expansion, whilst at the same time, not goading markets into pricing even more easing in. Lessons learned from the RBA's recent similar performance, possibly?

What we have seen with the Fed's 25bp rate cut, taking the target range down to 2.0-2.25%,

and the cessation of balance sheet roll-off - as of today - is a slight repricing at the front end of the curve, and a bit more rallying by the back end - probably an equity market spillover as stocks have taken umbrage at the lack of promise of a string of easing.

Fed funds futures now price an implied yield of 1.47% in December 2020, and 1.83% in December 2019. That is up from two days ago when the respective yields were 1.40 and 1.785%. These aren't big moves, but there is likely more of this to come as the message that all that may be coming is another 25bp, and perhaps not immediately, starts to sink in.

**The dissension by two voters, Esther George and Eric Rosengren, underlines the fact that as rate easing goes, this is likely to be more "nouvelle cuisine" than "all you can eat".**

For the [Fed's statement](#) and the [following Q&A](#), please click the links.

### End of quantitative twaddle

Now for the ranty bit.

The Fed will, as of today, stop allowing maturing assets on their balance sheet to roll-off, and will instead, re-invest their proceeds. This is happening about two months earlier than originally planned, as the original plan was to end this at the end of September. This is not a big deal.

The end of quantitative tightening? Don't make me laugh. It was never any such thing. If it had been, then we would have seen 10Y Treasury yields at uncomfortable highs, not struggling to stay above 2.0%. The latter stages of QE in the aftermath of the financial crisis had arguably no meaningful effects on either asset prices, expectations or the real economy (NB I do not write off the earlier actions, which were a useful firebreak).

It makes no sense at all to assume that simply allowing these bonds to mature, would do anything meaningful in the opposite direction. The later stages of the asset accumulation by the Fed did little if anything on active buying policy the way up. We should not imagine it would do anything as their asset holdings make their way passively down again (and a lot more sedately than on the way up).

It's not like the Fed has been aggressively selling down its balance sheet. The term "quantitative tightening" is a horrible misnomer and should be immediately and forevermore consigned to the lexicographer's trash can.

End of ranty bit.

### Asia's response

Asian stock futures are mainly showing red today, currencies are more of a mixed bag, with the SGD and AUD looking particularly soft against USD strength, whilst the higher yielders don't seem to have responded as much. The THB is also showing uncharacteristic signs of weakness, perhaps reflecting the recent manufacturing weakness and surging balance of payments, reflecting the lopsided domestic / export balance of the economy, and likely further weak inflation today.

Like the BoK, another reluctant easer, the Fed's actions make some easing from the Bank of Thailand look all the more probable, and in our view, rate cuts can come as early as this month. We still see scope for an early move from the Monetary Authority of Singapore, perhaps softening markets up for a further move in October. And of course, we anticipate more from the BoK, and respective central banks in Indonesia and the Philippines may not be far behind.

So in the absence of much good news flying around currently, I would put the Fed's overnight cut and subsequent likely further modest easing into the basket of "welcome market developments". The US economy remains in decent shape, the Fed's easing now and later makes the continuation of that positive story more probable. So rather than sell-off in disappointment at the absence of a big easing cycle (which would probably mean a recession was on its way), as some markets are doing, this is a story that should make you want to be longer positioned in risk assets. A buying opportunity?

### Trade talks end after half a day

It was barely worth the flight from Washington to Shanghai. Trade talks between the US' Robert Lighthizer, Steven Mnuchin and China's Vice Premier, Liu He, ended yesterday and will not resume now until September.

Chinese officials have described the pressure from the White House in advance of these talks as "meaningless". Though the White House later described the meetings as "constructive".

The issues, that are making these trade talks hard to conclude are not likely to be any less difficult in September. We are not holding out much hope of a breakthrough then either.

### More inflation data ahead

As well as Thai inflation later today, we have already had Korean inflation for July, which has delivered a disappointing 0.6%YoY reading, down from 0.7% in June. The core reading was a bit better. But this data still adds to the sense that the BoK has more easing work to do. As does the export data also just out today. July exports fell a further 11.0%YoY, with semiconductors falling 28.1%YoY.

If you want to make a good news story out of this, it is that in levels terms, it looks as if semiconductor exports troughed in February of this year. But their passage since then has been pretty flat. I do not believe we can yet point to any sort of cyclical, or even just seasonal upswing. But the end of the decline is at least something to cling onto.

PMI data dominates the rest of the day here in Asia, with the Chinese Caixin survey worth a good look after yesterday's unexceptional official numbers.

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