# ODDO BHF CORPORATES & MARKETS

# Economy

**Focus US**
N° 2019 – 40

# Fed: When in doubt, cut rates (third edition)

**Friday 25 October 2019**

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***Barring a surprise, the Fed will cut its policy rates for the third time in a row next week. The total 75bp rate cut is similar to the adjustment observed in 1995 and 1998, two episodes that the Fed has sometimes used as an example. Should the Fed conclude that it has done enough? That Jerome Powell might suggest as much is possible. To say so would be risky, as we are not yet sure that the growth rate and business climate have really hit their low point. The recent turmoil in the repo market has served as a reminder that monetary conditions can tighten when least expected.***

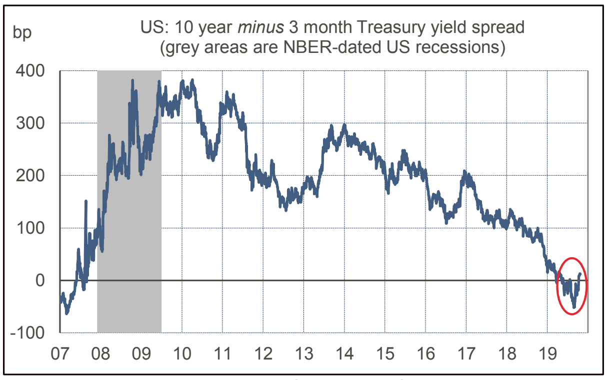
## The week's focus

In the run-up to its next meeting on 30 October, Fed officials have said nothing to correct the overwhelming majority expectation of a further 25bp rate cut. The probability from futures is 90%. Three cuts in a few months, this is what the Fed calls a "*mid-cycle adjustment*". This is different from easing in a recession phase characterised by much more frequent and broad-based rate cuts. The Fed has the examples of 1995 and 1998 in mind, two cases where the adjustment was sufficient to stabilise economic and financial conditions. The risk of recession is currently higher than usual, but, according to our calculations, it has not increased since this summer. Recent data point to sub-optimal growth, at around 1.5% annualized, but not a stagnation, let alone a contraction in activity. The yield curve that was the most alarming signal has returned to a more normal shape, in response to the decline in short-term rates (charts). This apparently leaves enough leeway to play for time.

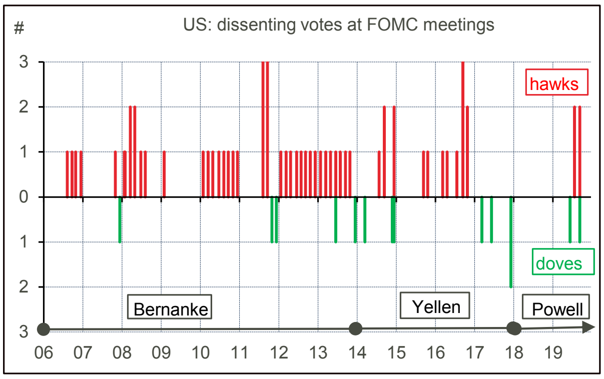
Since June, the FOMC has been divided (chart rhs). In September, a majority of 7 out of 10 voting members opted for a 25bp cut, but two preferred the status quo, another a 50bp cut. Since then, the "hawks" have not changed their minds, and the calmer relations between the US and China does not strengthen the position of the "doves". Once again, Jerome Powell will have to perform a delicate balancing act. Two days after his press conference, two statistics will be released that will influence market expectations: the ISM-manufacturer, which is at its lowest level in four years, and job creation, which is likely to be significantly weakened in October by the strike at GM (see p. 2). At the very least, this does not encourage to slam the door on rate cuts. The recent turmoil in the repo market also seem to reflect the same caution. Even if the Fed says that the decision to pump up its balance sheet[1] is not an easing, like QE, it indicates the care it is taking not to tighten monetary conditions, even if unintentionally.

1 See our *Focus-US* of 11 October 2019: "Fed resumes asset purchases"

**US: slope of the yield curve**




**US: dissenting votes amongst FOMC members**




Sources: Thomson Reuters, Fed, Oddo BHF Securities

## Economy

- Home sales fell in **September** (-2.2% m-o-m for existing homes, -0.7% for new homes), but not enough to reverse the upward trend. Sales rose by 3.9% y-o-y in the existing homes segment and 15.5% in the new homes segment. With sales up and inventories fairly low, activity in the residential construction segment should firm further out to year-end.
- The same cannot be said of business investment. Durable goods orders and shipments declined in **September** (by -1.1% and -0.4% respectively). Once again, orders for civil aircraft weighed very heavily in this result (-11.8% m-o-m) but they do not explain everything. Even removing the volatile elements of aircraft and defence goods, shipments of capital goods declined (-0.7%); they were down over the quarter (-3.3% q-o-q annualised), which had not happened since 2016. At Boeing, mired in the 737MAX problem, there is no hope of improvement in the short term. More generally, the trade uncertainty shock continues to weigh on investment plans. Even though the White House recently tried to ease tensions with China, it has now been confirmed that whilst it is quite easy to disrupt the business climate, efforts to restore it are complicated (and lengthy).
- The regional indices released this week, for Richmond and Kansas City, as well as the PMI surveys, do not reflect a further deterioration in sentiment in **October**. The PMI index recovered timorously in the manufacturing sector (+0.4pt to 51.5) and in services (+0.1pt to 51). The "employment" components are in a zone where monthly job creations could fall below the 100,000 threshold. The PMI-composite index is associated with a real GDP increase of 1.5% annualized.

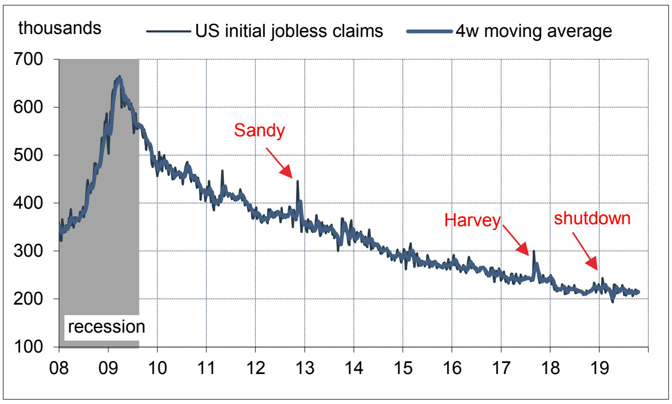
## Monetary and fiscal policy

- As the end of the month approaches, the Fed will increase the liquidity amounts offered at repo operation, from \$100bn to 120bn for overnight operations and from \$35bn to 45bn for two-week operations. With one exception, none of the operations carried out since 26 September have exceeded the ceiling, which seems to indicate that the repo market is once again well supplied. As of **24 October**, the cumulative amount of liquidity injections amounted to \$136bn, compared to a peak of \$248bn on 30 September.

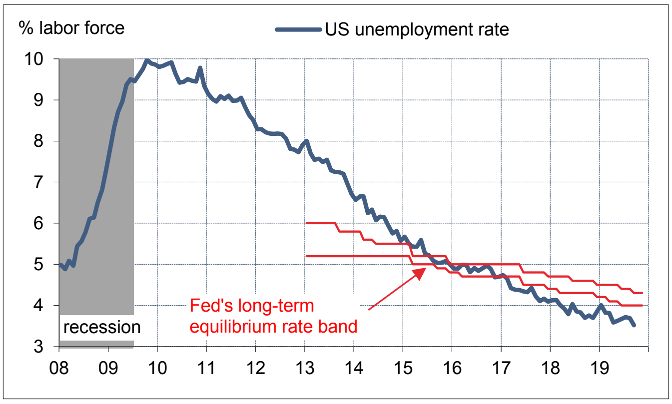
## The week ahead

- The economic calendar is busy. In addition to the FOMC meeting on **30 October** 30 (see p. 1), attention will focus on the first estimate of the Q3 national accounts (on **30**), the report on job creation and unemployment in October (**November 1st**) and the ISM-manufacturing survey (**Nov. 1st**).
- The Atlanta Fed “nowcast” estimates real GDP growth at 1.8% q-o-q annualized, while the New York Fed estimates the gain at 1.9%. Historically, Atlanta has been a little closer than New York to the official estimate of the Bureau of Economic Analysis. The consensus forecasts range from 1.4% to 1.8%, with consumption and housing investment making the major contribution to growth. On the other hand, business spending has probably been a drag.
- In October, the rate of job creation is expected to be slightly below 100,000, which would be the third time this year, after February and May. If this is the case, it would confirm that companies are more cautious in their hiring, even if, at this stage, they are not adjusting their existing workforce. Jobseeker claims are unchanged over the past month. About 50,000 GM employees were on strike when the BLS conducted its job market surveys in mid-month. They will likely not be included in employment statistics, nor should some workers indirectly affected by the strike. The impact could therefore be very significant, which constitutes a downside risk. This was observed during a previous strike at GM in 1998 (about 150,000 employees for 54 days), as well as strikes at Verizon in 2011 and 2016. Once the social conflict has been resolved, the catch-up is then very rapid.
- The decline in the ISM-manufacturing last month (-1.3pts to 47.8) was striking, especially since the other surveys did not portend such a decline. What accounts for discrepancy? One possible explanation is the type of companies surveyed. In the case of the ISM, the panel is quite small (about 400 companies, half as many as the PMI survey) and includes many multinationals. These firms are more exposed to global shocks, and in particular to conditions of trade in goods, than SMEs. Given the first signs of an easing of US-China tensions, it is possible that the ISM may recover a little. The consensus is forecasting 49pts. This would be the third month in a row in a critical zone.

## Appendix 1 - Labour market

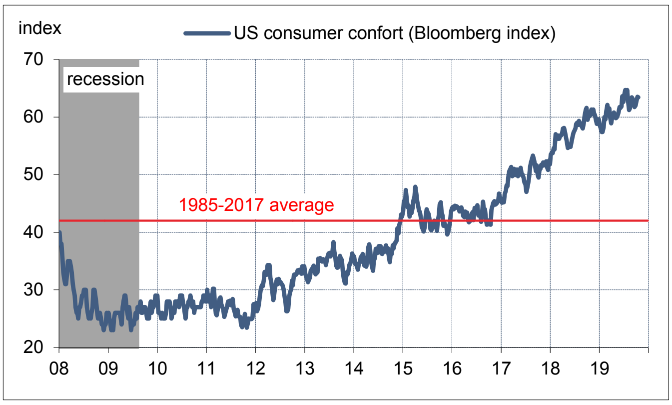




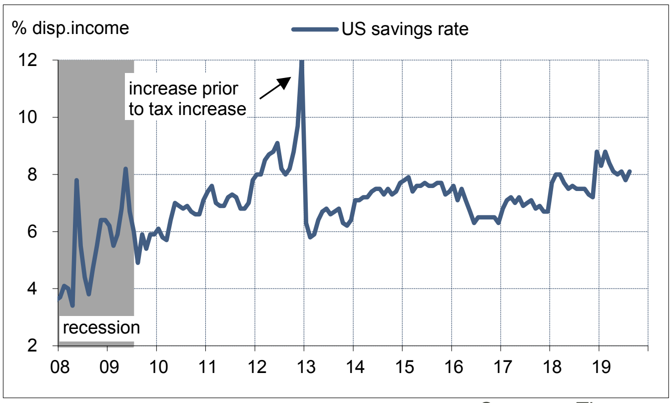


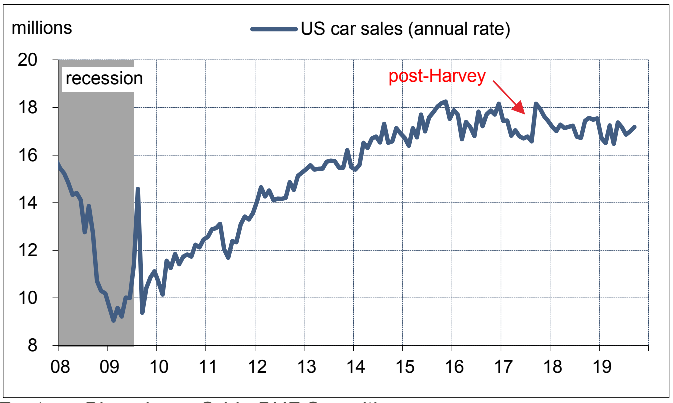


## Appendix 2 - Consumer



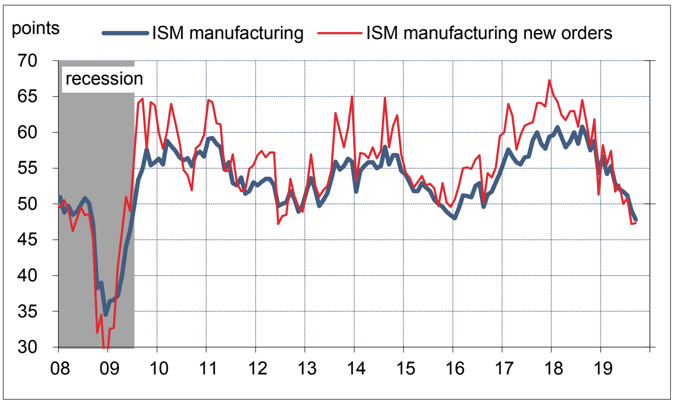


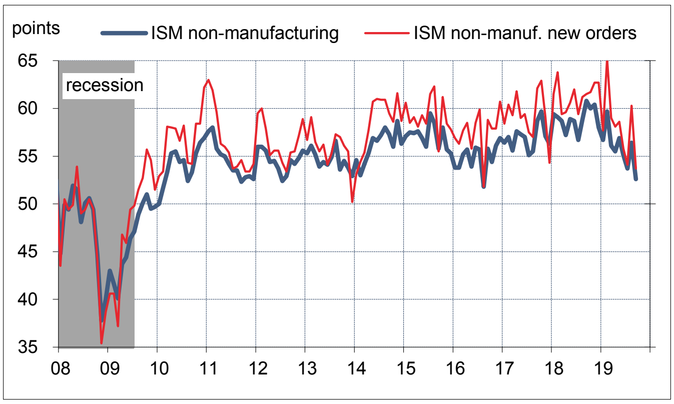


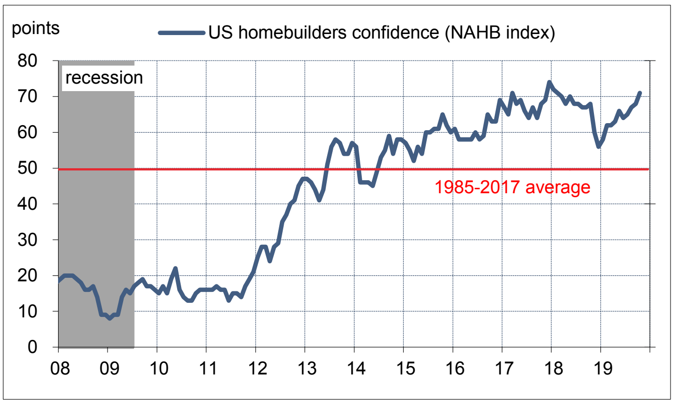



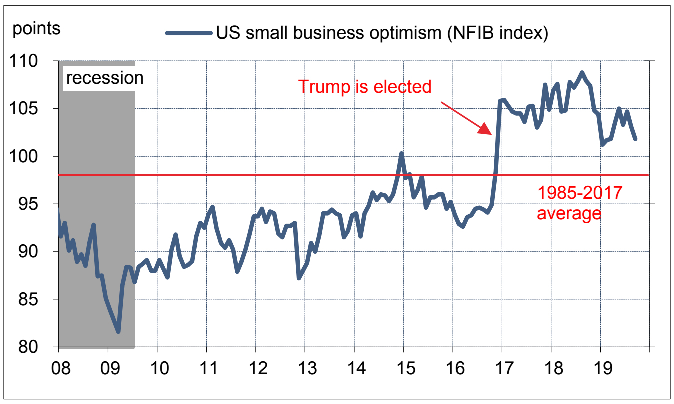

*Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities*

## Appendix 3 - Business climate

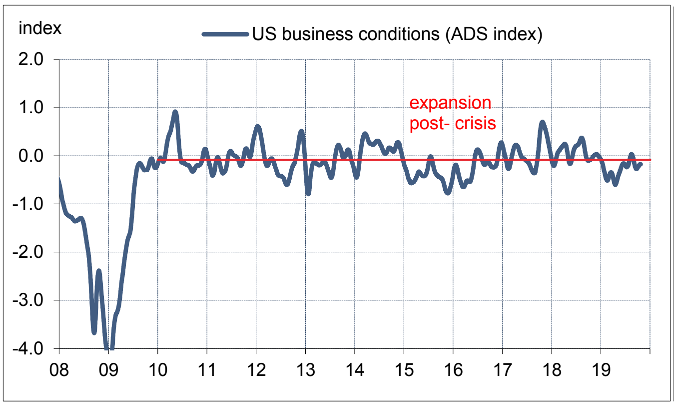


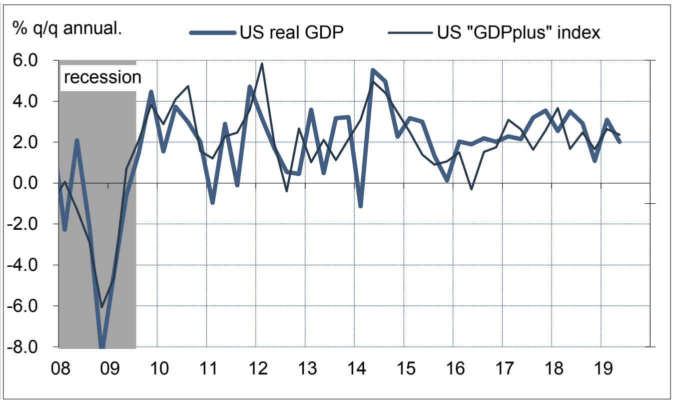



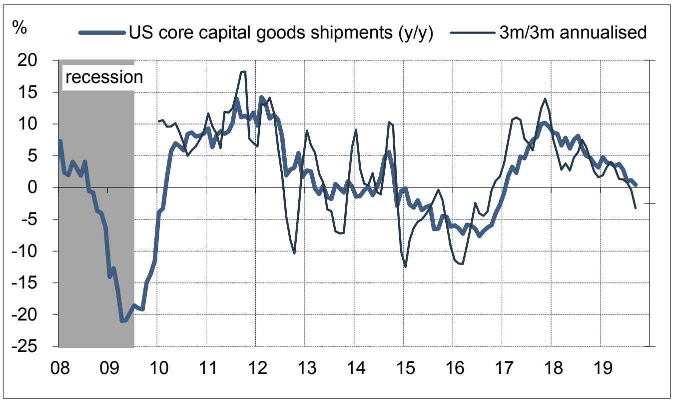



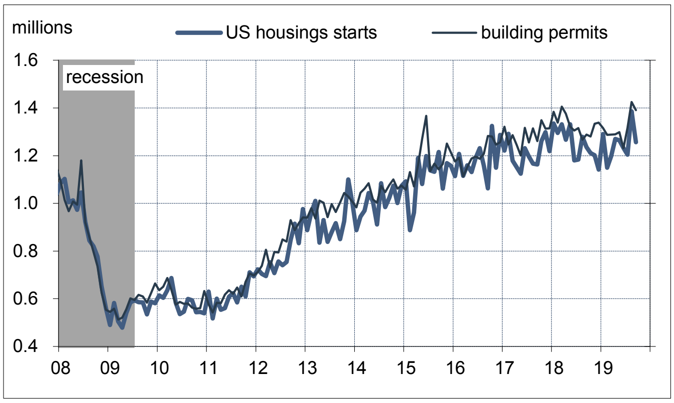




## Appendix 4 - Conditions of economic activity



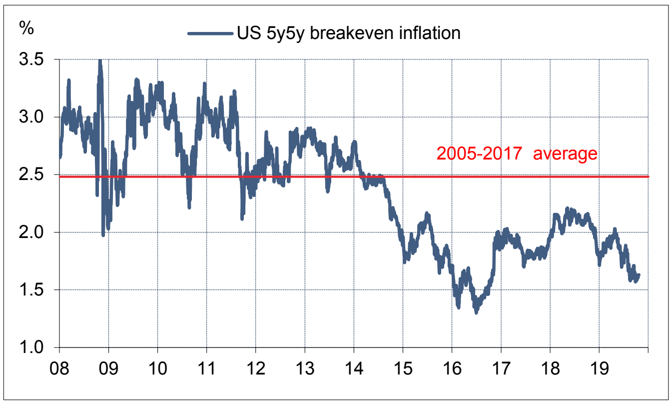



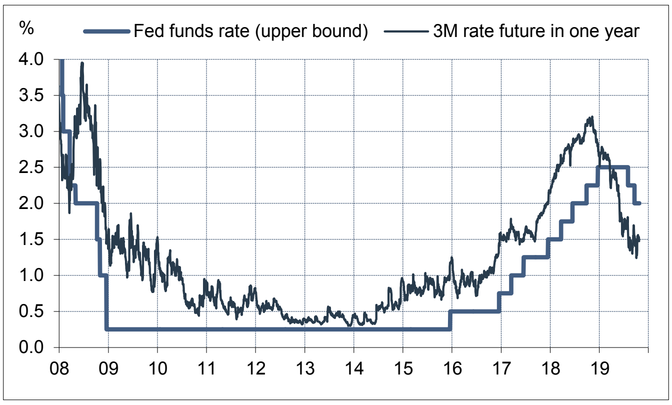



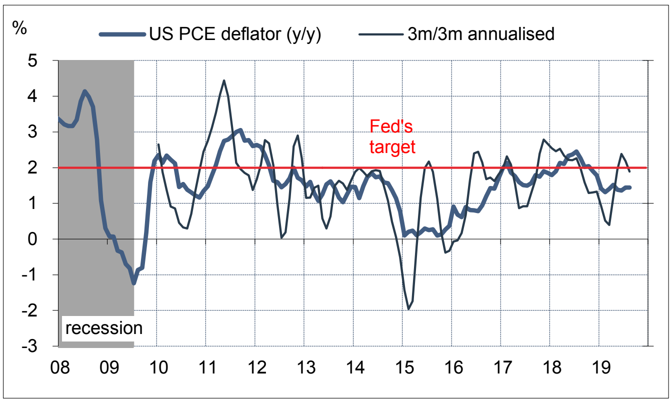



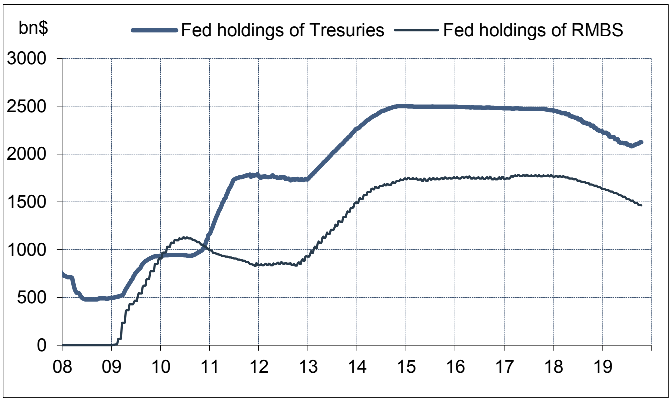

*Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities*

## Appendix 5 - Inflation and monetary policy

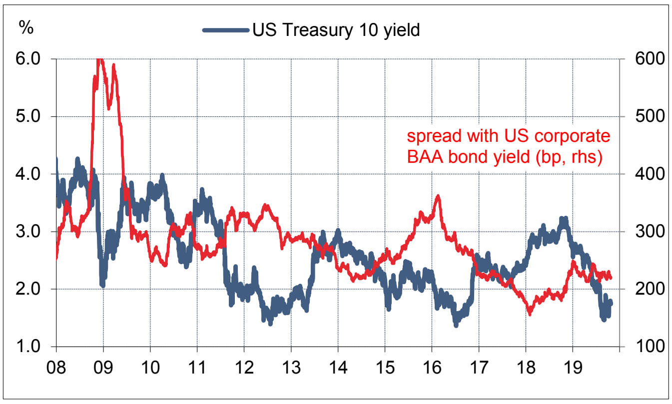


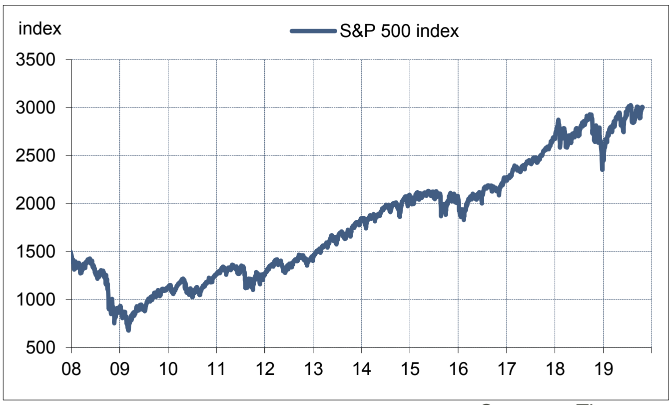



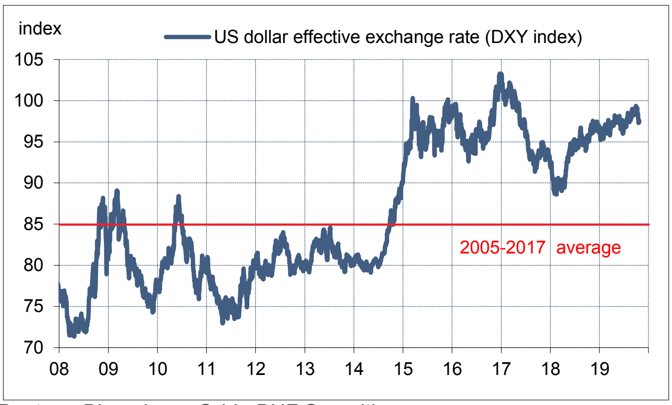




## Appendix 6 - Financial markets








*Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities*

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