June 19, 2019

President Bullard Dissents
at FOMC Meeting

Transcript

Bill Emmons: Hi. I'm Bill Emmons, and I'd like to talk about the FOMC meeting that took place June 18th and 19th.

The FOMC signaled a strong overall economic outlook tempered, though, by business investment and inflation that are somewhat weaker than desired. The FOMC kept the Fed funds target range unchanged at two and a quarter to two and a half percent for the fourth straight meeting, and they left the interest rate on excess and required reserves, IOER, at 2.35 percent.

Importantly, St. Louis Fed President, Jim Bullard, dissented from the committee's rate decision, referring an immediate cut of a quarter percentage point in the target range. President Bullard had warned the FOMC and the public that he wanted a rate cut soon.

In a speech in Chicago, June 3, President Bullard said the FOMC faces an economy that is "expected to grow more slowly going forward, with some risk that the slowdown could be sharper than expected due to ongoing global trade regime uncertainty."

He went on to say, "In addition, both inflation and inflation expectations remain below target, and signals from the Treasury yield curve seem to suggest that the current policy rate setting is inappropriately high." Therefore, "A downward policy rate adjustment may be warranted soon to help re-center inflation and inflation expectations at target and also to provide some insurance in case of a sharper-than-expected slowdown."

I think this is very important, the dissent from President Bullard. It was the first FOMC dissent by any member since December 2017, when President Evans of Chicago and President Kashkari in Minneapolis dissented in a preference for a cut, and it's the first dissent during the Jerome Powell Chair era.

The last time President Bullard dissented was six years ago, June of 2013, and this is only his second dissent in 11 years. President Bullard was joined this time by seven other FOMC members, calling for at least one rate cut this year. Most of those wanted two rate cuts. As recently as December 2018, only one other FOMC member had joined President Bullard in projecting any cuts in 2019.

So I think President Bullard is very aware that the FOMC has consistently trailed market expectations for rate cuts this year. This shows both the median FOMC members' projection of where the Fed funds range would be in January of 2020 and where financial market expectations derived from futures and options prices suggest that rate will be. The difference has now reached 75 basis points; that is, investors believe the FOMC is behind the curve again, as it was briefly at the end of last year; and it was when Chairman Powell signaled a change in Fed outlook that markets recovered early this year.

It's been very clear–and we've talked about this quite a bit–market interest rates are falling, in fact, I would say even plunging in the last few weeks. Long rates have fallen 125 basis points. Some of the intermediate rates have fallen even further. All of the rates from ten years and below are now below the Fed's IOER rate of 2.35.

It's also pretty clear that the economy has weakened since 2018. This indicator is from the Chicago Fed, a very broad-based indicator that they call the National Activity Index, and the strong 2018 economy has definitely softened substantially early this year.

So I think what bankers should be really looking at is that despite an optimistic outlook from the FOMC in the statement and in the press conference by Chairman Powell, evidence is accumulating that the economy is slowing and inflation continues to run below target.

The inverted yield curve is a strong recession signal, and it is pointing toward late 2019 or 2020 as very high probability of a recession. Financial markets and the Fed remain out of sync, which could result in market volatility, as we saw late last year, early this year.

So what should we expect this year? Remarkably the dot plot that came out of the FOMC meeting showed no changes at all in the rate target range this year, but President Bullard's dissent and movements in financial markets strongly disagree, expecting the Fed to cut rates as early as next month, that is, in July, and possibly by three times, three quarter point cuts, by the end of this year or early next year.

Thanks for listening, and we'll see you next time.

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