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The Fed carries out its first rate cut in over 10 years

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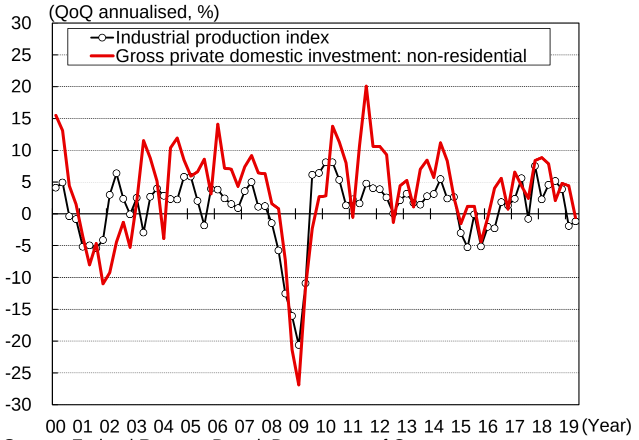
At the Federal Open Market Committee (FOMC) meeting held on 30th and 31st July, the target range for the federal funds rate was lowered by 0.25% points from 2.25%~2.50% to 2.00%~2.25%, as was widely predicted. This is the first federal funds rate cut in around ten and a half years, the last being in December 2008. Of the ten members who voted, two (Esther L. George and Eric S. Rosengren) argued for maintaining the FF rate and voted against the policy.

The decision at this FOMC was perceived as somewhat hawkish by financial markets, yet it generally lies within the range of assumptions based on the statements made up until now by senior officials of the Federal Reserve Board (FRB). At the press conference following the FOMC, FRB Chair Powell gave three points as reasons for the rate cut: to insure against downside risks from weak global growth and trade policy uncertainty; to help offset the effects these factors are currently having on the economy; and to promote a faster return of inflation to the symmetric 2 percent objective.

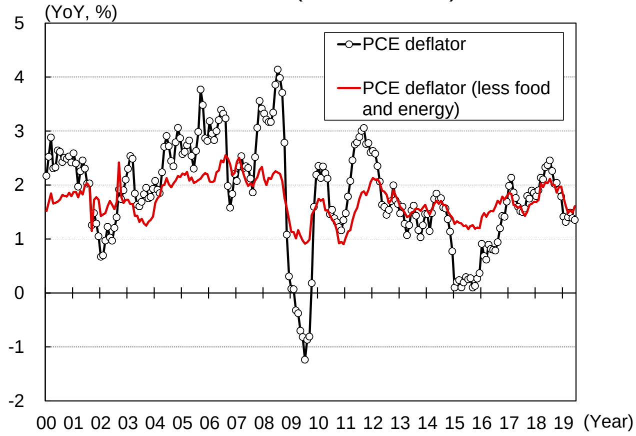
Chair Powell emphasised that the FRB does not have a set course for the FF rate in the future and added that additional rate cuts would be “data dependent”. While he mentioned that this rate cut is “not the beginning of a long series of rate cuts”, he also added, “I didn’t say it was just one”. Powell said that the FRB considered the rate cut “essentially in the nature of a (economic) mid-cycle adjustment to policy”. If there appears to be a significant recovery in the weak growth of private domestic investment by the next FOMC meeting on 17th and 18th September, there is a possibility that another interest rate cut will be postponed (Chart 1). However, there have not been any momentous developments in the trade discussions between the US and China which have restarted. In addition, it is unlikely that the cautious attitude towards investment by businesses will relax in the short term and there appears to be no signs that the inflation rate is accelerating (Chart 2). Furthermore, the FRB acknowledged “uncertainties about this outlook remain” in its latest FOMC statement, and in light of its continued decision to “monitor the implications of incoming information … and … act as appropriate” which it also included in its June statement, the probability that it will carry out another rate cut at the next FOMC meeting in September is fairly high.

Chart 1: Industrial Production and Private Investment



Source: Federal Reserve Board, Department of Commerce, MUFG Bank Economic Research Office

Chart 2: Personal Consumption Expenditures Price Index (PCE Deflator)



Source: Department of Commerce, MUFG Bank Economic Research Office

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