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The Boston Globe

What happens after the Fed's rate cut on Wednesday? Here's what you need to know

By Larry Edelman
October 29, 2019

Federal Reserve chairman Jerome Powell.OLIVIER DOULIERYA/FP/GETTY IMAGES/AFP/GETTY IMAGES

You can bet on it: the Federal Reserve will lower interest rates Wednesday for the third time since August.

That's the overwhelming consensus of Fed watchers and investors. Fed fund futures, which can be used to wager on the central bank's moves, showed something like a 97 percent chance that officials would wrap up their two-day meeting with a quarter-percentage point cut, leaving the range at 1.5 percent to 1.75 percent.

But what the world will be paying really close attention to is what the Fed says about the health of the economy, the future direction of rates, and how it plans to address problems in the all-important overnight lending market among banks and others on Wall Street.

"Everyone's focus will be on what's next, whether that's another cut or if the Fed sees this as the end of mid-cycle rate cuts," said David Smith, a managing director and chief investment officer at Rockland Trust.

Here are a few things to know ahead of the Fed's announcement, scheduled at 2 p.m., and followed by a press conference with Fed chairman Jerome Powell a half hour later.

1. The Fed is lowering rates in a bid to ensure that the mild slowdown we are seeing in economic growth doesn't get worse.

Powell has said the economy is in "a good place." Unemployment is at a 50-year low, inflation is tame, and stocks are near all-time highs. But there are threats to the record-long US expansion: a downturn in global growth and the tariff fight with China.

Powell has cast the quarter-point cuts made by the Fed on July 31 and Sept. 18 as "insurance." Since credit was already pretty loose, the moves were mostly aimed at bolstering confidence among business leaders, who have been curtailing new spending amid the trade uncertainty, and in the stock market, which has been treading water since July.

Not everyone on the rate-setting Federal Open Market Committee thought the insurance was necessary. Federal Reserve Bank of Boston president Eric Rosengren, along with his counterpart at the Kansas City Fed, opposed both rate reductions.

Rosengren is forecasting growth next year of about 2 percent, and expects the US-China trade battle, as well as the Brexit mess, to be resolved in ways that don't significantly harm the domestic economy.

"I'm more worried about financial stability," he said in an interview earlier this month, noting that reducing interest rates, especially with inflation below the Fed's 2 percent target, may encourage excessive borrowing by companies and households, and inflate prices for assets such as stocks and real estate.

2. Powell faces a tough balancing act.

After a rate hike last December — considered a mistake by many — the Fed boss has spent most of this year vowing to support the economy. His constant refrain — that the Fed "will act as appropriate to sustain the expansion" — was taken by financial markets to mean that officials would err on the side of easing credit even if conditions didn't overtly warrant it.

If the Fed had not lowered rates at its July and September meetings, disappointed investors likely would have sent stock and bond prices sharply lower.

Powell was backed into a corner, and now he needs to hit the rest button. Investors will parse every word of the Fed's statement and Powell's post-meeting press conference for clues on what the FOMC will do next.

"I think he wants to reestablish that the Fed is in control," said Greg Staples, head of fixed income for North America at DWS Group in New York. "There will be a higher bar for easing. There will have to be true, persistent signs of weakening" in order for rates to go lower, said Staples, who believes the Fed will pause for at least the rest of the year.

Calibrating the message will be tricky. Powell doesn't want to suggest that the economy is headed for smooth sailing or rough seas because conditions could change quickly. Moreover, the biggest risk to the economy — tariffs — are beyond the Fed's control.

3. Powell will be pressed to explain how the Fed will prevent another disruption in short-term money markets.

Last month, rates on overnight loans among banks and brokers spiked after the Fed's gradual shrinking of its balance sheet left banks with fewer reserves for lending. The central bank has since been injecting money into the financial system through the purchase of Treasury securities.

“The question is, do they have a longer-term plan?” said Vincent Reinhart, the Boston-based chief economist and macro strategist at Mellon, the investment unit of Bank of New York Mellon. “Are they going to put a mechanism in place to make sure there are ample reserves in the system?”

4. Lower rates are a mixed blessing for consumers.

When the Fed lowers its benchmark rate, the cost of other variable-rate borrowing also falls. That includes interest on credit card balances and home equity lines of credit. Although new fixed-rate mortgages and car loans are driven more by the yield on 10-year Treasuries, they tend to drop as well.

On the downside, the rate on bank accounts, money market funds, and CDs also fall, cutting interest income for savers.

“It will pay to shop around for the best rates or for longer-term savings products,” said Jill Fopiano, a financial adviser and CEO of O’Brien Wealth Partners in Boston.

While falling rates are usually good for stocks, she recommends that long-term investors don’t change their holdings based on a handful of Fed cuts.

“Set a strategy that meets your goals and stick with it,” Fopiano said.