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ECONOMY

Fed Cuts Rates by Quarter Point but Faces Growing Split

Central bankers divided over Wednesday's decision and the outlook for further reductions.

By Nick Timiraos

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WASHINGTON—The Federal Reserve cut its benchmark interest rate by a quarter-percentage point for the second time in as many months to cushion the economy against a global slowdown amplified by the U.S.-China trade war.

Fed Chairman Jerome Powell left the door open to additional cuts and repeatedly cited the costs of rising trade-policy uncertainty. But central-bank officials were split over Wednesday's decision and the outlook for further reductions.

"There will come a time, I suspect, when we think we've done enough. But there may also come a time when the economy worsens and we would then have to cut more aggressively," said Mr. Powell at a news conference Wednesday. "We don't know."

Fed Chairman Jerome Powell explaining the central bank's monetary-policy decision at news conference in Washington.
PHOTO: PATRICK SEMANSKY/ASSOCIATED PRESS

U.S. stocks wobbled, then pared losses after the Fed's decision. Treasury yields, which move inversely to prices, ticked higher though held their recent range.

Markets have been looking to the Fed for more concrete promises of rate cuts, but Mr. Powell has been reluctant to make any. The trade-related risks are out of the Fed's control and difficult to predict, and officials are divided over how to respond.

Seven of 10 Fed officials voted in favor of lowering the benchmark federal-funds rate to a range between 1.75% and 2%, with two reserve bank presidents preferring to hold rates steady and one favoring a larger, half-point cut.

The Fed also on Wednesday injected money into the banking system for the second day in a row to ease a crunch in overnight funding markets, and said it would do so again on Thursday. The operations are aimed at keeping the fed-funds rate in the central bank's target range.

> Mr. Powell said the funding issues and the Fed's operations "have no implications for the economy or the stance of monetary policy."

He signaled concern that uncertainty about trade policy was chilling business investment and that a pullback in manufacturing activity would continue. But the U.S. consumer has been resilient this year, and a modest slowdown in the pace of hiring hasn't pushed the unemployment rate higher.

"It's an unusual situation," Mr. Powell said. "Our eyes are open. We're watching the situation. We've cut rates twice."

The Fed has been under attack from President Trump to aggressively cut interest rates—to boost stock markets and weaken the U.S. dollar—after the White House's trade talks with China hit an impasse this spring. Mr. Trump had called for the Fed to cut rates by a half-point in April, but he has since said the Fed should lower rates more aggressively.

Soon after the Fed announced its rate cut Wednesday, Mr. Trump lashed out at Mr. Powell on Twitter. “Jay Powell and the Federal Reserve Fail Again,” he wrote, one of 30 such statements about Fed policy since the July meeting. “No ‘guts,’ no sense, no vision! A terrible communicator!”

Mr. Powell has repeatedly declined to respond to those attacks and did so again. “I continue to believe that the independence of the Federal Reserve from direct political control has served the public well over time,” he said Wednesday. The Fed “will continue to conduct monetary policy without regard to political considerations.”

The Fed’s moves to shelve rate increases earlier this year and later to cut them twice this summer—combined with broad declines in market-determined rates due to weak global-growth prospects—have already led to lower borrowing costs for consumers buying cars or taking out mortgages.

Mr. Powell said officials still have a positive outlook for the U.S. economy. But he signaled less certainty about the rate path than at the Fed’s late July meeting. The majority of Fed governors and reserve bank presidents who decide on policy “is going meeting by meeting,” he said.

Officials expected the U.S. economy to slow this year, but increased uncertainty means they aren’t sure if the economy is going to cool a little bit or a lot.

“The idea that if you see trouble approaching on the horizon, you steer away from it if you can, I think that’s a good idea in principle,” Mr. Powell said. “Applying that principle in a particular situation is where the challenge comes.”

The policy statement released after the meeting was little changed from July, when officials cut rates and held the door open to more reductions. Projections released after Wednesday’s two-day meeting showed the extent of the split over the policy outlook, complicating the challenge facing Mr. Powell.

Seven of 17 officials penciled in one more rate cut this year. The other 10 were split evenly between those who thought the new level of rates, after Wednesday’s cut, would be appropriate through the rest of 2019 and those who thought rates shouldn’t have been cut.

“A divided committee is not that surprising given there’s a high level of uncertainty in the economic trajectory,” said Michelle Meyer, an economist at Bank of America Merrill Lynch.

The Fed appears largely split between “those who believe the global situation is going to keep slowing the U.S. economy and threaten to unleash disinflation versus those who view the world as background noise and focus on domestic variables," said Steven Blitz, chief U.S. economist at TS Lombard.

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While Mr. Powell is in the former camp, that group of officials has been unable so far to sway their colleagues "from a well-worn position that historically kept the Fed too tight for too long," Mr. Blitz said.

Recent research from Fed staff economists estimated that uncertainty over trade policy is likely to reduce U.S. economic output by more than 1% through early 2020.

That paper "suggested a pretty big effect that could justify easier policy if you thought the conclusion was right for sure," said William English, a former senior Fed economist who now teaches at Yale University. "But presumably they don't think it's right for sure, because their outlook is not the outlook you might get from that paper."

Mr. Powell faces related pressure from investors betting that lower rates will be needed to support stock and credit markets.

"The Fed doesn't think it can stand still because of the potential disruption to markets that could feed back to the economy, but it can't go forward because there is no economic justification for aggressive rate cuts," said Mohamed El-Erian, chief economic adviser at Allianz SE, the German insurance giant.

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