19 September 2024

Fed cuts key interest rate by 0.5% and teaches the ECB a lesson

The US Federal Reserve cut its key interest rates by 50 basis points yesterday. This puts the target corridor for the Fed Fund Rate at 4.75%-5.0%. What was unusual about this decision was that it was not taken unanimously. Michelle Bowman, who has been a member of the Fed since 2018, was only in favor of a key interest rate cut of 25 basis points. This is in some ways an astonishing occurrence, as interest rate decisions have been made unanimously at the Fed for almost 20 years. However, the obvious differences in the assessment of the monetary policy situation within the Fed were also a reflection of what could be observed on the broader market, as there was no consensus on the upcoming decision here either. The fact that the Fed had not previously succeeded in preparing the market with sufficient clarity for a more significant rate cut also indicates that Fed Chairman Powell could not yet be sure of a majority of votes in favor of a more significant rate cut before the start of the so-called blackout period, which began on 7 September.

Courage pays off

How should the decision now be assessed? In our view, the larger interest rate hike is well justified. As the Fed members' economic projections show, there have been small but significant shifts in the assessment of key indicators since the last meeting in June. For example, the median expected real GDP growth for 2024 has been revised marginally downwards and expectations for the unemployment rate have been revised upwards. At the same time, the expected path for the inflation rate was revised downwards again. From a sober point of view, it is almost logical to make the first interest rate move large rather than small, especially as this first move cannot be a terrible mistake. After all, the inflation and cyclically neutral interest rate is dramatically lower than the current interest rate. And even if no one on this planet knows exactly where this neutral interest rate is, it is clear that monetary policy will still be restrictive even after this interest rate cut. And so there are good reasons, especially at the beginning of interest rate cut cycles, to shoot a little harder, and that is exactly what the Fed has done. You have to admire the Fed a little for this courage, because a few days ago you could have argued that a move like this could be dangerous. In a world where the majority of markets were pricing in a small rate move ten days ago, there may have been a fear that a move that was too large might even scare off market participants.

The tail doesn’t wag the dog at the Fed

However, in this logic, the tail would be wagging the dog. Ultimately, however, the central bank must set the direction of monetary policy, not the markets. It is not acceptable to refrain from making the right decisions just because they might be misinterpreted by the markets for a few hours. In the end, the Fed is committed to the welfare of the country and not to the smoothest possible processing of information on the markets. It is encouraging to see that the Fed remains firmly committed to this guiding principle. However, that doesn't necessarily mean that it isn't a master at communicating with the markets when it really matters. And yesterday's press conference by Jerome Powell was a lesson in this, also and above all for the ECB and its head Christine Lagarde. Because Lagarde tends to speak in technocratic platitudes and tends to chicken out at the crucial moment when action is called for.

In contrast, it was really fun to watch the Fed chief explain monetary policy and live monetary policy with every fiber of his being. Instead of bloodless and sometimes hackneyed, reflexive phrases, with every sentence you recognized a practitioner who tries to explain the pitfalls of monetary policy honestly to journalists and ultimately the markets in order to prepare them for all eventualities and various conceivable scenarios. For example, the moment when he explained to a journalist that the concept of a structural, neutral interest rate is very academic in nature and that it is not yet possible to anticipate interest rate paths that will one day run out at the neutral interest rate, because nobody knows where this interest rate will be in the future. You can probably tell at a certain point when you are close to this interest rate, but you can only see it when it happens. Until then, the path sometimes resembles a path of trial and error, where you tend to move forward by feeling your way. Therefore, the Fed members' dot plot should not be taken too seriously. He described the creation of these dot plots, which indirectly show which interest rate path the Fed members consider appropriate, in an almost disrespectful manner. He was not entirely wrong to point out that the huge range of estimates and expectations between Fed members alone was an indication of the enormous uncertainty, so that one should not read too much into this.

The overrated dot plot

Even as an investor, it would not always have been a good idea to read too much into the development or level of dot plots in recent years. This is because monetary policy does not follow academically predictable patterns to the extent that many mistakenly think it does. Monetary policy is undoubtedly based on monetary theory, but in view of uncertain data and economic correlations that cannot always be perfectly explained (fluctuating moods and psychological effects should never be underestimated), monetary policy sometimes resembles not only a science, but also an art. Communicating this, at least indirectly, is an achievement in itself and demonstrates a great sense of reality and also great sovereignty, because you don't take yourself more seriously than you are. When Jerome Powell tries to answer journalists' (sometimes not very purposeful) questions, he is sometimes reminiscent of a doctor who explains to his patient that he has a good understanding of the illness in principle, but that the choice and amount of medication has to be "tried out" to a certain extent from time to time in order to find the optimum dose. But just as a doctor never wants to be accused of not having tried everything necessary, the Fed also acts according to the motto of not falling "behind the curve".

And Powell himself admitted yesterday that this is exactly what would have happened if key interest rates had not been lowered by 50 basis points now, courageously and decisively. And he explicitly emphasized once again that this mistake should not be allowed to happen. Now it is debatable whether he has already laid the foundations for the next 50 basis point move with this comment. At yesterday's press conference, the author of these lines had the impression for a second that this was what he was implying. On the other hand, it can be assumed that there would not yet be a majority in the Fed committee for such a move. Powell was also clever enough to give various fundamental reasons why a subsequent 25 basis point move would also be appropriate. After all, although unemployment has risen, the economy and the labor market are still in very robust and good shape, which is true. Just how tricky things can get in detail was demonstrated yesterday at the press conference when a critical journalist asked why the Fed still had a moderately optimistic overall picture for the labor market. Part of the answer was that the Fed's monetary policy was also ensuring that things would turn out this way. The interdependencies indirectly expressed here show how difficult monetary policy is in practice, because with your monetary policy you influence the data that you in turn use as a basis for your work. This makes the determination of an appropriate interest rate a very dynamic problem, and presumably Jerome Powell does not yet know which interest rate change he will favor at the next meeting on November 6 (two days after the presidential election). What we already know, however, is that the decision will also be made with courage and independence - without trying to please everyone. But always in an honest effort not to fall behind the curve. The ECB should also try to do this; we could learn a lot from the Fed here.

Dr. Christian Jasperneite

Market data

Stock marktes	As of 20.09.2024 09:25	Change versus 13.09.2024 -1 week	19.08.2024 -1 month	19.06.2024 -3 months	19.09.2023 -1 year	29.12.2023 YTD
Dow Jones	42025	1,5%	2,8%	8,2%	21,7%	11,5%
S&P 500	5770	2,6%	2,9%	5,2%	29,8%	21,0%
Nasdaq	18014	1,9%	0,8%	0,8%	31,7%	20,0%
DAX	18864	0,9%	2,4%	4,4%	20,4%	12,6%
MDAX	26151	2,3%	4,8%	2,7%	-2,8%	-3,6%
TecDAX	3320	0,2%	-0,9%	1,5%	9,9%	-0,5%
EuroStoxx 50	4917	1,5%	0,9%	0,6%	15,9%	8,7%
Stoxx 50	4444	0,4%	-0,7%	-1,4%	11,7%	8,6%
SMI (Swiss Market Index)	12038	0,0%	-1,9%	-0,2%	8,8%	8,1%
Nikkei 225	37724	3,1%	0,9%	-2,2%	13,5%	12,7%
Brasilien BOVESPA	133123	-1,3%	-2,0%	10,7%	13,0%	-0,8%
Indien BSE 30	84152	1,5%	4,6%	8,8%	24,5%	16,5%
China CSI 300	3201	1,3%	-4,6%	-9,3%	-14,0%	-6,7%
MSCI Welt	3690	1,5%	2,0%	4,7%	25,0%	16,4%
MSCI Emerging Markets	1100	1,6%	-0,3%	0,4%	12,9%	7,5%
Bond markets						
Bund-Future	134,32	-40	17	177	476	-290
Bobl-Future	119,52	-23	184	275	374	24
Schatz-Future	106,90	-6	73	114	206	36
3 Monats Euribor	3,46	-21	-21	-21	-48	-42
3M Euribor Future, Dec 2024	3,01	0	-2	-30	-43	71
3 Monats $ Libor	5,08	-13	-31	-53	-58	-52
Fed Funds Future, Dec 2024	4,32	-8	-27	-65	-42	48
10 year US Treasuries	3,71	6	-15	-50	-65	-15
10 year Bunds	2,19	10	-1	-19	-53	19
10 year JGB	0,85	0	-5	-8	14	23
10 year Swiss Government	0,49	5	9	-21	-63	-21
US Treas 10Y Performance	625,73	-0,4%	1,5%	5,1%	9,5%	4,1%
Bund 10Y Performance	569,30	-0,3%	0,8%	2,6%	7,4%	0,7%
REX Performance Index	453,56	-0,4%	0,6%	2,2%	5,6%	1,3%
IBOXX AA, €	3,04	-2	-15	-38	-84	-2
IBOXX BBB, €	3,56	-4	-15	-44	-115	-20
ML US High Yield	7,23	-22	-37	-77	-145	-57
Commodities						
MG Base Metal Index	425,34	3,6%	3,2%	-1,8%	11,0%	8,8%
Crude oil Brent	74,76	3,2%	-5,8%	-12,5%	-20,9%	-3,8%
Gold	2607,60	1,3%	4,1%	12,1%	34,9%	26,2%
Silver	31,09	0,6%	5,9%	5,7%	34,1%	28,2%
Aluminium	2528,87	3,0%	4,8%	3,3%	16,3%	7,8%
Copper	9388,22	2,2%	2,7%	-2,7%	14,0%	10,9%
Iron ore	92,03	-0,2%	-6,2%	-14,1%	-24,7%	-32,5%
Freight rates Baltic Dry Index	1976	4,6%	15,7%	1,7%	29,5%	-5,6%
Currencies						
EUR/ USD	1,1176	0,9%	1,2%	4,0%	4,3%	1,1%
EUR/ GBP	0,8381	-0,6%	-1,6%	-0,7%	-2,8%	-3,3%
EUR/ JPY	160,02	2,5%	-0,7%	-5,7%	1,2%	2,4%
EUR/ CHF	0,9468	0,9%	-0,8%	-0,4%	-1,3%	2,2%
USD/ CNY	7,0521	-0,6%	-1,3%	-2,9%	-3,4%	-0,7%
USD/ JPY	142,63	1,3%	-2,7%	-9,8%	-3,5%	1,1%
USD/ GBP	0,75	-1,3%	-2,6%	-4,5%	-6,9%	-4,4%

Source: Refinitiv Datastream

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Simon Landt
+49 40 3282-2401
mlandt@mmwarburg.com