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Instant Thoughts

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Cutting in the Vacuum

- **Fed Chair Powell styles himself as a centrist. He warned another rate cut in December was "far from a foregone conclusion".**
- **A characterization of "a risk management cut" in September did not stop the FOMC from cutting rates today. Why would it stop the FOMC from a follow-up easing?**
- **The balance sheet runoff that began over 3 years ago will also end on 1 December. We expect the Fed to inject reserves via buying bills soon, a tacit admission of the beginning of the next "excess cash" era.**
- **We reckon that any reaction will be short-lived as the situation is delicate: Powell is forced to make call in a data vacuum, and the meeting in Korea is just as high-stake.**

Powell was not ready to entertain a 50bp cut amidst data limbo. That left a 25bp cut as the only feasible choice, and he delivered.

The real firework was Powell's warning that another rate cut in December was "far from a foregone conclusion." Is Powell a hawk in dove's clothing? Certainly, little guidance was tabled beyond "caution" and "data dependence." But fact is a stubborn thing. A characterization of "a risk management cut" in September did not stop the FOMC from cutting rates today. Why would it stop the FOMC from a follow-up easing? Centrists have a habit of rhetorically overdoing it. We still think Fed will end up cutting rates further.

The balance sheet runoff that began over 3 years ago will also end on 1 December. Proceeds from maturing MBS holdings will be rolled over into Treasury bills. Why push it considering the monthly run-off amount is only about US$15-20 billions? The Fed's "alarm system" is flashing amber. SOFR is trading above IORB, and the Standing Repo Facility has seen regular usage. Liquidity is tight enough for the Fed to pull the plug. It marks the end of the "excess collateral" regime. We expect the Fed to inject reserves via buying bills soon, a tacit admission of the beginning of the next "excess cash" era.

We reckon that any reaction will be short-lived as the situation is delicate: Powell is forced to make a call in a data vacuum, and the meeting in Korea is just as high-stake.

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