



An intriguing development at the Fed

Could debate about the rate hike turn into a showdown?

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Deborah Cunningham, CFA

Executive Vice President

Chief Investment Officer Global Liquidity Markets

Senior Portfolio Manager

Is dissent forming in the Federal Reserve? The markets are convinced policymakers will cut rates at the September Federal Open Market Committee (FOMC) meeting, but they'd be wise to re-read the bottom of the July meeting's statement that said "Voting against the action were Esther L. George and Eric S. Rosengren, who preferred at this meeting to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent."

This could get interesting. Especially so as the dissenters are regional Fed presidents, not governors. A lot of regional presidents, especially those whose economies are doing OK, seem to be saying they don't see a need to lower rates. Growth in their regions may be slower, but still positive and that's not a sign of weakness. And as a whole, the U.S. economy is holding up. Consumer, housing and employment data are humming.

The contrasting view—articulated better by Fed Chair Jerome Powell in his Jackson Hole, Wyo., speech than his press conference after the July FOMC meeting—is that the Fed must take into account the potential damage from external shocks. Fulfilling its mandate can't be done by pushing buttons and pulling levers without paying attention to the greater world. Much of it was heading toward economic downturn even before the intensification of the trade war.

An example is manufacturing. While hanging in there, production and confidence dipped in July on the spate of global uncertainties. And it is not just China. Germany, France, Italy and, of course, Britain, are going through rough spots that look to get rougher. Not to be forgotten is that many global central banks are easing and the dollar is strong. In the end, we can't do much more than watch the debate unfold, but keep in mind that, with two open seats on the board of governors, the regional presidents have an even weighting, five to five. Things indeed could get interesting.

In the meantime, cash managers—really everybody—can only deal with what is in front of them. The global rush to the haven of Treasuries caused the curve to fluctuate (although the U.S. Treasury's massive issuance of bills and notes kept it within a reasonable range).

But with the Treasury and Libor yield curves fluctuating in August, we had to be very selective in our purchases. On any given day, the best offerings were vastly different than the day before. Some days, the 3-month area looked attractive; other days, 6-month paper stood out. Floaters continued to be a crucial part of our book of business, with spreads widening out, if only slightly. We did not alter our weighted average maturities (WAM) of 30-40 days for government funds and 40-50 for prime and muni funds. But we were able to move the actual WAMs longer within those ranges.

Some unequivocal good news is that all sectors of the liquidity space on an industry-wide basis continued to take in flows. In August, the industry reached the highest amount of assets under management (around \$3.6 trillion) since the peak of 2007 (\$3.9 trillion). That is pretty amazing, especially for prime funds that many left for dead after reform. And how about this nugget: industry-wide, flows into prime funds in the second quarter of this year numbered more than total assets in the space immediately after reform.

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London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. The Libor is fixed on a daily basis by the British Bankers' Association and acts as a benchmark for other short-term interest rates.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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