Odds For Fed Rate Cut July 31 Just Hit 100% - Unbelievable!

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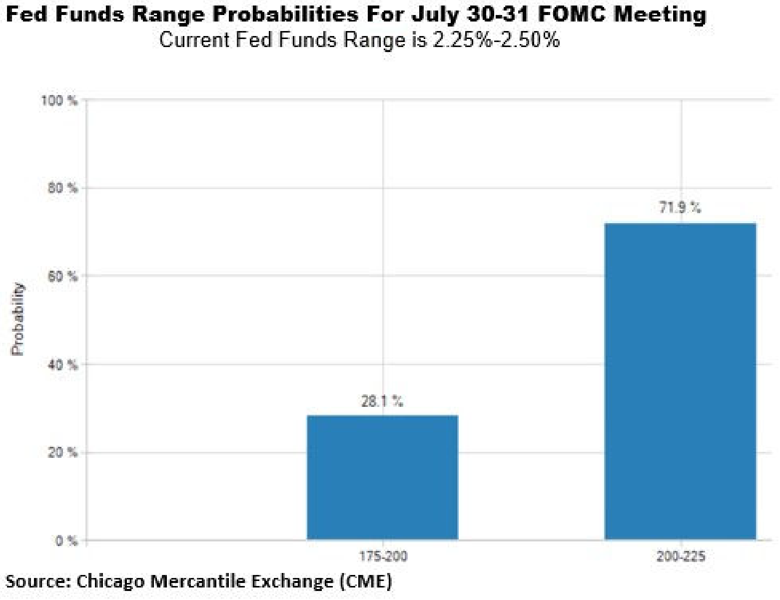
Zero Percent Chance Fed Will Stand Pat on July 31

Let me say at the outset, I've never seen anything remotely like this in my almost 40 years of following the Fed. Based on Fed Funds futures (CME FedWatch), the odds of a Fed interest rate cut on July 31 have **surged to 100%**. This is unbelievable based on what the Fed has said since its most recent policy meeting on June 18-19.

And it's even more unbelievable when you look at the numbers in the chart below. Almost **72%** of traders believe that there will be a 25-basis point cut (0.25%). Shockingly, over **28%** of traders believe the Fed Open Market Committee (FOMC) will cut its key interest rate by 50 basis points (half of 1%) on July 31! I can't remember the last time the FOMC cut (or raised) the Fed Funds rate by 50 bps in one move.

Most importantly, the latest reading of the Fed Funds futures shows a **0% chance the FOMC leaves the rate unchanged** at the end of July. I don't recall that ever happening before! What this means is that traders of Fed Funds futures have fully bought into the media hype for a Fed rate cut ASAP. Here's the chart:



Regular readers know that I have been skeptical about *any* Fed rate cuts this year, certainly not in July. Yet with Fed Funds futures signaling a 100% chance of a rate cut in July, and a nearly 60% chance of a cut in September (not shown), I have had to rethink my position. So, where am I now? **I remain skeptical**.

With the odds for a rate cut on July 31 at 100%, there would have to be a very compelling story to convince the Fed to go against what it has said recently and cut its key interest rate at the end of this month. If the FOMC leaves the Fed Funds rate unchanged at its July 30-31 meeting, **it will be one of the greatest *market misses* of all time!**

Of course, if there is a rate cut on July 31, it will be a big miss for Yours Truly!

What I thought would be helpful today is to summarize the case **for and against** rate cuts this year. As you read my summaries below, keep in mind that the Fed said in January that it was pausing its rate-hiking campaign temporarily, and that it would be ***"patient"*** and would ***"wait and watch"*** before raising the rate higher still.

Last week in a speech at the Council On Foreign Relations, Fed Chairman Powell said the FOMC would only consider cutting rates if there is a **negative change** in its outlook for the US economy, and the odds of a recession increased. Specifically, he said:

> "***We will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion.***"

While most forecasters believe the US economy did slow down in the 2Q, the economy is still growing, and there is no indication a recession is coming in the near future.

The Case For a Fed Funds Rate Cut at the End of July

Obviously, I don't agree with the case for a Fed Funds rate hike at the end of this month, but I will summarize the advocates' argument. The case for a rate cut this month typically begins with concern that the global economy has been softening this year, even though growth in the US was strong at 3.1% in the 1Q.

In April, the International Monetary Fund (IMF) reduced its forecast for global economic growth in 2019 to **3.3%**, down from 3.5% in January and 3.7% in October. While this is the lowest IMF forecast since the financial crisis of 2008-09, the IMF expects a rebound to **3.6%** in 2020.

Second, the rate cut advocates cite the growing trade tensions between the US and China, Mexico and others -- which have added to worries about the global economic growth outlook. Yet tariffs on Mexico have been suspended for 90 days, and our southern neighbor appears to be taking significant actions to lessen the "immigration crisis."

As for China, President Trump and Chinese President Xi Jinping met last Saturday during the G-20 Summit. The two leaders agreed to restart the trade talks that had recently stalled, and Trump agreed to suspend further trade tariffs indefinitely.

Third, rate cut advocates point to the weak employment report for May which showed only 75,000 new jobs created that month, well below what we've been averaging the last several years. That number no doubt worried members of the FOMC, but it remains to be seen if this is the start of a trend or is merely an outlier

Fourth, those advocating for rate cuts frequently point to the fact that inflation continues to run below the Fed's target of 2%. Somehow, these people believe the Fed should cut rates and stimulate higher inflation… *just because*. I don't agree!

Finally, the rate cut crowd zeroed in on a comment Chairman Powell made last week at the Council On Foreign Relations, when he said: ***"an ounce of prevention is worth a pound of cure."*** To the cut rates now crowd, that was a veiled promise of a rate cut at the end of this month.

These are the primary arguments of the cut rates crowd. There are others, of course, but I think you get the point. Now, let's look at the arguments against a rate cut on July 31.

Why We Shouldn't Cut Rates Now, Or At All This Year

Again, I'll take them in order. First, there is no indication the US economy is headed for a recession anytime soon. US Gross Domestic Product soared to **3.1%** (annual rate) in the 1Q. While most forecasters believe it slowed in the 2Q, the Atlanta Fed's ***GDPNow*** indicator has the US economy growing at **1.5%** in the 2Q, as of yesterday. That's hardly a signal of a recession looming.

Before they cut rates, Fed officials would need to see some hard evidence that the outlook for the economy has materially worsened since they met on June 19. About the only thing that might have qualified would have been a disastrous meeting between Donald Trump and China's Xi Jinping at last weekend's G-20 Summit. They apparently had a great meeting, the trade talks are on again and President Trump put further sanctions on hold for now.

Another weaker-than-expected jobs report this Friday might do it, but it would have to be as bad or worse than May’s 75,000 payroll gain. Given the growing slowdown in population growth, 75,000 jobs per month is close to the breakeven pace of monthly job growth that would keep the unemployment rate steady.

Seventy-five thousand new jobs a month may be the *‘new normal,’* not some disaster that calls for the Fed to take drastic action. If 75,000 is the new normal, it will take us some time to get used to this. Even if job creation is slowing, no recession is in sight, so the Fed should not be compelled to lower rates.

Consumer spending has rebounded from a weak 1Q and is believed to have increased in the 2Q to a healthier **3.3%** rate. Wages are rising at a **3.1%** annual rate, the best level in several years.

Household incomes continue to rise much faster than their debts. Household balance sheets are in good shape, defaults are low and debt-service obligations are near record lows. Mortgage interest rates have fallen significantly recently. This is all good.

The bottom line is this is not an economy in desperate need of a Fed rate cut.

While several members of the FOMC indicated at the June FOMC meeting that they are now open to a rate cut, the majority were not. In fact, a slim majority still indicated they don’t support any rate cuts at all this year.

Finally, for many years, there has been an old saying in the investment world: ***“Don’t fight the Fed.”*** In other words, Fed policy is a variable that is outside of your control. But lately, investors have turned that idiom on its head: ***“Fed, don’t fight the markets.”***

Perhaps what the markets believe with 100% certainty is that the Fed can now be **bullied** by the markets, or by President Trump, into doing something that goes against its research and judgment. I don’t buy it.

I could be wrong, of course, but I will be very surprised if there is a rate cut on July 31 at the conclusion of the next FOMC policy meeting.

Best regards,
Gary D. Halbert