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ECONOMY

Fed Begins Debate on Whether to Cut Rate as Soon as June

Trade tensions darken economic outlook, raising possibility of interest-rate cut in weeks or months ahead

Fed officials have signaled recently that they are attentive to the risks of a sharper-than-expected slowdown in growth—a sign that an interest-rate cut could be on the table in coming months. PHOTO: MANDEL NGAN/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Nick Timiraos

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WASHINGTON—Federal Reserve officials are beginning preparations for a June policy meeting with difficult choices to deliberate.

A month ago, Fed Chairman Jerome Powellplayed down speculation of a rate cut this summer. Now officials at the central bank face a darker economic outlook and heightened trade tensions, making a rate cut possible—if not at their meeting on June 18-19, then in July or later.

The officials need to decide what would trigger such action, how much more information they want before making a decision and how to signal their intentions and plans. They are to begin their customary premeeting quiet period at the end of this week.

Traders in futures markets have signaled about a 20% chance of a rate cut at the June 18-19 meeting, and a 70% chance of at least one cut by the meeting after that, on July 30-31, according to CME Group . Unlike in May, Fed officials haven't expressly pushed back against the market pricing in rate cuts in recent days.

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Instead, the officials, who gathered at the Federal Reserve Bank of Chicago this week for a research conference, signaled in interviews and speeches that they are attentive to the risks of a sharper-than-expected economic slowdown, a sign that an interest-rate cut could be on the table at coming meetings.

New York Fed President John Williams underscored the fluid dynamic facing policy makers at their coming meeting. Officials "need to be prepared to adjust our views of what's happening in the economy," he said at a New York forum Thursday.

"There is heightened uncertainty about how this economy exactly is going to evolve over the next year or so, and I think that's what the markets are seeing and telling us as well," he said.

Mr. Powell, along with Fed Vice Chairman Richard Clarida and Fed governor Lael Brainard, voiced similar attentiveness to trade-related risks in recent days without indicating when any action might be taken. Just two weeks ago, Fed leaders indicated they didn't see a strong reason to move rates up or down.

While U.S. economic data hasn't weakened dramatically, escalating trade strains between the U.S. and both China and Mexico have convinced bond investors in recent days that it is only a matter of time before these developments hit business investment. That could slow hiring and consumer spending.

Mr. Powell on May 1 had cited a possible resolution of trade tensions as one reason for an optimistic outlook. Then on May 5, President Trump announced he would increase tariffs on China, and Beijing later retaliated with increased levies on imports from the U.S.

On May 30, Mr. Trump delivered an even bigger surprise, threatening to impose 5% tariffs on Mexico beginning June 10 to force that country to stem the rising migration of Central Americans to the U.S. border.

In recent days, yields on the 10-year Treasury note have fallen well below those on three-month Treasury bills. If sustained for several weeks or months, this so-called yield-curve inversion could indicate markets believe short-term rates are too high.

"Clearly, it's a pretty strong signal in the markets that they think rates are going to be lower in the future," Mr. Williams, a key lieutenant to Mr. Powell, said Thursday. Without saying whether he agreed with the signal, he added, "It's something I definitely take into account."

In another notable shift, Mr. Williams didn't repeat the Fed's recent mantra that policy makers can afford to be "patient," a key word initially deployed in January to signal an end to rate rises. He instead said that interest-rate policy is entering a new, less predictable phase.

"The world we're in now, there's uncertainties. We may need to keep interest rates the same, or we may need to adjust them," he said.

Fed officials face a tension: On one hand, they don't want to react prematurely to events that could quickly change. Just as Mr. Trump's sudden decisions to boost tariffs on China and Mexico blindsided markets, so too could potential White House deals that avert further escalation and improve the economic outlook.

Mr. Trump and Chinese President Xi Jinping are set to attend the G-20 summit of world leaders in Japan at the end of June, after the Fed's next meeting, and some officials may want to wait to see if trade negotiations improve at that forum before deciding to cut rates.

On the other hand, one loud message out of this week's Chicago conference is that Fed officials should move more quickly than the central bank has in the past to shore up growth at the first sign of weakness, because with their short-term benchmark rate at a historically low level they don't have as much room to cut rates as in previous downturns.

In other words, they must balance the risks of easing too soon with the costs of waiting too long. In recent weeks, some Fed officials have approvingly cited examples from 1995 and 1998 in which the central bank took out "insurance" against looming economic weakness by cutting rates, extending economic expansions.

In addition to debating the merit of such a move, one question they could confront at their coming meeting is whether the window for acting might close sooner than they anticipate.

Other major central banks are lowering rates or considering cuts to combat weaker global growth. European Central Bank President Mario Draghiopened the door to rate cuts on Thursday. India's central bank cut its key lending rate Thursday, and the Reserve Bank of Australia lowered its benchmark rate Tuesday, the latest of several Asian central banks to ease policy this year.

Fed officials already expect economic growth to cool to around 2% this year from 3% last year, but any forecast of a sharper slowdown would be worrisome because they have already revised down their projections of inflation. They no longer expect inflation to rise to their 2% target this year after a string of surprisingly soft readings in the first quarter.

Weakness in both growth and inflation could be a sign the Fed's policy stance, with a benchmark rate between 2.25% and 2.5%, is too tight.

Fed officials preparing for the June meeting will closely watch economic data and trade talks. On Friday, the Labor Department will deliver its May employment report.

Mexican ministers are meeting in Washington this week to head off tariffs, meaning a resolution is possible before the Fed meeting. Indications that the economy is holding up and progress is being made in the Mexico and China negotiations could bolster the Fed's current wait-and-see policy stance.

Fed officials would then watch for developments ahead of their July meeting, including in U.S.-China trade talks.

Central-bank policy makers will aim to avoid a rerun of their December meeting, when they raised rates by a quarter-percentage point and signaled more increases were likely at a time when markets believed the economy couldn't support higher borrowing costs.

Markets didn't think the Fed was acknowledging the risks to the outlook and tumbled in the weeks after the meeting, leading Mr. Powell to signal a pause in early January. By March, most Fed officials concluded the economy wouldn't warrant higher rates this year.

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