The Fed Is Losing Its Grip on U.S. Interest Rates Once Again (2)
2019-11-13 18:12:36.263 GMT

By Alexandra Harris

(Bloomberg) -- Although the Federal Reserve has calmed money markets during the past two months, success has a downside: The main interest rate that officials try to wrangle is getting close to the edge of the range they're targeting.

Actions including the Fed's recent repo-market liquidity injections and Treasury-bill purchases have pushed the effective fed funds rates down to 1.55%. That's still within the 1.50%-to-1.75% band where central bankers want it to be, but it's unusually near the lower boundary. Some are worried it could dip below.

When that rate strays, it tends to signal that the Fed doesn't have strong control over its main tool for implementing monetary policy, a worrisome prospect for central bankers. It happened in mid-September as fed funds briefly jumped 5 basis points above the upper bound, prompting hundreds of billions of dollars of Fed intervention to get things back under control.

"It's all just about Fed credibility and maintaining control over fed funds," said BMO Capital Markets strategist Jon Hill. "That's absolute."

Fed Chairman Jerome Powell is addressing Congress on Wednesday and Thursday. While Powell's prepared remarks didn't explicitly address the technical aspects of monetary policy implementation, he did conclude with a few thoughts on the September turmoil in the funding markets. Last month, the Fed said it would buy Treasury bills to maintain a level of bank reserves at or above levels last seen two months ago.

"These actions are purely technical measures to support the effective implementation of monetary policy as we continue to learn about the appropriate level of reserves," Powell said.

Powell later told lawmakers that he thinks the Fed has contained the problem with the repo market. "I think we have it under control," he said. "We're prepared to continue to learn and adjust, but it's a process and it's one that doesn't have implications for the economy or general public." It appears, he added, that U.S. banking reserves need to be just under $1.5 trillion to maintain the peace.

*T

==============================================================

Read More About Repo Troubles
================================================================
Money Markets Yearn for More Fed Guidance on Plans for Repo

Fed Outlines Rationale for T-Bill Buying, But Keeps Options Open

Repo Fragility Exacerbated by a Hot New Corner of Funding Market

Why the Fed's Pumping Big Money Into the Repo Market: QuickTake

Why Dimon's Repo Gripe Stirs Sympathy, Skepticism: QuickTake
*T
The fed funds rate has threatened to move outside the band since mid-2018, though in previous episodes it was the upper limit that was in jeopardy. To keep it inside the range, policy makers have on four occasions adjusted a separate benchmark, something called the interest on excess reserves rate.
Lowering IOER acted as an anchor that pulled fed funds back down. The first three times IOER was tweaked, the central bank took action when fed funds got within 5 basis points of the top of the range. The fourth occasion was in the midst of September's market turmoil, when it actually breached.
Now, fed funds is 5 basis points from the bottom of the central bank's range. And while it's dead in line with the current IOER rate of 1.55%, there are suggestions that it may be weighing too much. Some analysts are considering whether the Fed could raise it closer to the midpoint -- currently 1.625% -- between the upper and lower limit.

'Pretty Compelling'

"The symmetry is pretty compelling that they might do this," said BMO's Hill. "Five basis points seems to be when they decided."
BMO sees around a 1-in-3 chance that the Federal Open Market Committee raises IOER to 1.60% at the December meeting. The company's strategists recommend selling January and February fed funds futures contracts to hedge the risk of an adjustment.
But the Fed may do nothing. Short-term rates have shown a tendency to spike at month- and quarter-end, most notably in December 2018, and many fear that could happen again next month.
Knowing that, policy makers might find some extra room between fed funds and the upper boundary useful.
"A lot of the same frictions that happened in September are

still there," said NatWest strategist Blake Gwinn. "The Fed's actions clip the tail end of a spike, but there's still frictions in getting cash to where it needs to go."

He sees 70% odds of a year-end jump in fed funds. "There's no downward spikes" in that rate, "so I'm not really worried about it dropping below" the low end of the Fed's target range, he added.

There's reason to believe the Fed may never need to worry about the fed funds rate breaching the bottom of the range. Two months of liquidity injections suggests there is little risk that the central bank is providing too much liquidity that will push fed funds below the lower bound, according to Thomas Simons, money-market economist at Jefferies.

Too much liquidity "is a problem the Fed would love to have," he wrote in a report.

To contact the reporter on this story:
Alexandra Harris in New York at aharris48@bloomberg.net
To contact the editors responsible for this story:
Benjamin Purvis at bpurvis@bloomberg.net
Nick Baker