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FED SHADOW

Trump 1, Powell 0

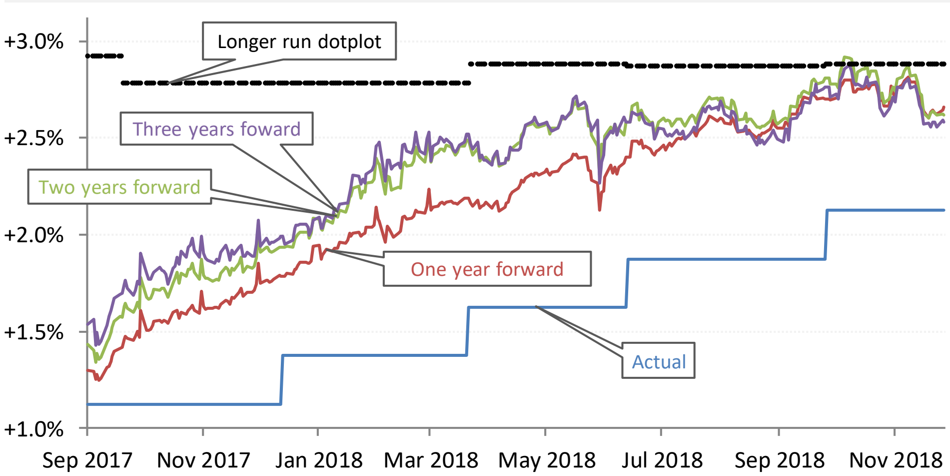
Wednesday, November 28, 2018
Donald Luskin

Trump and Mr. Market have ganged up on our rookie chair. He recants his hawkish gaffe.

Fed Chair Jerome Powell's statement yesterday that the funds rate is "just below the broad range of estimates of the level that would be neutral for the economy" gives the stock market one less thing to worry about. This reverses Powell's October 3 remark that "we're a long way from neutral at this point, probably." *But it's only a question of investor sentiment, not reality – we've said all along that the current equity markets correction has nothing to do with any real possibility the Fed will over-reach on rate hikes* hike (see "One Sell-Off, So Many Causes" October 15, 2018).

- We've always brushed off "long way from neutral" as a gaffe, an off-hand remark, a rookie fumble, from a Fed chair who has made a point of diminishing the whole notion of "neutral" (see "On Powell's Debut at Jackson Hole" August 24, 2018).
- We said last month that the 10-year yield above 3% was "ratifying" a December rate hike as mere normalization, not tightening, and that "If normalization doesn't continue to materialize, neither will the rate hikes" (again, see "One Sell-Off, So Many Causes").
- We actually think this is what Powell meant by "long way from neutral." We think he was saying that the economy has a lot of room to grow, so the funds rate has a "long way" to go in order to stay indexed to the economy.

Fed funds rate: actual, forecasted and forward



Source: FOMC, Bloomberg, TrendMacro calculations

Update to strategic view

US FED, US MACRO, US STOCKS, US BONDS: Powell has recanted his October 3 statement that the funds rate is "a long way from neutral." We have always seen this as a mere gaffe, and now it is officially corrected. Powell has done it under pressure from a consensus that has moved the forward funds rate down to a mere two hikes over three years. Trump has stepped up his criticism of Powell, yesterday making it personal for the first time. Powell's recantation following that shows Trump as being effective in a matter with which markets strongly agree, a boost to sentiment after the mid-terms and before Trump's summit with Xi. A December hike is still in the cards, but after that, Powell has now been clear that further hikes are contingent on growth causing the Fed to believe that the neutral rate is moving higher. The December FOMC statement will find a way to reflect that.

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- But as the growth consensus has softened (see "Recession Risk at Last?" November 20, 2018), so have the forward funds markets. For a couple week's they've been calling for just two more hikes over three years (please see the chart on the previous page). So Powell just went along with the consensus, as Fed chairs normally do.
- *What's especially interesting – and bullish – here, in our view, is that Powell is correcting his gaffe and softening market perceptions of the path of rate hikes just as President Donald Trump is tripling down on his criticism of Powell's policies.*
- For the first time yesterday, in an interview with the *Washington Post*, Trump made the his ongoing criticism personal to Powell – saying, "I am not at all happy with my choice… I'm just saying, I'm not happy with the Fed. So far, I'm not even a little bit happy with my selection of Jay. Not even a little bit." Next comes a nickname for him, we suppose.
- And yesterday, Treasury Secretary Steven Mnuchin reportedly asked primary dealers whether they would prefer to see the Fed accelerate its balance sheet normalization as an alternative to further hikes.
- We've said all along that Trump was perfectly right in cautioning the Fed on further rate hikes – which is to say, he is right in insisting that they be no more aggressive than to simply index to more rapid growth and higher inflation (see "Like It or Not, Trump is Right about the Fed" July 20, 2018).
- *What's so bullish about this is that it demonstrates Trump emerging as effective* – after a mid-term election in which his party lost the House of Representatives (see "On the Mid-Term Elections" November 7, 2018), and just ahead of a highly consequential summit meeting with Chinese President Xi Jinping (see "On the Margin: In the Beginning was the Word 'Framework'" November 16, 2018) – *on a matter about which Mr. Market very definitely agrees.* Say what you will about the propriety of Trump's remarks (though he's not even close to being the first president to jawbone the Fed) – Mr. Market has been worried about Powell, and obviously likes the fact that Trump seems to be getting his way.
- *A December hike is probably still on the table*. But again, that's already been ratified by the 10-year, which has managed to stay above 3% even as growth and inflation expectations have softened. *What's changed is that Powell has had to make clear what we've expected from the beginning: that further hikes are strongly contingent on economic growth moving up the Fed's estimate of the neutral rate. The December FOMC statement will find a way to reflect that.*

Bottom line

Powell has recanted his October 3 statement that the funds rate is "a long way from neutral." We have always seen this as a mere gaffe, and now it is officially corrected. Powell has done it under pressure from a consensus that has moved the forward funds rate down to a mere two hikes over three years. Trump has stepped up his criticism of Powell, yesterday

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The Suburbs Are Changing. But Not in All the Ways Liberals Hope.
Emily Badger, Quoctrung Bui and Josh Katz
New York Times
November 26, 2018

Noam Chomsky joins academics boycotting China Marxism conferences
Yuan Yang
Financial Times
November 27, 2018

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World Trade Organization
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Glenn Harlan Reynolds
USA Today
November 19, 2018

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