

TRENDMACRO LIVE!

On Powell at Jackson Hole, and Over the Edge with China

Friday, August 23, 2019

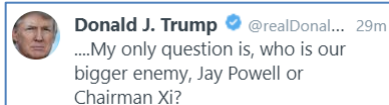
Donald Luskin


“Trade uncertainty” got bigger today. Powell doesn’t realize how tight that makes the Fed.



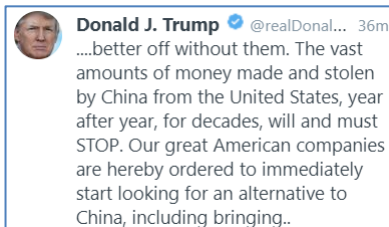
Donald J. Trump  @realDonaldTrump... 2h
Now the Fed can show their stuff!


[speech this morning](#), avid Fed-watcher President Donald J. Trump [tweeted](#), “Now the Fed can show their stuff.”



Donald J. Trump  @realDonaldTrump... 29m
...My only question is, who is our bigger enemy, Jay Powell or Chairman Xi?

From what we can see on the first read-through, no stuff was shown. In response to Powell’s speech, and to [news this morning](#) that China would be raising tariffs on imports of US goods – including soybeans which it isn’t buying anyway – Trump [tweeted](#): “My only question is, who is our bigger enemy, Jay Powell or Chairman Xi?”



Donald J. Trump  @realDonaldTrump... 36m
...better off without them. The vast amounts of money made and stolen by China from the United States, year after year, for decades, will and must STOP. Our great American companies are hereby ordered to immediately start looking for an alternative to China, including bringing..

- There followed numerous other tweets, including [one](#) ordering US carriers to “SEARCH FOR & REFUSE” Chinese parcels containing fentanyl, and [another](#) ordering US companies “to immediately start looking for an alternative to China, including bringing...your companies HOME and making your products in the USA.”
- *As we have been saying for three weeks, we have entered a new and more dangerous phase of the US-China trade war, in which it appears that Trump is willing to push China off “the edge of chaos” in order to get a deal* (see [“On the New China Tariffs”](#) August 1, 2019 and [“RMB Breaks 7: Is this “the Edge of Chaos?”](#) August 5).
- *The elevated risk premia we are seeing in world markets – equities correcting, and safe-haven sovereign bond yields making historic lows – is entirely appropriate in this environment, even if you think that everything will ultimately turn out fine, which does remain our base case. The fact remains that, in the meantime, very substantial risks are being taken.*

Against this fateful backdrop, it would have been constructive if Powell could have uttered a single word to indicate he understands that Fed policy is too tight. How good it would have been if he had said something [like what Dallas Fed President Robert Kaplan told CNBC yesterday](#):

“...the whole curve has moved down over the last three and a half

Update to strategic view

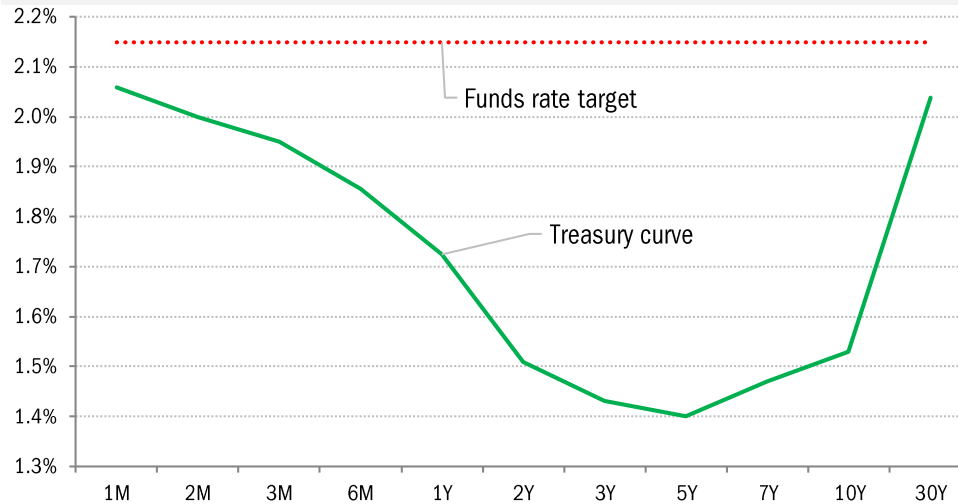
US FED, US MACRO, ASIA MACRO, US STOCKS, US BONDS:

New tariffs from China on soybeans they aren’t buying anyway, and another “blame Trump” speech from Powell at Jackson Hole. On Twitter Trump compared Powell to Xi, and ordered US companies to explore alternatives to China, and US carriers to interdict Chinese fentanyl shipments. For Powell “trade uncertainty” is an excuse, but it’s nevertheless real, driving wide risk premia that tighten financial conditions. Easier monetary policy is the obvious response, but Powell acts as though there is something especially difficult about it, as it concerns “international trade.” The Fed will cut rates for sure, but with it already having been too tight, now it would take a 75 bp cut to un-invert the yield curve. For trade and the Fed, things still have to get worse in order to get better.

[\[Strategy dashboard\]](#)

months and the Fed funds rate at two to two and a quarter is now above every rate along the curve” (please see the chart below) “which to me is a bit of a reality check that says it’s possible our monetary policy stays a little tighter than I would have thought three or four months ago.”

Target fed funds rate versus US Treasury yield curve



Source: Bloomberg, TrendMacro calculations

- How ironic and how annoying that this is exactly what Powell himself said a year ago [in Congressional testimony](#):
“If you raise short-term rates higher than long-term rates, then maybe your policy’s tighter than you think...”
- We have reminded him of his own words over and over (see, among many, [“It’s So Time to Cut Rates”](#) June 3, 2019). But heeding them now would be too much of an admission that the Fed’s posture, under his leadership, has been too tight – at least since March, and probably since last December – whatever else he or other policy-makers may say about other economic factors in the world.

With Trump’s tweets after Powell’s speech, it turned out to be a good morning in Jackson Hole for doubling down on the chair’s “blame Trump” strategy introduced at the June FOMC. The narrative: the problem isn’t Fed policy *at all*; it’s “trade uncertainties” (see [“On the June FOMC”](#) June 19, 2019).

- To be sure, and to repeat ourselves, “trade uncertainty” is indeed a thing. But it’s one of an infinite number of elements that any central bank has to accept as politically-driven features of the economic landscape against which appropriate policy must be formulated. It’s no different in kind than, say, the considerable “health care policy uncertainty” or “bank regulation uncertainty” that prevailed in the first term of the prior administration.

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- Powell formally grants this in his speech this morning, saying:

“In principal, anything that affects the outlook for employment and inflation could also affect the appropriate stance of monetary policy, and that could include uncertainty about trade policy.”

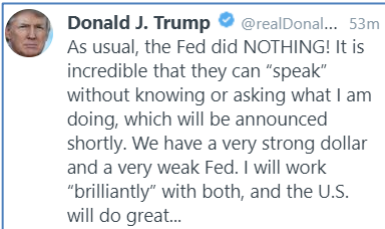
- But then he positions trade uncertainty as a uniquely difficult exogenous factor.

“...fitting trade policy uncertainty into this framework is a new challenge. Setting trade policy is the business of Congress and the Administration, not that of the Fed... There are, however, no recent precedents to guide any policy response to the current situation. Moreover, while monetary policy is a powerful tool that works to support consumer spending, business investment, and public confidence, it cannot provide a settled rulebook for international trade.”

- Wait. Stop and savor that last sentence:

“...while monetary policy is a powerful tool that works to support consumer spending, business investment, and public confidence, it cannot provide a settled rulebook for international trade.”

- Whoa, big fella! No one asked you to use monetary policy to regulate international trade. You’re starting to sound like [an Ayn Rand villain](#) – one of the bureaucrats who always demands “broader powers.” especially after you’ve made a mess of things with the broad powers you already had.



- Trump, with his sharp ear for weakness, picked up on this in his [tweetstorm](#) this morning, chiding Powell for “not knowing or asking what I am doing” – that is, for not having even bothered to inform himself about policies that he complains are so hard to handle.

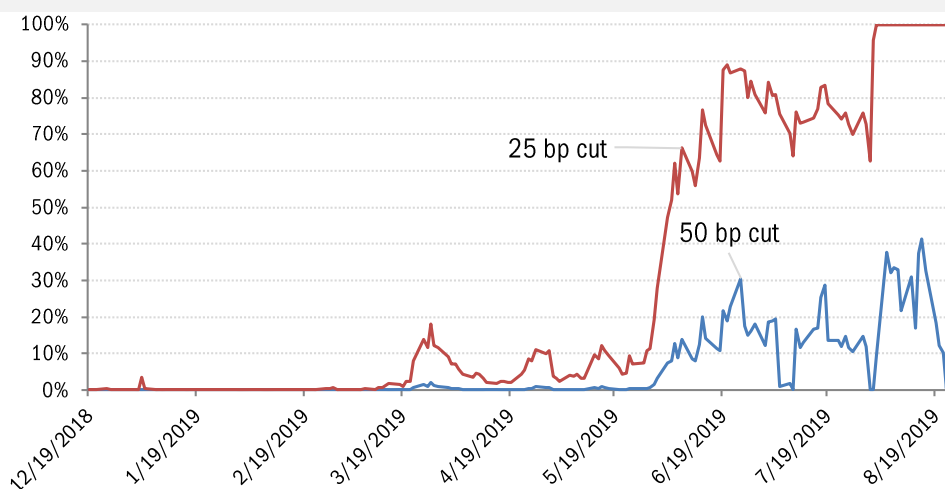
• But for Powell now, harping on “trade uncertainties” does the double-duty of both blaming his rival Trump and exonerating himself. No, triple-duty, because it plays into a new political narrative that US recession is right around the corner, and virtually inevitable – and that it’s Trump’s fault.

- After last week’s first intra-day inversion of the 2-10 Treasury curve, the [Washington Post reported](#) that the White House was planning a temporary payroll tax cut as an anti-recession stimulus measure. The story was entirely unsourced, but it itself became the source for an echo-chamber of follow-up stories, including a [front-pager in the New York Times](#). Marginal publications imagined, and reported as fact, that the White House was “[panicked](#)” and “[terrified.](#)” Then when Trump denied the existence of non-existent tax-cut plans, the media declared that to be “[sharp reversal](#)”.
- For us the irreducible essence here is that trade uncertainty is like any uncertainty. It erodes confidence and builds wide risk premia in

markets – exactly as we’ve said all year, even though we have been over-optimistic on the speediness of a deal with China (see [“2019 Outlook: Confidence Rots from the Head Down”](#) December 31, 2018).

- As to the Fed, the irreducible essence is that widening risk premia – for whatever reason, including “trade uncertainties” – effectively tighten financial conditions, which all else equal ought to call for a loosening of monetary conditions. All the more so when monetary conditions have already been too tight.
- For the moment, ongoing – indeed, intensifying – trade uncertainties guarantee a rate cut at the September FOMC (please see the chart below).

Futures-implied probability at September FOMC meeting, from December 2018 FOMC



Source: Bloomberg, TrendMacro calculations

- But if that guaranteed rate cut only tracks monetary policy to tightening financial conditions, it is not effectively an easing at all. It just maintains the status quo – a Fed that was too tight before all this “trade uncertainty” even rose to a level that mattered.
- The judge, jury and executioner is the yield curve. As of this writing, all else equal, it would take a 75 bp rate cut to un-invert the funds-10 curve. As of this writing, the market-implied probability of even a 50 bp cut is only 21% (please again see the chart above).
- So with “trade uncertainty” and the Fed – one more time – it’s going to have to get worse in order to get better.

Bottom line

New tariffs from China on soybeans they aren’t buying anyway, and another “blame Trump” speech from Powell at Jackson Hole. On Twitter Trump compared Powell to Xi, and ordered US companies to explore alternatives to China, and US carriers to interdict Chinese fentanyl shipments. For Powell “trade uncertainty” is an excuse, but it’s nevertheless real, driving wide risk premia that tighten financial conditions. Easier monetary policy is the obvious response, but Powell acts as though there is something especially difficult about it, as it concerns “international

trade.” The Fed will cut rates for sure, but with it already having been too tight, now it would take a 75 bp cut to un-invert the yield curve. For trade and the Fed, things still have to get worse in order to get better. ▶