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FED SHADOW

Powell Not to the Rescue

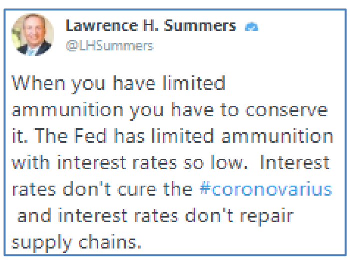
Wednesday, March 4, 2020

Donald Luskin

Leave it to Chairman Jay to turn a perfectly sensible rate cut into a confidence-killer.

The 50 bp rate cut we have been anticipating (see "Covid-2019 and Bernie-2020" February 26, 2019 and "Covid-2019 Becomes Covfefe-2020" February 28, 2020) came sooner than expected with yesterday's highly atypical inter-meeting move for the FOMC. Fed Chair Jerome Powell's statement last Friday made a move inevitable, and as we expected, that contributed to some degree of restoration of confidence. *But packaging it in the form of yesterday's surprise eroded confidence instead, by allowing a plain-vanilla move to be characterized as an "emergency cut" or the "Powell virus warning."*

- *We think the markets' negative reaction was largely short-term and subjective, ignoring the longer-term objective positives arising from both the Fed's move and hints of OPEC moves to come.*



- By making it seem like an "emergency" response – what, you couldn't have waited two weeks till the March FOMC? – the Fed loses credibility, because the present situation isn't the kind of emergency that can be handled the way the Bernanke Fed handled, say, the 2008 collapse of the commercial paper market. Yesterday the Fed empowered the straw-man argument we've been hearing for weeks, that "interest rates don't cure the #coronavirus and interest rates don't repair supply chains," as former Treasury Secretary Lawrence Summers put it in a snarky tweet. Of course they don't, and it's fruitless to focus on that fact to the exclusion of the reality that *cutting interest rates does usefully ease financial conditions made tight by the actual and anticipated slowing of economic activity resulting from efforts to contain the virus*.
- *And then there is Powell's horrible bedside manner.* Surely there would have been a way to show in his demeanor and articulate with his words why this sensible move was better sooner than later. Why not? Anything worth doing is worth doing sooner. But from the first moments of yesterday's press conference he was nervous, distracted and evasive. He lapsed into his old ways of being a bit rude in giving peremptory boilerplate answers to thoughtful questions.
- When Powell took the first question from a reporter, he couldn't remember the second part it and had to ask to have it repeated – a

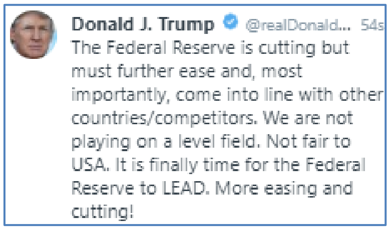
Update to strategic view

US MACRO, US STOCKS, US BONDS, OIL: The Fed's 50 bp rate cut fell flat, because by making it a surprise, it was perceived as an "emergency cut" and a "Powell virus warning." Powell's bedside manner was nervous and evasive, leaving investors focused on the straw man argument that a rate cut can't cure Covid-2019, and ignoring that it does ease financial conditions that have become tight. The G7's statement was a hollow gesture, but it could have been nothing else. Actions will be up to individual countries, where we expect fiscal stimulus programs to be announced in the coming days; in the US it will become an election-year bidding war. OPEC hinted it will cut production significantly on Friday. Subjectively, these moves failed to restore confidence, but every one of them is an objective positive. We think the astonishing new low yesterday for the 10-year yield was a bottom, and remain comfortable averaging into equities.

[Strategy dashboard]

bad habit from his rookie days as chair. It was especially awful that the second part of the question was, "how much confidence do you have that there will be a quick and relatively complete recovery?" Powell's inept response was, "In terms of my confidence that we will return to, what was your question?"

- *Such gaffes allow for fantasies about what horrible scenarios only the FOMC is privy to might be running through his head to distract him so.*



- In the aftermath, the US Treasury 10-year yield went to even more remarkable all-time historic lows, trading as low as 0.9043% at one point. *This is a particular embarrassment to Powell, and it didn't help that President Donald J. Trump piled on.* Powell probably enjoyed his nutritious breakfast expecting that a 50 bp cut would cure the 43 bp inversion of the yield curve indicator he has said he watches most closely, the spread between the funds rate and the 10-year (see "Video: What Jay Powell should be telling you about the inverted yield curve" April 1, 2019). It ended the day still inverted by 11 bp, and is inverted by 12 bp as of this writing.
- *No one likes trying to catch a falling knife, but we can't resist. While subjectively Powell muffed it yesterday by inflaming risk perceptions, objectively the Fed really did ease financial conditions. Unless there are seriously negative and unanticipated new developments with Covid-2019 or the economic costs associated with containing it, we have to think that yesterday's lows will mark the bottom in this amazing move for the 10-year yield. Indeed, it reminds us of the flash-crash of October 14, 2014, at the worst moments of the Ebola panic* (see "Something You Probably Didn't Know about Ebola" October 14, 2014).
- *And we remain acceptably comfortable with our calls last Wednesday and Friday to timidly average into equities* (again see "Covid-2019 and Bernie-2020" and "Covid-2019 Becomes Covfefe-2020").
- All this was set against the statement by the G7 finance ministers and central bankers that "We…are closely monitoring the spread of the coronavirus disease 2019 (COVID-19) and its impact on markets and economic conditions." *Oh, and we are actually doing exactly nothing.*
- Here, too, the tone-deaf manner of the announcement plays into a corrosive straw-man argument – that there is something the G7 itself could actually do. The G7 itself does not have a legislature, a treasury or a central bank that could do anything, even if the G7 wanted to – *it's up to the individual countries, no matter what a G7 pronouncement might promise*.
- *So we expect it's only a matter of days before individual countries start talking about fiscal stimulus. In the US, it is remarkable that in this election year it hasn't happened already.*

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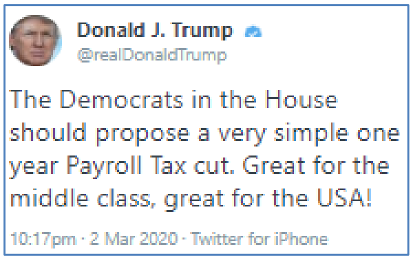
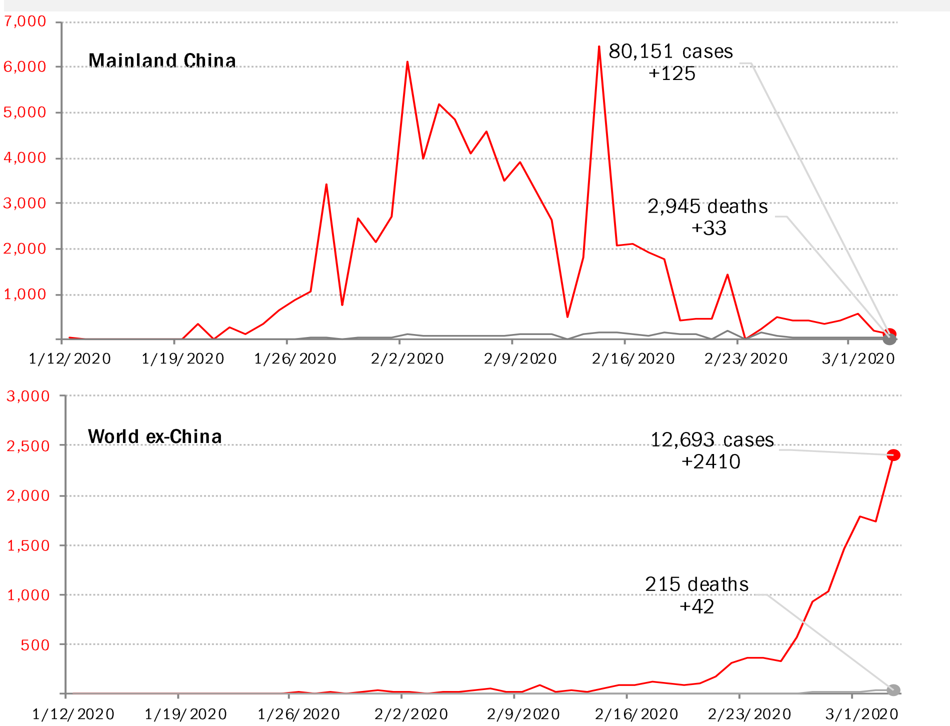


- *Maybe Trump got the ball rolling with his tweet Tuesday challenging House Democrats to "propose a very simple one year Payroll Tax cut."* Next Trump and Senate minority leader Charles Schumer (D-NY) – or better yet a leading Democratic presidential aspirant – should get in a bidding war, each to make the other seem insufficiently responsive to this emergency. This may be the way some version of the long-awaited "infrastructure program" finally gets born.
- *At the same time, OPEC moved closer to fulfilling our prediction of a substantial production cut* (again, see "Covid-2019 Becomes Covfefe-2020"). Yesterday an expert panel of the cartel reportedly recommended a cut of 1 million barrels a day, to potentially be made official on Friday at an emergency meeting in Vienna. This has already pulled oil prices back from Monday's lows, which in turn has helped credit spreads in the US non-investment grade bond market's energy sector ease at least a little from their highs last week above 10%. *Such an easing is absolutely critical – we have said from the beginning* (see "Another Damn Export from China" January 27, 2020) *that the leveraged US energy sector is the most likely trigger for systemic spillover from the Covid-2019 outbreak, as global petroleum demand temporarily contracts and prices fall.*
- Again, the subjective atmospherics of all this are quite poor. But objectively, all this is pointing in the right direction. At the same time, new Covid-19 cases in China have fallen to nearly nothing,

Covid-2019 daily confirmed cases and deaths



Source: John Hopkins, TrendMacro calculations proving that this beastie can be licked. Now it’s up to the rest of the world – where cases are still on the rise, but mortality rates are only half that of China (please see the charts on the previous page) – to take the locally appropriate steps in coming weeks to reproduce China’s achievement from the dark days of mid-February.

Bottom line

The Fed’s 50 bp rate cut fell flat, because by making it a surprise, it was perceived as an “emergency cut” and a “Powell virus warning.” Powell’s bedside manner was nervous and evasive, leaving investors focused on the straw man argument that a rate cut can’t cure Covid-2019, and ignoring that it does ease financial conditions that have become tight. The G7’s statement was a hollow gesture, but it could have been nothing else. Actions will be up to individual countries, where we expect fiscal stimulus programs to be announced in the coming days; in the US it will become an election-year bidding war. OPEC hinted it will cut production significantly on Friday. Subjectively, these moves failed to restore confidence, but every one of them is an objective positive. We think the astonishing new low yesterday for the 10-year yield was a bottom, and remain comfortable averaging into equities.