Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

MACROCOSM

Powell Flails Again: Wuhan Flu Over the Cuckoo's Nest

Sunday, March 15, 2020

Donald Luskin

The Fed acts like it has all the answers, but Powell can't remember the questions.

As we expected (see "Just What We Didn't Need: An Oil Price War" March 8, 2020), the Fed has moved in advance of this week's scheduled FOMC meeting with rate cuts and more to ease the shock of the Covid-2019 crisis. *While it was not made clear at all in the Fed's written announcement, in an audio-only conference call Chair Jerome Powell indicated that this afternoon's brief emergency meeting will replace the two-day meeting on Tuesday and Wednesday.*

- The Fed announced it will immediately lower its target for the fed funds rate by one percentage point to zero (that is, to a range between zero and 25 bp).
- It will increase its "holdings of Treasury securities by at least $500 billion and its holdings of agency mortgage-backed securities by at least $200 billion."
- The Fed also announced the reduction of bank reserve ratios to zero, and implicitly promised temporary regulatory forbearance by encouraging banks to use their capital and liquidity buffers to support lending during the crisis.
- At the same time, the Fed also announced coordinated FX swap lines with the other major central banks of the world, to assure the availability of global dollar liquidity.
- *With just three days to go till the FOMC's scheduled meeting, this is the Fed's equivalent of the arguably cuckoo precautionary measures that you've all probably seen this weekend if you've gone to a grocery store and seen the shelves cleaned bare. It feels to us that since Friday, America has woken up to the risks ahead and is suddenly mobilizing itself both bottom-up and top-down to "do something" – or at least to feel like it's "doing something." Who knows if it's necessary. But our sense is that it mobilizes "animal spirits" in a way that ensures any economic impact will be a short valley that can be looked across – an emergency rather than a recession.*
- *That said, we fully recognize that Mr. Market, as of this writing, is not seeing it that way at all.*
- Perhaps it's the slipshod way this announcement was made – leaving out obvious elements of information as though the Fed were in a great hurry, driven by panic. It's probably enough to say that Powell didn't even come close to manifesting the deep and credible institutional commitment with which former ECB President

Update to strategic view

US FED, US MACRO, US BONDS: Rescheduling this week's two-day FOMC meeting into a few hours this afternoon, the Fed announced lowering the funds rate by 1 percentage point to a range of zero to 25 bp, and new asset purchases of $500 billion in Treasuries and $200 billion in MBS, on an unspecified schedule. The Fed also eliminated bank reserve requirements, indicated forbearance on capital and liquidity buffers and announced FX coordination with other central banks. This is all in step with what we think is a generally useful atmosphere of panic developing in the US, manifesting the national resolve that will ensure the economic fallout of the Covid-2019 crisis remains a valley that can be looked across. The sudden and slipshod nature of the Fed's announcements, and Powell's atrocious conference call performance are big negatives, but the asset purchase program is indeed QE4, and it will de-risk the markets just as its predecessors successfully did.

[Strategy dashboard]

Mario Draghi quite literally saved the European Union with three little words – “Whatever it takes” (see "On Draghi in London" July 26, 2012).

- *Perhaps it’s the markets’ frustration with an institution that, by not waiting till Wednesday, imagines itself to be more effective than it is in this kind of emergency. It’s not useful to have powerful institutions that don’t understand their powers*. At the last surprise rate cut two weeks ago, Powell undermined the markets’ initial positive reaction with a downright silly promise in his press conference that this would “provide a meaningful boost to the economy” (see “Powell Not to the Rescue” March 4, 2020). That’s just inane.
- *The reality is all a central bank can do with rate cuts and regulatory forbearance is to remove itself as a financial or regulatory impediment. That’s not nothing, but neither is it a “boost to the economy.”*
- *On the other hand, the new asset purchases are in some sense a “boost.” It’s unfortunate that the Fed’s written announcements gave no details as to the critical elements of timing and securities composition.*
- But this is likely no mere exercise in liquidity provision, like what we’ve seen since the “repo crisis” last fall with the maintenance of a large on-demand repo facility and the increase of the Fed’s holdings of short-term Treasuries. We’ve had many vigorous arguments with smart clients as to whether these past efforts have truly been quantitative easing. We say not. *We think what was announced today will almost certainly deserve to be called QE4.*
- As we conceive it, true QE de-risks the market. When the Fed buys long-term Treasuries, it takes maturity risk that had previously had to be borne by the marketplace onto its own balance sheet. Buying MBS is even more effective, draining duration risk, credit risk and pre-payment risk out of the market.
- In a low-tech low-quality audio-only conference call this afternoon – in which it seemed at times, that Powell was calling in from his convertible – Powell indicated that the purpose of these purchases was to ensure the smooth functioning of the all-important Treasury market, which he said has been experiencing liquidity strains. We don’t see how it helps in such a situation to have the Fed be a major new buyer in a market in which a buying stampede drove the 10-year yield as low as 31 bp last week.
- Powell was asked directly by a reporter if this should be called QE. He petulantly stood by his story – “I’m not interested in labels” – that it was only to support the functioning of the Treasury markets.
- *The next reporter asked for more details, and Powell literally couldn’t remember the question, just seconds after it was asked. A moderator had to intervene and repeat it. Is Powell starting to manifest, well, symptoms…? The same thing happened twice more.*
- *When asked by a reporter point-blank whether he has been tested for COVID-2019, he said he is feeling fine, so there is no need (much as President Donald J. Trump said last week, until public criticism forced him to get tested).*

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Dallas TX
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

- If somehow these purchases help the functioning of the markets, that's great. But we do know that, by de-risking the market, whatever else it may do, QE gives the private sector a breathing spell from unwanted levels of risk-bearing, or makes room for additional risk-bearing as participants re-risk to replenish their risk-budgets. It worked the last three times we tried it. We aren't sure why Powell is so averse to talking about it in these terms, as his predecessor Ben Bernanke frequently and unashamedly did.

Bottom line

Rescheduling this week's two-day FOMC meeting into a few hours this afternoon, the Fed announced lowering the funds rate by 1 percentage point to a range of zero to 25 bp, and new asset purchases of $500 billion in Treasuries and $200 billion in MBS, on an unspecified schedule. The Fed also eliminated bank reserve requirements, indicated forbearance on capital and liquidity buffers and announced FX coordination with other central banks. This is all in step with what we think is a generally useful atmosphere of panic developing in the US, manifesting the national resolve that will ensure the economic fallout of the Covid-2019 crisis remains a valley that can be looked across. The sudden and slipshod nature of the Fed's announcements, and Powell's atrocious conference call performance are big negatives, but the asset purchase program is indeed QE4, and it will de-risk the markets just as its predecessors successfully did.