Federated®

Powell threads the needle

The Fed leader successfully addressed several issues weighing on monetary policy.

Published 08-23-2019

Philip Orlando, CFA
Senior Vice President
Chief Equity Market Strategist
Head of Client Portfolio Management

BOTTOM LINE

Federal Reserve Chair Jerome Powell threaded the proverbial needle with his keynote speech at this year's Jackson Hole, Wyo., gathering, hitting on three competing concerns the Fed needs to successfully address simultaneously: domestic data dependency, global economic headwinds, and independence from President Trump's inappropriate public pressure to cut rates.

As a result, we expect the Fed will lower rates another quarter point at its next policy-setting meeting on Sept. 18, with perhaps an additional fourth-quarter reduction coming on Oct. 30 or Dec. 11. Although stocks have suffered a sharp 2% decline today, while benchmark 10-year Treasury yields have enjoyed a powerful flight-to-safety rally to a 3-year low of 1.5%, we believe financial markets are responding negatively to today's mutual escalation in the ongoing trade and tariff war between the U.S. and China, rather than investor disappointment with Powell.

Why is Jackson Hole important? This prestigious monetary-policy symposium, which was started by the Kansas City Federal Reserve in 1978, routinely draws top central bankers from around the world to discuss important global economic issues. The Fed chair typically delivers a high-profile keynote speech to discuss important monetary-policy thoughts and plans. In past years, Fed Chair Ben Bernanke discussed plans for "Quantitative Easing 3" and European Central Bank President Mario Draghi outlined the strategy for European QE.

U.S. economic outlook is favorable Powell noted that the U.S. expansion is now in its eleventh year, a record length. The labor market is at its strongest point in half a century, while core inflation is surprisingly stable, albeit below the Fed's 2% target. This suggests it has successfully achieved its dual mandate to foster maximum employment and price stability.

"The outlook for the U.S. economy since the start of the year has continued to be a favorable one," Powell said. "Business investment and manufacturing have weakened, but solid job growth and rising wages have been driving robust consumption and supporting moderate growth overall."

Storm clouds on the horizon? But Powell highlighted three factors he believes are weighing on this favorable outlook: slowing global growth, trade policy uncertainty and muted inflation.

"The global growth outlook has been deteriorating since the middle of last year," Powell said. "Trade policy uncertainty seems to be playing a pivotal role in the global slowdown and in weak manufacturing and capital spending in the U.S. Inflation fell below our objective at the start of the year. It appears to be moving back up closer to our symmetric 2% objective, but there are concerns about a more prolonged shortfall."

Global headwinds abound The Fed cut interest rates for the first time in a decade by a quarter point at its most recent policy-setting meeting on July 31. "The three weeks since our July FOMC meeting have been eventful, beginning with the announcement of new tariffs on imports from China," Powell explained.

"We have seen further evidence of a global slowdown, notably in Germany and China," Powell continued. "Geopolitical events have been much in the news, including the growing possibility of a hard Brexit, rising tensions in Hong Kong and the dissolution of the Italian government."

As a result, he explained, "equity markets have been volatile, [and] long-term bond yields around the world have moved down sharply to near post-crisis lows."

We've noted that some $16 trillion in sovereign bonds presently have negative yields, led by German bunds' negative 70 basis points and Japanese bonds' negative 25 basis points. These are driving global bond investors to U.S. Treasuries, helping to force their yields to cycle lows.

Whatever it takes "We are carefully watching developments as we assess their implications for the U.S. outlook and the path of monetary policy," Powell concluded. "Based on our assessment of the implications of these developments, we will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2% objective."

China escalates trade-war fervor Earlier today, China threatened to impose additional tariffs on $75 billion of American goods, including soybeans, automobiles and oil. Their retaliatory move was in response to President Trump's recent tariff increase on Chinese imports, and Trump promised a tit-for-tat response later today, roiling financial markets. The simmering global trade war is reaching a boil.

Fiscal policy by tweet Trump appears to be waging a two-front war of words against both China and the Federal Reserve. In a series of tweets today, Trump suggested that Powell could be a bigger enemy of the U.S. than China's President Xi Jinping.

"We have a very strong dollar and a very weak Fed," Trump tweeted. "As usual, the Fed did NOTHING! It is incredible that they can "speak" without knowing or asking what I am doing, which will be announced shortly."

Trump also tweeted that he "hereby ordered" American companies to start looking for alternatives to making products in China. But companies throughout the world have already begun to move their supply chains out of China, which is likely contributing to the sharp economic deceleration in China over the past year.

Connect with Phil on LinkedIn

TAGS

MONETARY POLICY | MARKETS/ECONOMY | EQUITY | INTEREST RATES

DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Federated Advisory Services Company

1879396008

Federated®