Markets await key speech by US Fed chair

By Nick Beams
22 August 2019

The eyes of the global financial markets are focused on the meeting of bankers and financial policymakers that starts today in Jackson Hole, Wyoming. The keynote address will be delivered by US Federal Reserve governor Jerome Powell tomorrow, with markets looking for indications of the future direction of its program.

It is expected that Powell will adopt an "accommodative" tone in line with the broad expectation that the policymaking Federal Open Market Committee (FOMC) will cut its base interest rate by at least 0.25 percent (25 basis points) when it meets next month.

However, amid turmoil in international financial markets as the volume of bonds with negative yields continues to escalate—now well over $16 trillion—the clear indications of a significant slowdown in the global economy, and the escalating trade war between China and the US, Powell's speech will be scoured for indications about what it portends for the longer term.

Powell will take the rostrum under pressure from a number of quarters. Ahead of the meeting, Trump repeated his criticisms of the Fed, likening Powell to a golfer who could not putt because he did not have a "soft touch." He called for the Fed to cut its base rate by at least one percent and to relaunch its bond-buying program, tweeting that "our economy would be even better and the world economy would be greatly and quickly enhanced."

At the same he insisted that the US economy was "very strong, despite the horrendous lack of vision by Jay Powell and the Fed."

Powell has sought to brush off the Trump criticisms, insisting the Fed acts independently of politics and is guided by the data. But the minutes of the FOMC from its July 31 meeting reveal there are considerable differences among its members over what the data indicate.

The minutes show the majority of members considered the rate cut of 25 basis points at the end of last month to be a "recalibration of the stance of policy, or a mid-cycle adjustment, in response to the evolution of the economic outlook."

This was the position adopted by Powell when he announced the decision. However, the use of the term "mid-cycle adjustment" sparked an adverse reaction from Wall Street because it seemed to indicate the Fed did not have larger cuts in mind over the longer term. Since then the market has made large swings, experiencing its biggest fall for the year—the Dow dropped by 800 points—on Wednesday last week, before recovering most of those losses since then.

Within the FOMC there were considerable divergences, on both sides, from the general consensus articulated by Powell. According to the minutes "a couple" of members said they wanted a cut of 50 basis points immediately and there had to be "stronger action" to counter "stubborn low inflation."

On the other side, the minutes record that "several" members argued in favour of keeping rates at existing levels on the grounds that "the real economy continued to be in a good place." Two of them cast a dissenting vote against the majority rate cut decision.

The minutes also noted that "a few" officials expressed worries about the inversion of the yield curve, referring to a situation where the yield on long-term government bonds falls below that on short-term debt—an indicator of recessions in the past.

They said inversion "could indicate that market participants anticipated weaker economic conditions in the future and the Federal Reserve would soon need to lower the Fed funds rate substantially in response."

An indication of the push coming from within the FOMC for stronger action was provided in a comment published in the *Financial Times* yesterday by Neel Kashkari, the president of the Federal Reserve Bank of

Minneapolis.

He began by noting that the global economy is slowing, US business investment has stalled and the yield curve has inverted, a “quirk that has preceded previous recessions.”

He wrote that his response on the FOMC, of which he is a member, would be to “argue that we should not only cut the federal funds rate, but that we should also use forward guidance to provide even more of a boost to the economy than a rate cut alone can deliver.”

Forward guidance would consist at a “minimum” of a commitment by the Fed not to raise interest rates again until inflation returned to 2 percent on a sustained basis.

“If the global economy continues to weaken and the trade war between the US and China intensifies, the Fed could find itself cutting rates aggressively,” he wrote, arguing that it would be better to use forward guidance now before the base rate returned to zero.

The Jackson Hole meeting is taking place amid considerable uncertainty over what is the economic policy of the Trump administration, if indeed it has one.

On Tuesday, Trump flagged cuts to payroll taxes, something he said he had been thinking about “for a long time,” as well an indexing taxes on capital gains, supposedly measures to boost the economy. “I would love to do something on capital gains,” he said.

The next day he told reporters that he was “not looking” for a tax cut now. “We don’t need it. We have a strong economy.”

On the issue of capital gains tax indexation—a measure that would do nothing to boost the economy but simply pour additional millions into the coffers of the ultra-wealthy—Trump said he was not looking to do it. “I think it will be perceived, if I do it, as somewhat elitist,” he said, adding that it was an option “but not something I love,” completely reversing his position of 24 hours earlier.

The bankers’ meeting at Jackson Hole will be followed by a weekend meeting in France of the G7 group—comprising France, Germany, the US, the UK, Italy and Japan and Canada. The G7 forum was established in the 1970s to coordinate a response to global economic problems. While it does not command the power it once did, the G7 economies still comprise a major force and the heads of government now confront a significantly worsening economic outlook. China’s economy is slowing, and two key economies in Europe, the UK and Germany, are on the edge of recession.

However, in an indication that coordination and collaboration are well and truly things of the past, French president Emmanuel Macron, who is chairing the meeting in the seaside resort of Biarritz, announced that he would abandon the tradition of issuing a joint final communiqué. The decision follows the row that erupted at last year’s meeting between Trump and Canada’s prime minister Justin Trudeau over the final text.

Speaking to a news conference, Macron said: “We are living through a very deep crisis of democracy.” There was a “crisis of capitalism” and a “crisis of inequality” as well as a “fascination with authoritarian regimes.”

But, he said, it was “pointless” to try to issue a final statement. “No one reads the communiqués, let’s be honest. And in recent times, you read the communiqués only to detect disagreements.”