



# Tim Duy's **Fed Watch**

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## Looking For Policy Continuity From Powell

Federal Reserve Chairman Jerome Powell will tackle his first Semiannual Monetary Policy Report to the Congress this week. **The expectation is that Powell will by and large reiterate the case for continued gradual tightening of monetary policy.** That has come to mean three rate hikes in 2018, although given the data dependence of policy the risk is that three becomes four. **Market participants remains nervous, however, that Powell will set a more hawkish tone indicating a sharp acceleration of rate hikes. I think this very unlikely at this juncture.** I do think there is room, however, to emphasize that if fiscal spending supercharges growth in 2018, then rate hikes will continue into 2019.

**In my opinion, policy expectations have been somewhat set adrift by the leadership change at the Federal Reserve. We lack an anchor until Powell delivers a substantive policy speech.** There exists a broad expectation of policy continuity, but that has so far gone unstated. Market participants are looking for Powell to firm up that expectation this week.

**The concern is that Powell suggests an accelerated pace of rate hikes.** Market participants are comfortable with the idea of four hikes, but not five or more. And in some sense it is fairly easy to tell a story that gets to five or more hikes. In the minutes of the last FOMC meeting, we learned that policymakers saw a stronger fiscal impulse than expected in December. Since then Congress and the Trump administration delivered a spending package with additional fiscal stimulus. This will add additional fuel to an already simmering nearly full-employment economy.

Consider this additional fiscal stimulus in light of the Fed's current forecast. They already believe they have overshot full employment and will need a restrictive monetary policy by 2020 to quell inflationary pressures. The economy

is thus arguably already in a danger zone; the Fed has not proved successful in guiding unemployment higher without triggering a recession. That suggests that the Fed is already not sufficiently preemptive with policy. An expectation of three hikes was already too low, hence with additional fiscal stimulus four is also too low. Go big or go home.

But even if Powell believed something along these lines, would he reveal this week that he expected to accelerate the pace of rate hikes? That I think depends how much forcefully he intends to guide policy. Does he intend to publically project the FOMC consensus in that he builds that consensus internally and then relates it to an external audience? Or does Powell intend a more authoritarian approach we haven't seen since the days of Alan Greenspan?

**I see no reason to believe that Powell wants to break with the current style of consensus building within the Fed. I also don't think that the consensus has changed. Fed speakers have in recent weeks reiterated the case for gradual policy tightening, not an acceleration. Hence, I anticipate the Powell will not go rogue with a different message. If he does shift gears, that would signal to me a very different leadership approach compared with Ben Bernanke and Janet Yellen.**

Assume then that Powell maintains the current gradual policy approach but still needs to address the additional fiscal stimulus. It is a tricky space given current fears of a sharp rise in rates. Still, Powell has options. The easiest is that can just leave as part of the "data dependence caveat." Something like:

*If the economy accelerates faster than currently anticipated, due to either fiscal stimulus or other factors, we will recalibrate policy as appropriate to meet the objectives of the dual mandate.*

This seems a safe bet. Another option is to emphasize the 2019 forecast. The current 2019 projections are arguably

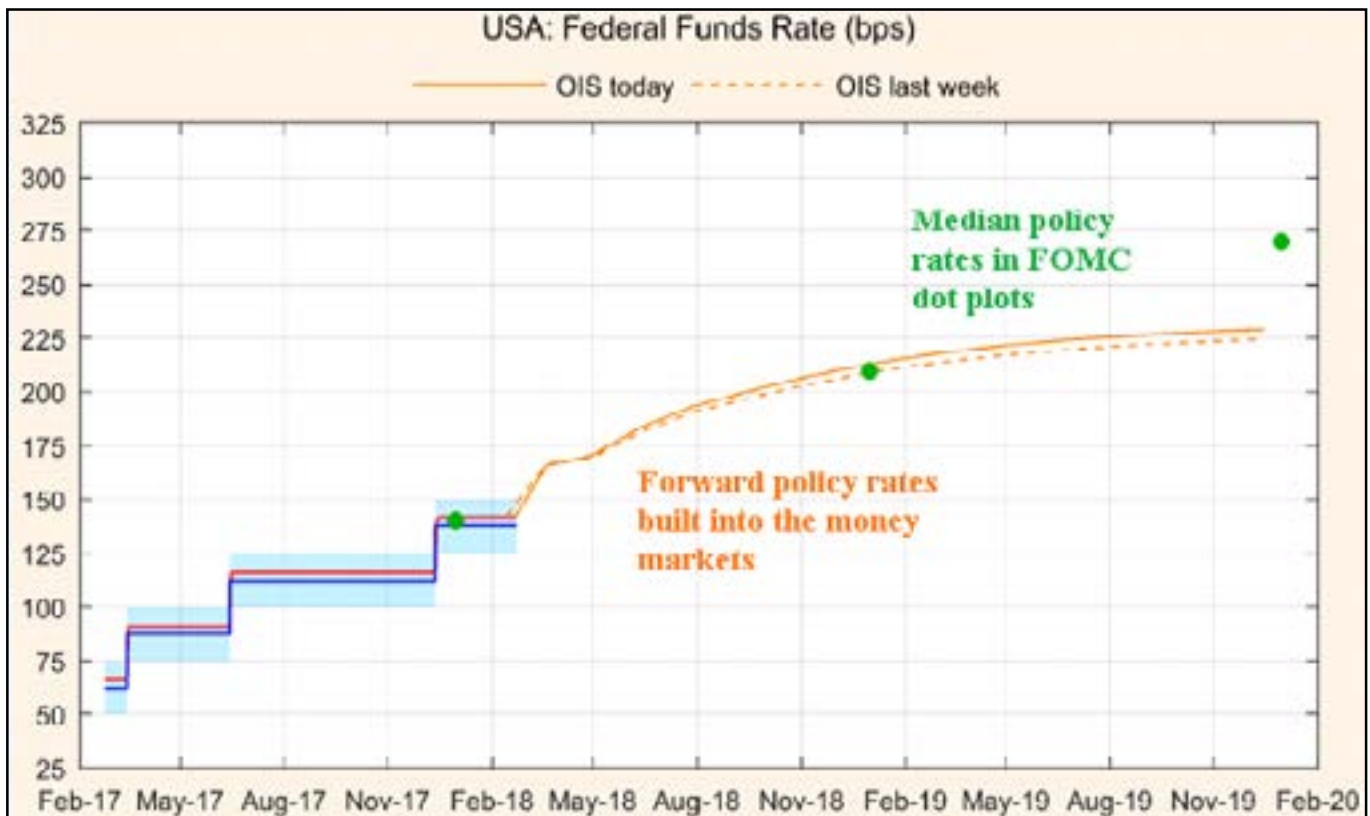
a bit indecisive with median policymaker forecast of two to three rate hikes. I think Powell could add a little hawkishness within the context of the current FOMC consensus with something like:

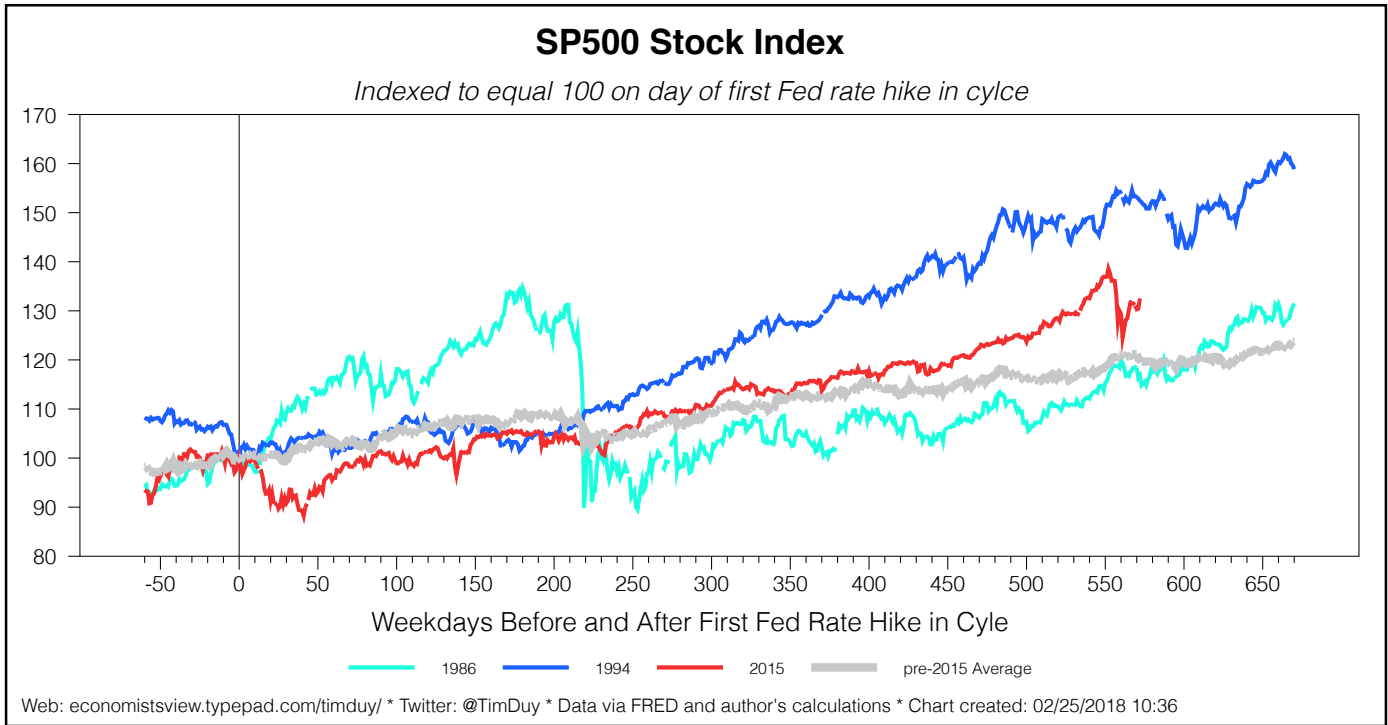
*Additional fiscal spending suggests the economy will not slow as much as anticipated next year and thus increases the likelihood that further gradual rate increases will be necessary through at least 2019.*

I tend to think 2019 is a good space to work with given still low rate hike expectations for next year. Consider market expectations for US policy rates in the below chart from [Gavyn Davies at the Financial Times](#). If these truly represents market expectations for 2019, then in my opinion Powell has plenty to work with if he wants to add a hawkish lean to the outlook. I very much doubt economic activity will slow sufficiently to bring rate hikes in 2019 to a virtual

standstill, especially in light of the additional fiscal stimulus. I think we would need to see a much greater pace of rate hikes in the first half of this year to bring about such a result.

**Bottom Line: I expect that Powell will emphasize policy continuity during this week's trips to Capitol Hill. That means further gradual rate hikes with the actual outcomes being data dependent. The basic outlook thus should be consistent with current policy expectations of three or four rate hikes. Fiscal stimulus could be addressed within the context of data dependence or the 2019 forecast without raising expectations of a faster pace of rate hikes. If Powell goes rogue with a noticeably more hawkish message, then we have reason to consider this a very different leadership approach relative to his predecessors.**






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Tim has published in the *Journal of Economics and Business* and is currently a member of the Oregon Governor's Council of Economic Advisors and the State Debt Policy Advisory Commission. Tim is a prominent commentator on the Federal Reserve. MarketWatch describes his blog as "influential." The Huffington Post identified him as one of the top 26 economists to follow on Twitter, and he is listed on StreetEye as one of the top 100 people to follow to discover finance news on Twitter. Major national and international news outlets frequently quote him, including the *New York Times*, the *Washington Post*, the *Financial Times*, the *Wall Street Journal*, and *Bloomberg*. He also writes a regular column for *Bloomberg Prophets*.

*Notice: This newsletter is commentary, not investment advice.*

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