March 11, 2019

Powell; Support for No Deal Brexit Rising; China

Powell Warmed Over: Sunday's 60 Minutes interview (full transcript here) of Federal Reserve Chairman Jerome Powell by Scott Pelley was a big, fat nothing burger. There was nothing of substance from the chairman on the future of monetary policy that he hasn't said before.

When Pelley asked the chairman if the rate increases of last year were wrong, Powell simply expressed satisfaction over where the economy is now and declared that rates were "roughly neutral."

As we read it, Powell was intent to avoid causing ripples with his interview.

He deferred to Treasury on the dollar's strength. He would not comment on his personal communications with President Trump. He would not comment on stock market valuations.

Powell rejected the suggestion that the swift switch from hawkishness to dovishness between December 19th and January 30th may have been prompted by Trump's public pressure against higher rates. Pelley even asked Powell if Trump could fire him. The Georgetown lawyer stated that the "law is clear" he has a four-year term, which he intends to serve. When pressed by Pelley as to whether Trump has the ability to fire Powell, he responded, "No." There are differing opinions on this, of course, especially given that Section 10.2 of the Federal Reserve Act allows the president to remove a Fed chair "with cause."

Indeed, more was likely gleaned from Lael Brainard's speech last Thursday indicating she was not ready to "prejudge" any rate move for "late in the year." In other words, former hawk Brainard is now firmly in the dove camp. And in line with other statements by FOMC officials, it's clear the board is slightly freaked out by recent economic indicators and is in fact openly acknowledging that more QE—and possibly a dip into negative rates, a la Europe and Japan, should a slowdown worsen.

Fed futures markets continue to suggest the more likely move with rates 9-12 months out is lower, not higher. (There is nearly a 30% probability of rate cut for January 2020.)

Yield Curve: We remain optimistic that on the Fed's new dovish tilt, the yield curve will continue to steepen so that the spread between long- and short-term rates can widen, such as the UST 10Y2Y spread and 10Y3M spread.

Arguably since the beginning of the year, when Powell invoked "patience" with rate policy (on January 4) the 10Y2Y and 10Y3M spread has leveled off. This is a significant development given how concerns of slowing global growth are forcing several central banks to become dovish, such as the ECB last week, under Mario "Whatever It Takes" Draghi.

So long as the Fed refrains from spooking the economy (and Powell seems to be sticking with that script), we believe spreads can widen, while risk aversion, as seen in the Baa-Aaa spread, declines. **We remain risk on.**

No Deal Brexit Support Rising Among Electorate? Although Remainer MPs would likely shudder at the thought, a recent survey suggests that there is more support for a "no deal" Brexit than for any further concessions in deal Prime Minister May might negotiate. The margin was 44% vs less than 30%.

Such sentiment is important to note going into Wednesday's parliamentary vote on whether to take a no deal Brexit off the table. While all the Remainer-friendly press has been focusing on Tory defections away from Brexit, the real surprise could issue from Labour defections on the question of removing a no deal option. As we noted last week, there are about 30 of them who are either pro-Brexit or feel strongly that the 2016 referendum should be upheld.

Additional polling suggests 52% of those asked do not want an extension of more than six months. Meanwhile, just 17% want an extension of Theresa May's deal. As for a second referendum, the numbers for such a proposal coming out of Parliament are not there. About 219 MPs said they were open to another referendum, well short of the 318 seats necessary to carry such a motion.

China: Top White House advisor Larry Kudlow was on the talk shows yesterday, speaking bullishly about prospects for a US-China trade deal by April. Given reports Friday that President Xi had canceled a planned trip to Mar-a-Lago, it seems part of his appearance was in the interest of damage control. But in terms of deliverables, Kudlow did not sway from the America First line: “Across the board, the deal has to be good for the United States, and for our workers, and our farmers, and our manufacturing. It's got to be good. It's got to be fair and reciprocal and it's got to be enforceable.” Responding to the news that Xi had rejected any plans to meet at Mar-a-Lago, Kudlow said correctly, "You can’t cancel something that wasn’t scheduled."

To be clear, BWR does not believe that a $30bn increase in the tariff schedule will drive China’s $~14 trillion economy into the ground. Although some agreement may be reached, we don’t believe the quick removal of tariffs will occur. And given reports that Xi is beginning to the feel pressure at home not to back down to Trump even as the economy weakens at home, token moves, such as dropping the slogan “Made in China 2025,” may be the best we can hope for in the early stages of what looks to be a multi-year process.

Bottom line: a 25% blanket tariff on all Chinese imports to the US is probably the upper threshold of where tariffs might go with China, but for Beijing this may be acceptable as part of the cost of doing business with the US and having access to such a lucrative consumer market.

Bretton Woods Research