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Briefing

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U.S. ECONOMIC AND EVENT OUTLOOK – MONDAY

Mon		
5/20	1:00 PM	**Clarida, Williams Appearances**
	7:00 PM	**Powell Speech (Atlanta Fed Conference)**

Global Markets

- Red across global equity markets Monday, with U.S. futures for 0.6% led by the NASDAQ (-1.3%), while Chinese share fell 0.9%, and European markets are broadly lower in the 1-2% range, 2.5% for Italy.
- **The shift to targeted trade war salvos may be picking up.** The U.S. kneecapped suppliers' ability to service telecom/tech giant Huawei, and speculation is growing that China may respond by shutting off the flow of key "rare earth" elements, for which U.S. firms source an overwhelming proportion of supplies.
- They are used in a wide range of materials that go into hi-tech products, and China will be starting with, at the very least, a 25% tariff on refined supplies sent back to the U.S. on June 1.
- First quarter GDP in Japan rose a surprising 0.5% q/q (Consensus: -0.1%; DE: 0.1%), albeit driven in large part by a plunge in imports (-4.6% q/q, or -17.2% annualized) while exports fell 2.4% (or 9.4% annualized). Household and business spending both fell q/q.
- In the U.S. Monday, Powell's speech at the Atlanta Fed's financial markets conference Monday evening will come at a time of renewed uncertainty. Powell so recently noted positive developments in the trade war and Brexit at his last FOMC press conference, and risks in both are now higher.

Powell Speech Ahead, Longer-Term FOMC Framework and Communications Review

The near-term U.S. economic landscape is still solid, and dominated by subdued inflation pressures, with a labor market that by all accounts is performing above-trend, but in a way that continues to suggest any guide from the Phillips Curve is poor at best, and misleading at worst.

Much depends on the length and level of escalation of the U.S.-China trade war, which up until just two weeks ago was a risk that had evolved firmly into the "more favorable" column. Markets price in nearly two 25 bps rate cuts between now and early 2020. In that sense, we expect little of note in the Minutes this week, but there are plenty of Fed appearances beginning today with Powell.

As midyear approaches, it's not just the near-term policy course but the Fed's whole operating framework that will be reevaluated. This has already begun with scattershot Fed speakers weighing pros and cons, and begins to look more formal with a conference in early June, with the review set to be completed by early 2020.

There's no shortage of potential changes, including:

- a higher inflation target,
- price-level or nominal GDP targeting,
- direct yield curve targeting in a crisis,
- a better sense of future QE/forward guidance tools,
- switching to an inflation range, not a point 2% target,
- or less likely, a rule-based system.

The benefits of any of those potential changes would need to be weighed against the costs of a shift. Or, as St Louis' Bullard noted last Thursday, weighed against the fact that in practice, the benefits of, for example, a change toward nominal GDP targeting could be a lot less clear than they are in theory.

Some Fed officials have intimated that in the end, it's possible no major changes are made. What could be useful is greater recognition that in practice the FOMC has undershot its price inflation goal, which would on its own keep markets focused on more accommodation, not less, in the months ahead and in a crisis.

Monetary and Fiscal Policy Might Edge Closer Together Ahead

There is a risk in all of this. Radical changes, and even the willingness of the Fed to assess its own goals and framework, could get Congress involved in taking another look at the Fed's mandate, particularly around an election year. The Fed is already battling assaults on its independence, and arguably remains open on both flanks to critiques on the Wall Street/Main Street divide.

With more radical proposals including MMT getting significant airtime, coming years could bring about a bigger evolution in monetary and fiscal policy than the Fed is currently considering. The transmission mechanism between interest rates and investment and other economic variables may be less tight than thought as the economy evolved over the last thirty years.