NOVEMBER 2018

MACRO BRIEF

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Financial Planning

LAST MONTH IN MACRO

Monetary policy (UK)

Unanimous

Last week, the Bank of England's Monetary Policy Committee – tasked with maintaining inflation close to the 2.0 percent target – voted unanimously to maintain Bank Rate at 0.75 percent and its stock of gilt purchases at £435 billion. By now, policymakers have settled into an easily defined narrative. One which sees supply and demand in balance if output growth is sustained at a year-on-year rate of 1.5 percent. Anything faster than that sees inflation risks rise and anything slower sees inflation risks fall.

Currently, the British economy is growing at 1.2 percent… ergo no rate rise. The prospect of faster growth is stifled by Brexit-related uncertainty. It follows then, that an orderly exit – with a deal of some kind – will encourage increased growth and further increased rates. Simples.

Manufacturing output (China)

Slowing less quickly

The official Purchasing Managers' Index reading fell from 50.8 in September to 50.2 in October – a shade above the neutral 50.0 mark. Meanwhile, the unofficial index, compiled by Caixin, rose a little from 50.0 to 50.1.

Taken together, these readings present compelling evidence of a slowdown in Chinese manufacturing output. That's not good.

The cavalry is on the way though. Policymakers are busy sprinkling a liberal dose of stimulus – measures to encourage more borrowing and yet more infrastructure spending – which will likely have the effect of boosting output in the short-term. Of course, what feels good in the short-term is often detrimental in the long-term. Policymakers cannot carry on like this forever.

Employment situation and inflation (USA)

Almost a certainty

The consensus called for an additional 188,000 jobs in the October non-farm payroll report. In the event, the Bureau of Labor Statistics counted a whopping 250,000. Meanwhile, unemployment – at 3.7 percent – remains at the lowest level in 49 years and further good news comes in the form of accelerated wage rises. Salaries are growing at an average rate of 3.1 percent year-on-year.

Consequently, I see no reason why the Federal Reserve would refrain from raising rates in December. Not even – and perhaps especially not even – a wibbly-wobbly stock market. Indeed, I suspect that Jerome Powell, Chair of the Federal Open Market Committee, will not be at all unhappy about what is a relatively mild decline in asset prices.

There are those that think that the current expansion will end with high inflation and high rates of interest; that the Federal Reserve will bring about a recession as a by-product of their attempts to cool runaway inflation. I'm not one of those. And neither, I suspect, is Jerome Powell. Actually, I think the greatest risks come in the form of a financial imbalance – some kind of asset price bubble perhaps.

Inflation certainly isn't a problem right now. The core rate of inflation – as measured by the Personal Consumption Expenditure index – remains in line with the target in spite of accelerated GDP growth. The Fed don't expect that to change much. Their projection materials see core inflation rising to around 2.1 percent, but not much higher.

Nevertheless, policymakers at the US central bank are keen to raise rates to some level which might be considered normal. In doing so they will mitigate the risks associated with runaway asset prices and they will be better positioned to fight the next downturn. That's all good.

Data from the Bank of England, tradingeconomics.com, Bureau of Labor Statistics and Federal Reserve.

Economic output (UK)

A long, hot summer

The Office for National Statistics estimates that the UK economy expanded by something like 0.6 percent during Q3 or 1.5 percent if you prefer the year-on-year figure. That represents a significant improvement on the 0.4 percent pace during Q2.

Apparently, 'real GDP growth… was driven by relatively strong growth in July'. It seems retail sales where particularly strong then.

If I recall correctly, the midday sun was hot and retailers were scrambling to sell booze to excited Englishmen while the national team flattered to deceive over in Russia.

Beyond that, there is little sign of strength in the British economy. Output growth in August and September came to a virtual standstill. The consensus calls for growth in the region of 1.3 percent this year. That feels about right to me, though I think the risks might be to the downside depending on what happens at the top of the Conservative party in the months ahead.

Actually, I wonder what odds I can get on Gareth Southgate being the next Prime Minister.

Monetary policy (USA)

Zero surprises

Last week, the Federal Open Market Committee voted to maintain the upper limit on the target for the Fed Funds rate at 2.25 percent.

The requisite statement cites continued strength in the labour market coincident with strong economic activity and core inflation consistent with the 2.0 percent target. Assuming those conditions persist for another 6 weeks or so, it seems very likely that the Fed will raise rates at the December meeting to bring about a fourth rate rise this year. Indeed, the market currently prices the likelihood of a December rate rise at 76 percent.

Actually, in my view, the market is underestimating the likelihood of a hike in December. I'd be more comfortable if prices reflected an 85 percent probability. I'm nit-picking, mind. On balance, I am much more comfortable with market-based measures of interest rate expectations than I was. As it stands, futures prices infer a 31 percent chance of rates hitting 3.25 percent during 2019, up from about 10 percent at the end Q3. And for that reason, I think October's equity market volatility has played out reasonably well and I expect asset prices to display fewer sharp movements in the remainder of 2018.

LAST MONTH IN WORDS

‘President Trump hasn’t called Fed Chairman Jerome Powell to directly express his frustration with the central bank’s interest-rate increases and currently has no intention of replacing the Fed chief, the top White House economic adviser said. Lawrence Kudlow said that the president’s repeated criticism of Mr. Powell’s decision to raise rates three times so far this year is a simple expression of opinion, but that Mr. Trump hasn’t taken any steps to shake up the Fed’s leadership’.

Source: Wall St Journal, Pro Central Banking Newsletter, 02 November.

‘Venezuela’s annual inflation rate accelerated to 833,000% in October, underscoring the country’s plunge into economic chaos and President Nicolás Maduro’s unsuccessful efforts to tame the world’s fastest-rising prices, lawmakers said Wednesday.

A monthly report released by the Venezuelan legislature’s finance commission showed the 12-month inflation rate rose from 488,000% recorded in September, putting the embattled South American nation on track to meet the International Monetary Fund’s estimate for 2018 inflation to top 1.3 million percent’.

Source: Wall St Journal, 07 November. .

NOTES

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