The Fed seems determined to snuff out economic progress

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President Trump's pro-growth tax and regulatory policies are creating the textbook-theory-expected faster economic growth along with the benefits that go with that faster growth. Meanwhile, Federal Reserve policy appears to be focused on preventing these positive economic effects from continuing through 2019.

Lower regulatory burdens translate into lower costs of conducting business and increases in output. A recent Federal government report puts that cost savings at $33 billion since the election of President Trump.

Likewise, tax reform is translating into increased capital investment and increased trend economic growth. Corporations are returning income and capital to stockholders through strong dividend growth, higher wages and higher equity prices.

Holders of equity are experiencing dividend increases of nearly 10 percent this year in response to tax reform. Capital investment is expected to be higher this year by approximately 8 percent.

Compensation for private-sector workers is up by nearly 2.9 percent to date in 2018, which is nearly one full percentage point higher than in 2016. Real disposable income is increasing by nearly 3 percent in 2018. Clearly, the benefits of pro-growth policy are flowing through to workers.

The Oct. 16 Jobs Opening and Labor Turnover (JOLTS) suggested employers were seeking to fill 7.14 million positions, higher by a million jobs from a year ago. Many of these job openings likely require skilled workers but as workers accept those positions, less-skilled positions open. That process is occurring in the U.S. economy.

The recent employment report of Oct. 5 contained marvelous news for U.S. workers. Overall unemployment was 3.7 percent. Adult women (3.3 percent), adult men (3.4 percent), high school graduates with no college degree (3.7 percent) and those with a college degree (2 percent) are all enjoying low unemployment. At 6 percent, black unemployment is a record low, same for Hispanics at 4.5 percent.

A strong economy and full employment translate into high levels of optimism as expressed in a recent Gallup report, consumer confidence surveys and high levels of business confidence.

Federal Reserve officials look at this positive data flow and seem to be telling themselves, “We can't have this — it's too much good news for the economy and labor market.”

The Fed's inflation gauge, the personal consumption deflator, came in at 2.2 percent year over year in the most recent month. The Fed's target is 2-percent inflation while inflation expectations remain anchored at close to 2 percent.

Fed officials have embarked on an aggressive tightening policy with inflation expectations anchored at about 2 percent. It is unclear why the Fed is doing this since inflation is contained. The Fed is on a path of jacking up interest rates about once per quarter and engaging in a massive quantitative tightening (QT) program, sucking up $50 billion per month out of the money supply.

The Federal Reserve has decades of experience with increasing interest rates and the time lags associated with that. But Fed officials have no experience with QT and plan on pulling $600 billion out of the money supply over the next 12 months, which will grind down excess reserves and dramatically slow bank lending.

This two-pronged tightening policy started with former Fed Chairwoman Janet Yellen at much smaller QT levels with more infrequent rate hikes. But current Chairman Jay Powell has allowed more frequent interest rate increases to occur along with a major step-up in the amount of QT per month.

The interest rate hikes, according to Federal Reserve officials, do appear to be data dependent. In comparison, the quantitative tightening policy appears to be on automatic pilot. The Fed, with QT, appears to be continuing down that road until the wheels fall off.

The equity market is a highly liquid market and one can expect wheels to fall off sometime in 2019 in response to QT. A downdraft of 15 percent or more in equity prices may be necessary before Fed officials will consider backing off QT.

In April 2007, then-Fed Chairman Ben Bernanke suggested that subprime housing issues would be limited at a time when the Fed was running a tight monetary policy. Bernanke did not have any experience with the subprime issue. This time around, Chair Powell has no experience with QT.

The subprime housing issue had an unhappy ending and quantitative tightening likewise may have an unpleasant result.

The major issue this time around is that just as American workers are experiencing increases in their standard of living in response to pro-growth economic policies, the Federal Reserve is taking direct aim at both the equity market and economy with a dual tightening policy to take away those improvements.

Mike Cosgrove, principal at Econoclast, a Dallas-based capital markets firm, is a professor at the University of Dallas.