



MORNING BRIEFING

April 15, 2019

The Fed Is Listening

See the [collection](#) of the individual charts linked below.

(1) The Fed's review of the Fed. (2) Open minds. (3) Despite renewed commitment to data dependence, FOMC folks can't resist forecasting interest rates. (4) Clarida suggests Fed's review is focusing on alternative ways to target inflation. (5) Trying to find something to do when the federal funds rate is at the effective lower bound. (6) Targeting the price level vs the inflation rate. (7) Inflation misses: Should bygones be bygones? (8) Bernanke and Yellen still matter.

The Fed I: Open to Suggestions. Last Tuesday, Fed Vice Chairman Richard Clarida gave a [speech](#) reviewing the Fed's monetary policy strategy, tools, and communication practices as part of its [Fed Listens](#) series of events, which will culminate in a 6/4-6/5 research conference dedicated to exploring the views of Fed outsiders on monetary policy approaches. It will feature the perspectives of "speakers and panelists from outside the System," such as academics, and present alternative frameworks for conducting the business of the Fed. "We are bringing open minds to" the review of monetary policy, Clarida said, "as part of a comprehensive approach to enhanced transparency and accountability."

The review's purpose is to evaluate the Fed's approach to its congressional dual mandate—maximum employment and stable inflation—and the effectiveness of the Fed's post-crisis policy tools and communication practices. It's "more likely to produce evolution, not a revolution, in the way that we conduct monetary policy," Clarida said. Three questions are central to the Fed's review:

- (1) "Can the Federal Reserve best meet its statutory objectives with its existing monetary policy strategy, or should it consider strategies that aim to reverse past misses of the inflation objective?"
- (2) "Are the existing monetary policy tools adequate to achieve and maintain maximum employment and price stability, or should the toolkit be expanded? And, if so, how?"
- (3) "How can the FOMC's communication of its policy framework and implementation be improved?"

Before Melissa and I have a closer look at Clarida's review of the Fed's review of monetary policy, we should note that last week's release of the [Minutes](#) of the 3/19-3/20 FOMC meeting confirmed that the Fed's current "patient approach" remains in place and that the Fed's decisions are data dependent.

However, rather than leaving it at that, the Minutes note that "a majority of participants [including voters and nonvoters] expected that the evolution of the economic outlook and risks to the outlook would likely warrant leaving the target range unchanged for the remainder of the year."

Why influence the financial markets' expectations with forward guidance on the interest-rate outlook if the Fed is data dependent? The stock market freaked out late last year when Fed officials predicted that interest rates had a ways to go on the upside. Now those officials mostly suggest there will be no change in rates at all this year, though it's not at all clear that the economic picture painted by the latest

data differs much from how it looked at the end of last year! In other words, if the FOMC was too hawkish last year, maybe the committee is too dovish now?

Rate-setting obviously depends on what the economy can handle when raising interest rates or needs when lowering them. We expect (hope) that the economy will adjust to last year's round of rate hikes so that it can handle another couple of hikes later this year and early next year, which would provide more basis points for lowering interest rates during the next recession.

Forward guidance is our job, not the Fed's. If we were in charge of monetary policy, we would be solely data dependent. We were under the impression that Fed policymakers came around to this view after the dot-plot debacle late last year. Instead, they seem to have committed to no rate hikes over the rest of this year and only one next year, and are now considering all sorts of cockamamie new approaches to conduct monetary policy, as discussed in the next section.

The Fed II: Review Focusing on Inflation-Targeting. Of the three questions for the Fed's monetary policymakers, Clarida's speech focused mostly on the first one about inflation. The two key assumptions behind Clarida's speech are that low inflation is here to stay, and so is the near-zero real neutral interest rate. That means that the nominal neutral federal funds rate is also likely to remain low, not leaving much room for the Fed to ease during the next recession. The neutral interest rate is the one at which the economy is moving forward at full employment with inflation remaining low and stable.

Clarida explains: "The decline in neutral policy rates likely reflects several factors, including aging populations, changes in risk-taking behavior, and a slowdown in technology growth. ... All else being equal, a fall in neutral rates increases the likelihood that a central bank's policy rate will reach its effective lower bound (ELB) in future economic downturns." Consider the following:

(1) *Monetary policy near the lower bound.* The ELB is the lowest point at which the Fed's primary interest rate tool, the federal funds rate, can effectively stimulate the economy in the event of a downturn. Clarida warned that because interest rates are already persistently low, it "could make it more difficult during downturns for monetary policy to support household spending, business investment, and employment, and keep inflation from falling too low."

In our opinion, the ELB should be the same as the zero lower bound (ZLB). We hope the Fed never seriously considers negative interest rates. The next time that the Fed gets down to ZLB, as it did for about seven years following the Great Financial Crisis, perhaps Fed officials should admit that's all they can do and recognize that they are trying to solve problems that can't be solved with monetary policy. Instead, they are more than likely to try quantitative easing again, which isn't a very effective monetary policy tool, in our opinion.

(2) *Let inflation bygones be bygones, or not?* Clarida also discussed the changing inflation dynamic evident in the flattening of the Phillips curve, or the theoretical inverse relationship between inflation and unemployment. He noted: "A flatter Phillips curve is, in a sense, a proverbial double-edged sword. It permits the Federal Reserve to support employment more aggressively during downturns—as was the case during and after the Great Recession—because a sustained inflation breakout is less likely when the Phillips curve is flatter. However, a flatter Phillips curve also increases the cost, in terms of economic output, of reversing unwelcome increases in longer-run inflation expectations."

In any event, the review won't change the Fed's inflation target. According to Clarida: "[T]he review will take as given that a 2 percent rate of inflation in the price index for personal consumption expenditures (PCE) is the operational goal most consistent with our price stability mandate."

The FOMC's Statement on Longer-Run Goals and Monetary Policy Strategy lays out the Fed's current approach to policy. It was first adopted in January 2012 and has been reaffirmed at the start of each subsequent year. The statement is the source of the Fed's stated 2.0% inflation target concurrent with maximum employment.

In terms of strategies to reverse past misses of the inflation objective, the Fed is considering whether it should provide for a period of lower-for-longer interest rates after inflation has missed its target. In other words, the level of prices would become a factor in the Fed's inflation-setting rather than just the inflation rate. That'd be an important change because in the past, inflation-rate "misses" have just been treated as "bygones."

(3) *Predecessors with their own opinions.* We are sure to hear more on this topic from former Fed Chairs Ben Bernanke and Janet Yellen, who have recently opined on alternative approaches to inflation-targeting.

In a 10/12 [opinion piece](#) for Brookings, Bernanke proposed "an option for an alternative monetary framework" that he calls a "temporary price-level target—temporary, because it would apply only at times when short-term interest rates are at or very near zero." Bernanke describes the approach in detail. The gist is that the Fed would commit to a "lower-for-longer" federal funds rate when it is near zero as long as inflation remains below 2.0%.

In a 12/6 [opinion piece](#) for *Yale Insights*, Yellen advocated for average-inflation-targeting. She wrote: "I frankly think it's appropriate after a long period when inflation's run shy of 2% to then allow inflation to run above 2%. I would be inclined to establish as a target something like 2% on average over the business cycle."

(4) *Meddlesome central bankers.* The unambiguous and unshakable assumption of all the Fed heads (including Clarida) is that monetary policy can determine inflation. Indeed, the 1/29 [Statement on Longer-Run Goals and Monetary Policy Strategy](#) states: "The inflation rate over the longer run is primarily determined by monetary policy, and hence the committee has the ability to specify a longer-run goal for inflation." That's been in the boilerplate since the first statement was issued at the start of 2012.

The FOMC can take some satisfaction from having achieved the coveted 2.0% inflation target, based on the core PCED, during May 2018 ([Fig. 1](#)). However, that was more than seven years after that target was explicitly stated in early 2012! The experiences of the major central banks, including the Bank of Japan and the European Central Bank, suggest that perhaps monetary policy doesn't have as much or any influence on determining the inflation rate as central bankers would like to believe.

(5) *A few parting shots at alternatives to targeting 2.0%.* Clarida briefly reviews "makeup" strategies. In effect, they all amount to tracking the actual level of the PCED relative to the target path. A 2.0% path starting January 2012 exceeded the actual PCED during January 2019 by 4.6% because the latter has been trending closer to 1.3% ([Fig. 2](#)).

Making up the shortfall has a number of shortcomings. For starters, why does it make any sense to do so? We can't come up with any good reasons. Furthermore, trying to explain the logic (if any) to the public would likely cause confusion as well as suspicion that the Fed intends to boost inflation permanently, not just to put it back on the 2.0% track.

The various makeup strategies all would justify keeping the federal funds rate lower-for-longer. That could very easily lead to financial excesses with rapidly rising asset prices financed with mounting debt.

The folks at the Fed tend to be so focused on their dual mandate that they rarely focus as much as they should on excesses in the financial markets. In all of their discussions of makeup strategies, we've never read about any such concerns.

CALENDARS

US. Mon: Empire State Manufacturing Index 8.0, Treasury International Capital. **Tues:** Headline & Manufacturing Industrial Production 0.3%/0.2%, Capacity Utilization 79.2%, NAHB Housing Market Index 64, Rosengren, Kaplan. (DailyFX estimates)

Global. Mon: China New Yuan Loans ¥1250b, China Aggregate Financing ¥1850b, China M2 8.2% y/y. **Tues:** Germany ZEW Survey Current Situation & Expectations 8.5/0.5, UK Employment Change & Unemployment (3-month) 173k/4.0% Japan Trade Balance ¥363.2b, RBA Minutes of April Policy Meeting. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 0.5%, ranking 30th of the 49 global stock markets we follow in a week when 35/49 countries rose in US dollar terms. That compares to the prior week's 26/49 ranking, when the US MSCI gained 2.0% as 41 markets rose. The AC World ex-US index rose 0.3%; that performance compares to a 2.1% gain a week earlier. Nearly all of the regions rose last week, led by EM Eastern Europe (2.2%), EMEA (1.6), EMU (1.0), and EM Asia (0.5). The regions underperforming last week: EM Latin America (-2.6), BRIC (0.0), and EAFE (0.2). Hungary was the best-performing country, rising 4.1%, followed by Greece (3.1), Austria (3.0), South Africa (2.8), and Portugal (2.3). Of the 15 countries that underperformed the AC World ex-US MSCI last week, Turkey fared the worst, falling 5.6%, followed by Brazil (-4.5), Peru (-1.6), Japan (-1.3), and Malaysia (-1.3). The US MSCI's ytd ranking dropped to 12/49 from 11/49 a week earlier, with its 16.3% ytd gain ahead of that of the AC World ex-US (12.2). All regions and 43/49 countries are in positive territory ytd. Among the regions, those outperforming the AC World ex-US ytd include: BRIC (16.6), EM Asia (14.0), EMU (13.9), and EM Eastern Europe (13.3). Regions underperforming the AC World ex-US: EM Latin America (7.6), EMEA (8.9), and EAFE (11.4). The best country performers ytd: Colombia (28.6), Egypt (23.5), Belgium (22.8), China (22.1), and Greece (19.3). The worst-performing countries so far in 2019: Morocco (-3.7), Turkey (-3.4), Malaysia (-2.1), Jordan (-2.0), and Argentina (-1.8).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes rose for a third straight week as MidCap's 0.8% gain outpaced both LargeCap (0.5%) and SmallCap (0.4). LargeCap ended the week 0.8% below its record high on September 20, with MidCap and SmallCap 4.1% and 11.7% below their August 29 records, respectively. Among the 33 sectors, 23 moved higher last week compared to 28 rising a week earlier. The biggest gainers in the latest week: MidCap Communication Services (3.0), MidCap Tech (2.2), LargeCap Financials (2.1), and MidCap Financials (1.8). LargeCap Health Care (-2.4) was the biggest decliner, followed by MidCap Health Care (-2.0) and SmallCap Health Care (-1.8). In terms of 2019's ytd performance, all three indexes are still off to a good start. MidCap leads with a gain of 18.2% ytd, ahead of LargeCap (16.0) and SmallCap (14.8). All 33 sectors are positive ytd, with the SmallCap and MidCap cyclicals leading the top performers: SmallCap Energy (29.5), MidCap Tech (28.3), LargeCap Tech (23.8), MidCap Energy (23.6), and SmallCap Materials (22.5). LargeCap Health Care (3.8) is the biggest underperformer so far in 2019, followed by SmallCap Health Care (6.7), SmallCap Utilities (7.0), SmallCap Consumer Staples (7.7), and MidCap Utilities (8.5).

S&P 500 Sectors and Industries Performance ([link](#)): Nine of the 11 S&P 500 sectors rose last week, and five outperformed the S&P 500's 0.5% gain. That compares to nine rising a week earlier, when seven outperformed the S&P 500's 2.0% gain. Financials was the best-performing sector, with a gain of

2.1%, ahead of Communication Services (1.6%), Tech (1.2), Consumer Staples (1.0), and Consumer Discretionary (0.6). Last week's biggest underperformers: Health Care (-2.4), Energy (-0.2), Utilities (0.2), Industrials (0.3), Real Estate (0.3), and Materials (0.5). All 11 sectors are higher so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These six sectors have outperformed the S&P 500's 16.0% rise ytd: Information Technology (23.8), Industrials (20.1), Consumer Discretionary (19.8), Communication Services (18.8), Real Estate (18.1), and Energy (17.8). The ytd laggards, albeit with gains: Health Care (3.8), Utilities (9.9), Consumer Staples (11.1), Financials (13.8), and Materials (14.9).

Commodities Performance ([link](#)): Last week, the S&P GSCI index gained 1.2% as 15 of the 24 commodities moved higher. That compares to a 3.0% gain a week earlier, when 17 commodities moved higher. The index is almost out of a correction with a drop of 10.0% from its high in early October after being down as much as 26.9% on December 24. Feeder Cattle was the strongest performer for the week, as it rose 4.7%, ahead of GasOil (2.5%), Unleaded Gasoline (2.4), and Kansas Wheat (2.0). Lead was the biggest decliner, with a drop of 2.9%, followed by Aluminum (-1.0) and Coffee (-0.8). The S&P GSCI commodities index is up 20.9% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Lean Hogs (61.5), Unleaded Gasoline (54.5), Crude Oil (41.0), Brent Crude (32.1), and GasOil (24.3). The biggest laggards in 2019: Kansas Wheat (-9.7), Coffee (-8.7), Natural Gas (-8.0), and Wheat (-6.9).

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index rose 0.5% last week and improved relative to its long-term 200-day moving average (200-dma), but weakened relative to its short-term 50-day moving average (50-dma). However, the index's 50-dma relative to its 200-dma improved for a ninth straight week to a 21-week high, and was in a Golden Cross for a third week after being in a Death Cross for 16 weeks. It had been in a Golden Cross for 137 weeks through late November, and its previous Death Cross lasted for 17 weeks through April 2016 (when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016). The current Golden Cross reading of 1.5% is up from 0.9% a week earlier and from -5.2% in early February, which had matched the lowest reading since November 2011. It's still down from a 55-month high of 7.2% in February 2018. The S&P 500's 50-dma rose for the tenth time in 11 weeks, after falling for 16 straight weeks in its worst downtrend since before the 2016 election. The index edged down to 3.7% above its rising 50-dma from 4.0% a week earlier, and is down from 6.6% during mid-February, which was its highest since October 2011. That compares to a seven-year low of 12.0% below at the end of December. The 200-dma rose for an 11th week after falling in 11 of the prior 15 weeks in the first downtrend since May 2016, when it had been slowly declining for nine months. The S&P 500 improved to a 28-week high of 5.3% above its rising 200-dma from 5.0% a week earlier. That compares to 14.5% below its falling 200-dma on December 24, which was the lowest since April 2009. However, it remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators ([link](#)): Ten of the 11 S&P 500 sectors traded above their 50-dmas, down from all 11 a week earlier, as Health Care moved back below in the latest week. That's a dramatic improvement from early January when all 11 were below. The longer-term picture—i.e., relative to 200-dmas—shows nine sectors trading above currently, down from 10 a week earlier, as Health Care moved below for just the second time in 14 weeks. Energy is the only other sector still trading below its 200-dma, as it has done for the last 27 weeks. Eight sectors are now in the Golden Cross club (with 50-dmas higher than 200-dmas), the highest count since mid-November and unchanged from a week earlier. Among the three laggards, Materials has been out of Golden Cross territory for 50 straight weeks, Financials for 26 straight weeks and during 37 of the past 41 weeks, and Energy for 22 weeks. All 11 sectors had been in a Golden Cross in January 2018 (for the first time since a 26-week streak ended in October 2016). Ten sectors now have rising 50-dmas, down from all 11 a week earlier, as Health Care turned down. Energy and Materials are still the only sectors with

falling 200-dmas; which compares to just two sectors with rising 200-dmas in early January in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.

US ECONOMIC INDICATORS

Consumer Sentiment ([link](#)): “Consumer confidence continued its sideways shuffle in early April, posting an insignificant decline following the small gain recorded last month,” according to Richard Curtin, director of the University of Michigan consumer survey. The Consumer Sentiment Index (CSI) fell in mid-April for the first time in three months, as the impact of tax reform legislation on consumer confidence has all but disappeared, according to the report. (The data do not imply that consumers were pleased or displeased with the reforms, especially the limitations on SALT deductions.) The overall CSI slipped to 96.9 in mid-April after climbing from a 27-month low of 91.2 at the start of the year to 98.4 in March, as the expectations component slipped to 85.8 after rebounding from 79.9 in January to 88.8 in March. Meanwhile, the present situation component climbed for the second month, from 108.5 in February to a four-month high of 114.2 this month.

Import Prices ([link](#)): Import prices in March rose for the third month after dropping sharply the last two months of 2018. Prices advanced 0.6% in March and 1.7% the past three months after sinking 3.0% during the two months through December. Petroleum prices soared 23.5% the first three months of the year after plunging 28.0% the final two months of last year, while nonpetroleum import prices increased 0.2% for the second month after dropping 0.6% in January—which was the steepest decline in four years. Versus a year ago, import prices were flat, narrowing steadily from -1.6% in January—which was the biggest yearly decline since August 2016. The yearly rate for petroleum prices (3.9% y/y) turned positive for the first time in four months after dropping from a recent peak of 44.6% last August to a recent low of -12.7% at the start of this year. The rate of nonpetroleum prices was slightly negative, at -0.3% y/y—holding just below zero for the third consecutive month. The rate for capital goods imports (-1.0% y/y) fell further into negative territory, after falling below zero in October for the first time since May 2017, while the rate for industrial materials & supplies (2.0) turned positive again after three months in negative territory. The price for consumer goods ex autos (-0.2) was below year-ago levels for the first time in 14 months, though barely, while auto prices were fractionally below zero for the third month. The rate for food prices (-1.4) turned negative last June for the first time in two years, and continued to fall in March—though the decline narrowed.

PPI ([link](#)): The Producer Price Index for final demand in March posted its largest gain in five months, driven by a spike in goods prices. Total prices rose 0.6% in March after a 0.1% uptick in February, which followed small declines the prior three months. Prices for final demand goods jumped 1.0% (the most since May 2015) following a 0.4% gain in February; these gains followed a three-month slide of 1.8%. Over 80% of March's gain can be traced to a 5.6% jump in energy—driven by a 16.0% increase in gasoline prices. Meanwhile, prices for final demand services advanced 0.3% last month after no change in February and a 0.3% increase in January. March's rise was attributable to a 1.1% jump in prices for final demand trade services—which measure changes in margins received by wholesalers and retailers. The yearly inflation rate for the headline series increased to 2.1% y/y after easing to a 20-month low of 1.9% in February. The yearly rate for final demand goods accelerated for the second month, to 1.3% y/y, from January's 26-month low of 0.5%; the rate was at 4.4% eight months ago. Meanwhile, the rate for final demand services (2.5% y/y) remained in a year-long flat trend between 2.4% and 2.8%. The rate for finished goods less food, energy & trade services slowed to 2.0% y/y—the lowest since August 2017.

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production ([link](#)): February output in the Eurozone edged lower after rebounding

in January from declines during three of the final four months of 2018. Industrial production (excluding construction) ticked down 0.2% following an upwardly revised 1.9% (from 1.4%) jump in January; output tanked 2.7% during the four months through December to its lowest level since June 2017. During February, only consumer nondurable goods output increased, climbing 0.9% m/m and 3.0% the first two months of the year. Volatile energy (-3.0%) output posted the biggest decline, more than reversing January's 2.7% jump, followed by consumer durable (-0.4) and capital (-0.4) goods production, with intermediate (-0.1) goods output little changed. Here are the output growth rates, from highest to lowest, versus a year ago: consumer nondurable goods (2.8% y/y), capital goods (0.5), consumer durable goods (0.2), intermediate goods (-0.6), and energy (-5.9). February data are available for the top four Eurozone economies, and the results were mixed. Italy recorded the biggest gain among the four, advancing 0.8% m/m and 2.7% the first two months of the year, while France's rose 0.4% in February and 1.8% the past three months. Spain (to -1.1% from 3.7%) posted the biggest decline after posing the biggest gain in January, following a 3.1% slump the last two months of 2018. Output in Germany contracted for the fifth time in six months, by 0.4% in February and 2.2% over the period. Based on yearly comparisons, Germany (-2.0% y/y) was the third weakest among the Eurozone economies, behind Latvia (-3.1) and Portugal (-2.9); the strongest gains were observed in Slovakia (5.6), Estonia (4.5), Slovenia (4.3), and Lithuania (3.9).

UK Industrial Production ([link](#)): Output rebounded sharply the first two months of 2019 after contracting the final five months of 2018—with manufacturing production particularly robust. Headline production increased 0.6% in February and 1.4% ytd after sliding 1.3% during the five months through December. Factory production advanced 0.9% in February—with 11 of the 13 subsectors rising—and followed a 1.1% gain in January, which was the strongest since September 2017. Looking at the main industrial groupings, production of consumer nondurable (3.1%) and consumer durable (2.6) goods led gains the first two months of this year, followed closely by intermediate (2.5) goods; output of capital goods rose 1.0%, while energy (-0.2) output was basically flat. Meanwhile, March's M-PMI (to 55.1 from 52.0) climbed to a 13-month high as companies stepped up production to build up inventories in advance of Brexit and also meet rising inflows of new work. New business improved from both domestic and export markets.

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