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TRENDMACRO LIVE!

On Yellen at Jackson Hole

Friday, August 25, 2017
Donald Luskin

By bucking Trump's deregulatory crusade, she just lowered her chances of reappointment.

Fed Chair Janet Yellen's speech this morning at Jackson Hole exclusively concerned financial stability, and contained virtually no clues about the direction of monetary policy. *However, Yellen used it to position herself as an opponent of significant rollback of financial regulation – and that lowers the probability that a deregulation-minded President Donald Trump would re-appoint her for another term. That, in turn, could imply significant policy risks – especially if Trump bows to pressure from the GOP establishment to appoint someone with a hawkish policy predisposition* (see "Trump's New Faces on the Fed" June 5, 2017).

- *The speech is, at the margin, a negative for growth prospects*, hence the modest risk-off reaction to it in markets. On the one hand, if Yellen *is* reappointed, it is disappointing that she will be an unenthusiastic partner in Trump's deregulatory mission. On the other hand, if she *is not* reappointed, we face the uncertainty that a perma-hawk like John Taylor or Marvin Goodfriend could replace her (again, see "Trump's New Faces on the Fed").
- *No one really knows where National Economics Council Director Gary Cohn's policy predilections lie. But he is not known to be a policy hawk, and would very likely support financial deregulation* (see "On the July FOMC, and Cohn for Fed Chair?" July 26, 2017)

The headline from the speech is that *Yellen said "any adjustments to the regulatory framework should be modest."*

- She is saying politely what Vice Chair Stanley Fischer said most impolitely last week: "One can understand the political dynamics of this thing, but one cannot understand why grown intelligent people reach the conclusion that [you should] get rid of all the things you have put in place in the last 10 years… I find that really, extremely dangerous and extremely short-sighted."
- Yellen claimed in her speech,

  "The balance of research suggests that the core reforms we have put in place have substantially boosted resilience without unduly limiting credit availability or economic growth."

- How different this is from her repeated statements, over the years

Update to strategic view

US FED, US MACRO: Yellen's chances for reappointment as Fed chair just got worse. By coming out as an opponent of relaxing financial regulation, she is signaling she would be a poor partner for Trump's deregulatory crusade. But if he appoints someone else, there is the risk it will be a permahawk like Taylor or Goodfriend, preferred by the GOP establishment. Cohn is an unknown on policy, but there is no reason to think he is a permahawk, and he would likely champion a rollback of regulations. The speech is, at the margin, a negative for growth because it creates these uncertainties. Meanwhile, the market is correct – under current inflation and growth assumptions – to see only two more rate hikes over three years. We see no risk from the onset of a gradual and tightly-capped balance sheet normalization program.

[Strategy dashboard]

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of her chairmanship, that tight credit conditions were limiting growth and contributing to the era of "secular stagnation." Among many, in September 2014 she said,

"…a variety of headwinds resulting from the crisis…have slowed growth, led to a sluggish recovery from the crisis, and…these headwinds will dissipate only slowly…an example would be the fact that mortgage credit really is, at this point, available really to those with pristine credit…"

- Or in December 2014,

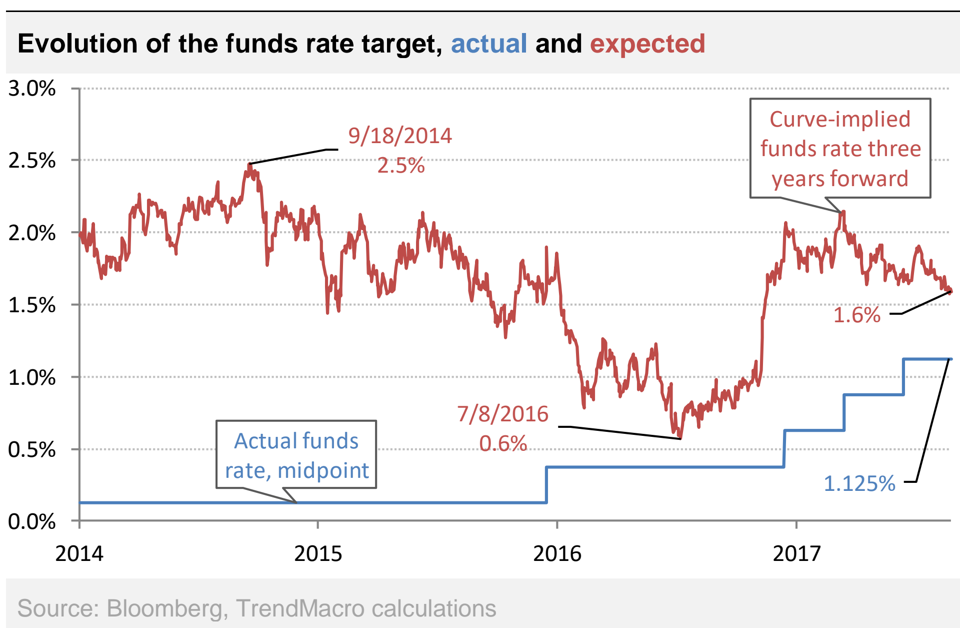
"I've been surprised that housing hasn't recovered more robustly than it has. In part, I think it reflects very tight credit – continuing tight credit conditions for any borrower that doesn't have really pristine credit, you know, credit ratings…"

- Anyone who doesn't think that's the direct result of over-regulation should look at any of the thousands of pages in the compliance section of the website of the Consumer Financial Protection Bureau.
- And while arguing this morning that today's financial regulations have been successful and should not be rolled back much, *she concludes that regulation itself is a source of instability*:

"…yes, regulation will result sooner or later in the all-too-familiar risks of excessive optimism, leverage, and maturity transformation reemerging in new ways…"

With this morning's speech having nothing to do with monetary policy, let us review where our forecasts and outlooks already were, and remain.

- *We think the market is generally correct in anticipating that the*



Evolution of the funds rate target, actual and expected

Source: Bloomberg, TrendMacro calculations

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Recommended Reading

How Wall Street Learned to Stop Worrying About the Debt and Love Tax Cuts
Max Abelson
Bloomberg BusinessWeek
August 24, 2017

The Magical Thinking Opposition
Scott Adams
Scott Adams' Blog
August 22, 2017

The Great Nazi Scare of 2017
Holman Jenkins
Wall Street Journal
August 23, 2017

Was I Right to Pull the Plug on a Nazi Website?
Matthew Prince
Wall Street Journal
August 23, 2017

[Reading home]

Fed's rate-hiking cycle is mostly done. The curve now anticipates only two more hikes over three years (please see the chart on the previous page).

- This is consistent with Fed statements that it will soon begin experimenting with letting its asset portfolio run off through limited maturation (again, see "On the July FOMC, and Cohn for Fed Chair?").
- *The Fed will see the onset of balance sheet normalization as a risky experiment, and will not wish to either add to the risk of it, or make market reactions to it harder to interpret, by hiking rates at the same time.*
- A June policy statement said the fed "will not cease or commence phasing out reinvestments until normalization of the federal funds rate is well under way." The funds target midpoint now is 1-1/8%. If that's "well under way," then the curve's expectation for a 1.6% funds rate in three years makes sense.
- We don't believe that the normalization of the balance sheet – especially given the very restrictive caps on the amount that will be permitted to mature each month – will have any market impact at all (see "Time for Taper Tantrum Two?" April 6, 2017).
- All that said, the curve's expectations for the funds rate impound expectations for lackluster evolution of the economy – particularly, the evolution of inflation.
- Market-implied expectations for inflation have risen off their lows of a year ago in the wake of the Brexit panic, but they are still quite low by any historical standards. We think they are depressed primarily by persistently low crude oil prices (see "On the June FOMC" June 14, 2017), and we think they will perk up when either oil and growth – or both – surprise on the upside (see "On the June FOMC" June 14, 2017).
- *When and if they do, then there would be more rate hikes than currently anticipated, but that doesn't mean that policy will become any tighter than anticipated. More hikes don't equate to tightening, provided they happen in lockstep with improving inflation and growth.*

Fed chairs at Jackson Hole in the new millennium

2017: Yellen

2016: Yellen

2015: *None*

2014: Yellen

2013: *None*

2012: Bernanke

2011: Bernanke

2010: Bernanke

2009: Bernanke

2008: Bernanke

2007: Bernanke

2006: Bernanke

2005: Greenspan

2004: Greenspan

2003: Greenspan

2002: Greenspan

2001: Greenspan

2000: Greenspan

Bottom line

Yellen's chances for reappointment as Fed chair just got worse. By coming out as an opponent of relaxing financial regulation, she is signaling she would be a poor partner for Trump's deregulatory crusade. But if he appoints someone else, there is the risk it will be a permahawk like Taylor or Goodfriend, preferred by the GOP establishment. Cohn is an unknown on policy, but there is no reason to think he is a permahawk, and he would likely champion a rollback of regulations. The speech is, at the margin, a negative for growth because it creates these uncertainties. Meanwhile, the market is correct – under current inflation and growth assumptions – to see only two more rate hikes over three years. We see no risk from the onset of a gradual and tightly-capped balance sheet normalization program.