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Amundi Pioneer
ASSET MANAGEMENT

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INVESTMENT TALKS

New Fed Chair:
Positive for Banks and GDP

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November FOMC Statement

As expected, the Federal Open Market Committee (FOMC) stood firm on its forecast for rate hikes in its November statement, which over the next year, foresees one hike in December and another three in 2018. While the overall statement contained no significant surprises, at the margin, the Federal Reserve (Fed) adjusted its view of both growth and inflation. The Fed appeared to upgrade its assessment of economic growth, moving from “rising moderately” to strengthening at a “solid rate”, while further downplaying any long-term or negative effects of the third quarter hurricanes. Counterbalancing this improved view of growth, however, was a more negative assessment of inflationary pressures. While the Fed continues to anticipate that the inflation rate may stabilize at their 2% target in the medium-term, they characterized core inflation, excluding food and energy, as “soft.”

New Fed Chair Nominee

The more significant FOMC event of the week was President Trump’s nomination of Governor Jerome Powell as the new chairman of the Federal Reserve Board. With this nomination, President Trump appears to have chosen the status quo with respect to monetary policy, rather than “draining the swamp” with a more dogmatic candidate like John Taylor. In light of record levels in the stock market, improving US GDP growth, and continuing declines in the unemployment rate, Trump seems to have been convinced that the slow and steady approach that has characterized Chairman Yellen’s tenure should be continued. Intent on “making his mark,” Trump chose to replace Yellen, but has opted for the candidate who has most aligned himself historically with Yellen in terms of the economic outlook and monetary policy. Interestingly, while Powell has been a Fed governor since 2012, and before that worked in the Department of the Treasury, he is not an economist and is the first non-economist since William Miller, who was succeeded by Paul Volcker.

The notable and perhaps critical difference leading to Powell’s nomination may have been his views on regulation. While Yellen has been outspoken in her defense of the increased regulation of the financial sector following the 2008 financial crisis, nominee Powell has taken a more pragmatic approach to regulation. While Powell voted for most of the financial reforms enacted since 2008, he has supported cost-benefit analysis with respect to financial regulations and believes the Volcker Rule should be amended.

Some investors supported the nomination of John Taylor, who developed the Taylor Rule, which in its original 1993 form, currently supports a significantly higher Fed Funds rate. Taylor has been very critical of the continuation of extraordinary easy monetary policy even as economic fundamentals have normalized. Taylor’s hawkish approach, however, could hurt future economic growth, thereby undermining one of Trump’s core campaign promises to create jobs.

Amundi Pioneer Analysis

We concur with the FOMC regarding improving economic growth. Among other data, our view is supported by strong business and manufacturing surveys, the 3.0% higher-than-expected third quarter GDP growth, and stronger retail sales. We take issue, however, with the FOMC's downgraded view of near-term inflation. The recent uptick in average hourly earnings to 2.9%, from a recent low of 2.5% in May, suggests that tighter labor markets are feeding into wage pressures. In addition, Producer Price Index (PPI) inflation has picked up. We would observe that with 33 of 36 countries reporting Purchasing Managers Index (PMI)s over 50, global growth appears synchronized and strong, and it is likely that higher inflation, which is a lagging indicator, will follow. (Source: BCA Research).

Jerome Powell's nomination seems to support the status quo. We would observe, however, that Powell's more mixed attitude toward regulation relative to Chair Yellen, coupled with the anti-regulation stance of Randal Quarles, vice chair for bank supervision, may lead to eased regulations for financial institutions and an increased supply of credit, which may contribute to higher GDP growth.

With Powell's appointment, we believe that the market continues to be "behind the curve" with respect to interest rates, and that the Fed may meet its forecast of raising rates four times by the end of 2018. We believe prudent investors may want to reconsider their investment in index strategies, and seek out thoughtful active managers, who can help mitigate the impact of rising rates in this stronger growth environment.

Important Information

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