Mr. President, Please Stop Tweeting!

By Stephen Slifer *Thu, Sep 5, 2019*

'If, as appears, Fed policy is truly being influenced by pressure from Trump, then we will have reckless monetary policy combined with fiscal policy that is out of control,' writes our guest columnist.

Trump's tweets are preventing him from achieving the 3.0% GDP growth he hoped for. Their random nature is unsettling to business leaders whose confidence has been shaken. As a result, investment spending has slowed. Productivity growth should soon follow.

It is now hard to envision potential GDP growth quickening to 2.8%. A 2.3-2.5% pace seems more likely. That is not bad, but it could have been so much better.

To us, the issue is no longer about tariffs and trade and their possible impact on the economy. They might shave a couple of tenths of a percent from GDP growth next year, but they are not going to turn an otherwise healthy economy into a recession.

The issue is about Trump and his relentless tweeting. We have tried hard to separate our views about Trump, the man, from his economic policies. We wholeheartedly supported his tax cuts and his enthusiastic support of de-regulation. That action boosted business confidence, increased the willingness to invest, and seemed likely to raise potential GDP growth from 1.8% a couple of years ago to 2.8% by the end of this decade.

But his trade policy this past year and recent Fed-bashing are undoing some of the benefits from the tax cuts and the focus on de-regulation which boosted business confidence.

While we were not enamored with his initiation of a trade war with China, if the goal was to force China to change its business practices and play by the same rules as other countries then perhaps it was worthwhile. But that goal came with a price – tariffs would reduce U.S. GDP growth slightly.

But the way he has chosen to implement trade policy has unnerved the business community. The haphazard imposition of tariffs one day followed by their removal or delay a day or two later is disquieting. Business leaders have no idea what to expect next.

A once high level of business confidence is beginning to fade, which means corporate willingness to invest is less now than it was a year ago. If investment slows, productivity growth (which has accelerated considerably) is likely to slow, which means that a pickup in potential growth to 2.8% will be difficult to achieve

Then there is Trump's unprecedented Fed bashing. He has been pressuring the Fed to cut rates since the beginning of the year. He expected his tax cuts to produce GDP growth of 3.0%. Because that has not happened, he lays the blame squarely on the Fed.

On August 23 at the Kansas City Fed's annual retreat Fed Chair Powell did not explicitly state that the Fed would initiate a series of interest rate cuts. Trump lashed out with, "My only question is, who is our bigger enemy, Jay Powell or Chairman Xi?"

Seriously? For years monetary policy has been based on the Fed's assessment of the future path of GDP growth, inflation, and the unemployment rate. In other words Fed policy should be "data dependent." And it has worked well. But that concept has been tossed into the garbage.

The current Fed story is that Trump's tariffs are so likely to slow the pace of economic activity that there is a compelling case for lower rates now. The Fed claims that in a low-interest rate environment it must act sooner than in the past to prevent the economy from weakening.

Thus, the Fed springs into action to head off something that may or may not occur, despite any compelling evidence to suggest that a slowdown lies ahead.

First quarter GDP growth was 3.1%, second quarter growth was 2.0%, third quarter growth seems on track to be 2.3%, the unemployment rate is at a 50-year low of 3.7%, jobs creation is steady at 170,000 per month, consumer confidence is near a 15-year high, consumer spending is steady at a 2.7% pace, and the stock market reached a record high level on July 26.

Despite all of those signs of solid economic growth the Fed not only cut rates 0.25% on July 31, it hinted strongly that further rate cuts were likely by year-end. This makes no sense.

On March 20 not a single Fed official anticipated a cut in the funds rate by year-end. By June 19, eight of 17 FOMC committee members expected the funds rate to be cut by the end of the year, and seven of the eight anticipated two cuts rather than one.

What happened? Trump's tweets. Trump significantly ramped up his anti-Fed rhetoric in June and the Fed has apparently capitulated to the political pressure. We never thought that would happen.

Once the Fed started talking about significantly slower GDP growth, the markets raised the recession flag. Short-term interest rates began to anticipate a 1.0% drop in the funds rate. In a slow growth environment inflation was likely to slow so long-term interest rates also declined.

Now, almost everybody seems to expect economic weakness and/or a recession in the months ahead. Trump started it by telling the Fed that it needed to cut rates by 1.0%. The Fed surrendered and started talking about how trade could significantly slow growth by year-end. The markets believed the Fed and began to price in substantially lower short-term and long-term interest rates.

It has become a self-reinforcing negative feedback loop – started by Trump. While that may be the consensus view, we still do not buy it.

What we don't understand is his relentless Fed bashing. It is unwarranted. Prudent monetary policy has successfully guided the U.S. economy to the two longest expansions on record. The record-breaking expansion of the 1990's lasted exactly 10 years. That record has now been shattered by the current expansion, which has surpassed the 10-year mark and is still going strong. That is no accident. The Fed has done a great job of producing steady growth.

But well-run monetary policy is now being threatened by Trump. If, as appears, Fed policy is truly being influenced by pressure from Trump, then we will have reckless monetary policy combined with fiscal policy that is out of control. Policy makers in Washington still pay no attention to a steady diet of $1.0 trillion per year budget deficits and an outstanding level of debt that is rising rapidly. In the long run that is a dangerous combo.

None of this suggests that a recession is imminent. It is not. But without some stability in monetary and fiscal policy, a pick-up in potential GDP growth to 2.8% – which was once within our grasp – will be difficult to achieve. Going forward, a potential growth rate of 2.3-2.5% seems more likely. That is still acceptable, but we could have done better. Mr. President, please stop tweeting!