

An odd week ahead

Some more awful GDP data is on the cards, but the Fed is in focus, and will likely say something supportive while we await the next fiscal package



Garbage

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Monetary policy to the rescue?

While the US politicians continue to bicker about what to do in terms of additional fiscal policy (more of a question of when, how much and on what, than if, in my view) the Fed meeting on Wednesday will doubtless come to the markets' rescue with some comforting words.

Precisely what remains a wild guess. In [James Knightley's FOMC preview](#), he reckons that any strategy changes from the Fed may not come until September. But there is plenty of talk that they will employ more forward guidance, and do so more forcefully.

Some weeks ago, I used the title, "forward guidance, forward garbage", which just about sums up my view of this, and I will explain why shortly. But markets are more easily pleased than me, so it may be enough to placate them while the next dose of fiscal "medicine" (I was going to say methadone) is prepared.

Why is this garbage?

Well, for brevity, let's consider the specific case of forward guidance being considered. Namely, a price level target - and as JK says, this is more likely for September if they do indeed choose to go down this route. But let's take a look anyway. A price-level target is a specific form of an inflation target. But whereas a downside miss for inflation relative to a conventional target in one period has no impact on the policy stance the next period, with a price level target, this implies a widening gap, and a greater effort needed to close the gap. So unlike an inflation target which "re-sets" each period, history matters for a price level target.

All of this would be interesting and relevant, but for one rather important fact. The descent and flattening of the Philipps curve in industrialised nations these days means that to achieve a 2% inflation target consistently and moreover, to make up for today's "undershooting", implies an amount of monetary easing so big that it really ought to worry us, given the likelihood of misallocation of resources, and future financial crises.

Any other form of forward-guidance, such as just making more explicit that rates will not be going up anytime soon, is merely telling markets what they already figured out months ago. So frankly, is of even less interest.

It really does appear that we are unable to learn anything from previous episodes of market boom and bust, going back all the way to the dot-com bubble, savings and loans crisis, and most recently, Global Financial Crisis. Covid-19 is helping propel us in the direction of the next of these I believe. I'm not sure what we will call it, but "The financial crisis where we finally learn that lax monetary policy is the cause, and not just the cure, crisis" would be a contender in my view. Though that optimistically assumes we will figure it out this time.

US picture still very mixed

One of the arguments for the FOMC providing more support at this meeting, even if only through some weasel-words, is that we are likely to see another one of those apocalyptically bad-looking GDP figures. The consensus forecast is, minus 35% seasonally adjusted and annualised (it isn't exactly, but that is close enough once we get down to these sorts of numbers). And so even with the brighter pockets of activity in terms of housing and auto sales (both predominantly driven by older consumers, who are probably dealing with lockdowns much better), this is clearly still a very alarming state of weakness.

Moreover, despite these better pockets of activity, recent jobless claims have suggested that the US economic recovery may be stalling. That may be true, though the latest Covid-19 numbers also suggest that the re-closure of some states and more self-social-distancing by an increasingly alarmed general public, is beginning to pay off. For now, the 7-day moving average (7d ma) of new cases in the US continues to rise, but that trend increase is beginning to flatten off, which is encouraging.

Asia today

Friday saw the second down day in a row by US equities, not helped by a further worsening in US-China tensions. And Asian equity futures are looking more red than green currently. That said, Asian FX, after a soft start, has shown some resilience already today, judging by the litmus-test currencies AUD, CNH and KRW. On balance then, it looks as if the USD is going to remain offered today, and this may persist until after the Fed on Wednesday, and before the GDP result.

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