Active is: Anticipating what's ahead

Facing growing geopolitical risks, Fed will likely cut rates

by Franck Dixmier | 11/09/2019

Summary

While domestic growth appears robust, international risks are rising – including worsening US-China trade tensions and the growing risk of a hard Brexit. As such, we think the Fed won't take any chances and expect the central bank to announce a 25bp rate cut at its next meeting.

Key takeaways

- We expect the Fed to cut the fed funds rate by 25 basis points at its 17-18 September Federal Open Market Committee meeting
- Faced with a still-robust economy and growing geopolitical concerns, Fed Chair Powell likely wants to avoid taking risk – preferring instead to keep monetary policy accommodative by lowering short-term rates
- We expect this will meet the market's expectations, and anticipate that long-term rates will stay firmly anchored at today's low levels

The US economy remains robust, driven by household consumption, low unemployment and low inflation. Growth in the service sector had slowed in June and July but rebounded in August, with economic activity (as measured by the Institute for Supply Management's non-manufacturing report) at 56.4% – up 2.7 points from July. However, other recent cyclical data points, including a slowdown in job creation, suggest that growth may continue at a more moderate pace.

It is unclear whether the internal dynamics of the US economy can compensate for the deterioration of the international environment. Trade tensions between the United States and China have grown worse, the risk of a hard Brexit persists and global growth has slowed down. Even though Fed Chair Jerome Powell dismissed the risk of recession in his recent statements, these downside global risks are at the heart of his concerns.

In this power struggle between robust domestic growth and increasing international risks, we do not expect the Fed to take any chances. Instead, we expect the central bank to continue its accommodative monetary policy by keeping the cost of borrowing low. In line with its July announcements, we expect the Fed to confirm its intention to support growth by announcing a 25-basis-point cut in the fed funds rate (a basis point is 1/100 of a percentage point). Like the July cut, this would be a mid-cycle adjustment to support growth. We do not currently view it as an entry point to a cycle of rate cuts.

For their part, the markets expect two rate cuts in 2019 and two more in 2020, and we believe these expectations will be met for the time being. The anticipated September rate reduction should allow long-term rates to stay firmly anchored at low levels, and should contain the appreciation of the US dollar.

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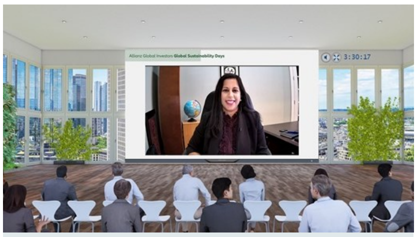

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Active is: Anticipating what's ahead

Is the ECB using a misguided inflation measure?

by Martin Hochstein | 09/10/2019

Summary

Inflation can significantly erode purchasing power, but the ECB may be underestimating the true increase in consumer prices by relying on a narrow measurement. Investors may want to ready their portfolios for a higher rate of real-world inflation in the euro zone, perhaps by employing an actively managed mix of equities, real estate and commodities.

Key takeaways

- The ECB seems to be focusing on an incomplete inflation measure, leaving out a key metric related to housing; unless the ECB fixes its approach, it may continue missing its official inflation target

- If the ECB factored key housing costs into inflation, policymakers might be able to address the kind of real-estate excesses that have historically helped trigger financial crises
- An incomplete inflation measure could expose bonds and other nominal assets to "stealth devaluation"; investors may want to consider real assets like equities, real estate and commodities as an inflation hedge

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