

Flash Note

Federal Reserve – New sheriff in town

Powell is cut from the same cloth as Yellen

Pictet Wealth Management - Asset Allocation & Macro Research | 3 November 2017

President Trump has nominated Jerome ('Jay') Powell to succeed Janet Yellen as Chair of the Federal Reserve from February 2018.

Powell is likely to stay true to Yellen's approach and unlikely to accelerate the tightening cycle set in motion by his predecessor.

Many politicians' focus is on banking de-regulation, a task likely to be carried forward by the newly appointed vice chair for banking supervision, Randal Quarles.

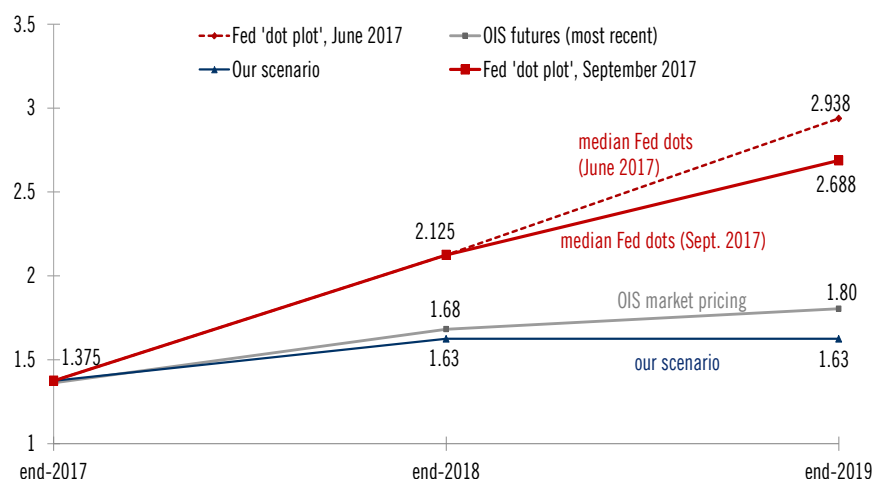
Our Fed scenario remains unchanged. We still see two further rate hikes (one in December, the other in March next). The risk of a June rate hike is rising given recent stronger-than-expected economic momentum.

On 2 November, President Trump nominated Jerome ('Jay') Powell to succeed Janet Yellen at the helm of the Federal Reserve System, confirming recent press speculation. The next step before the new Fed chairman can enter office next February is Senate confirmation. This looks unlikely to be problematic for Powell.

From a monetary policy perspective, Powell is unlikely to be very different from Yellen (who was herself very much in the vein of her predecessor Ben Bernanke). Powell is centrist-to-dovish, and the Fed is likely to remain prudent in its rate-hiking cycle as a result. In other words, rate hikes will most probably remain on the slow track. Powell's landing the role therefore leaves unchanged our monetary policy scenario, which foresees two 25bps hikes ahead (one in December, the other in March 2018).

Powell has broadly followed the Yellen line since being appointed Fed governor in 2012. Powell, who does not have a PhD in economics (he is a lawyer by education), appears to be strongly influenced by the Fed research staff, which tends to be dovish. This influence will most probably continue. The key pillars of the Yellen-Bernanke policy 'dogma' are likely to remain in place. Like them, Powell believes in the Philips curve link between a tighter labour market and higher inflation. He also believes that the theoretical neutral rate has shifted down significantly in recent years, which should limit the magnitude of rate hikes in the current cycle. This is why we think the Fed will indeed stop when short-term rates near 2% (by comparison, the Fed's interest rate on excess reserves now stands at 1.25%).

Rate hikes: The gap between Fed members' views and market pricing is still large



Source: Pictet WM-AA&MR, Thomson Reuters (as of 2 November 2017).

AUTHOR

Thomas COSTERG
tcosterg@pictet.com
+41 58 323 3963

Pictet Group
Route des Acacias 60
CH - 1211 Geneva 73
www.pictet.com

Will the Powell Fed step back from the spotlight?

Powell, also a former executive at a large Washington DC-based private equity group, has generally kept a low profile during his time as a Federal Reserve governor. His speeches have been very measured in tone, in contrast with that adopted by some regional Fed presidents. Powell's pronouncements generally reflect strong consensus-building skills and an ability to listen (particularly to the academically oriented Fed staff).

This contrasts somewhat with Trump's bombastic rhetoric and his willingness to rock the boat in Washington DC. Powell will definitely rock no boat at the Fed. His nomination probably echoes many Republicans' desire to see the Federal Reserve take a backseat after having been constantly in the spotlight since the financial crisis and several rounds of highly controversial quantitative easing. In a sense, Powell's nomination is the embodiment of efforts to push the Fed back to its more traditional role of payment-clearing house.

Many politicians, including probably Trump himself, are less interested in the Fed's role in setting monetary policy than in its role as banking regulator. Looser banking regulation is the current key priority of many Congressional Republicans, who have complained that the post-crisis regulation push went too far, choking credit to the economy and actually weakening the banks themselves (a view that remains debatable). In that respect, the spotlight will be on Randal Quarles, the Fed's newly appointed Vice Chair for Supervision.

While Powell has been advocating a more relaxed approach to regulation, but no deregulatory big bang, we think that Quarles, an avid de-regulator, will probably take the lead in the deregulation efforts. It will be interesting to watch how the relationship between the two men evolves.

It will be equally interesting to see who is nominated to the other vacant seats on the Fed board. The nominations could affect how decision making evolves at the Fed. Trump has remained quiet about these vacancies.

In the near term, the Fed appears very likely to hike rates another 25bps at the 13 December meeting, given solid economic data (which trump weak core inflation readings) and loose financial markets conditions. The current market probability of a December rate hike is 88%, according to Bloomberg data.

Notice: This marketing communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance.

The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

This document is issued by Banque Pictet & Cie SA. This publication and its content may be cited provided that the source is indicated. All rights reserved. Copyright 2017.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Distributors: Banque Pictet & Cie SA, Pictet & Cie (Europe) SA