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‘The Powell Put’ – 12 February 2019

Recently, Jerome Powell ï Chair of the Federal Reserve (Fed) - essentially reversed the policy of Americaôs central bank: instead of a regular programme of interest rate rises in 2019, intended to end Quantitative Easing (QE), and to ónormaliseô interest rates, the interest-rate hiking cycle will be paused.

He also said that the Fed is ready to ñadjust the size of the óbalance sheet run-offôñ, that is, the process of reducing the huge portfolio of bonds which has accumulated during QE.

So what?

What markets had been afraid of was the possibility of ópolicy errorôï that is the Fed would be so fixated on normalising rates that it might plunge the US economy into recession by raising them too far and too fast.

A policy error from the US Fed is therefore much less likely. In effect, rate rises are on hold, unless and until there is evidence of continued above-trend economic growth and/or an increase in inflation.

This is good news for the world economy because:

1. Borrowing is still effectively ócheapôï interest rates will continue ólower for longerô
2. Pressure for the $ to rise in value is reduced
3. Companies, especially in Emerging Markets, with $ loans will have lower costs
4. Highly-leveraged companies have more time to reduce their borrowing

And?

Markets reacted positively, rising back to levels of early December 2018. Were the $ to óroll overôï that is peak and perhaps fall in value - Emerging Markets will feel the benefit.

Lower levels of growth are still expected in 2019, but the removal of worries around a Fed-induced recession is good news for equity investors.

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