# Protectionism, war and monetary tightening not a good mix

**The Week Ending Friday March 24th 2018**

Instead of unexpectedly good earnings news to boost equities past recent record highs, we got two big changes from Trump that set alarm bells ringing around the world and did impact equities. It turns out the iron and steel tariffs were just a starter. The $60bn-worth of Chinese imports is the main course and clearly a huge concern hitting the share prices of many US equities early and mid-week. At the end of the week, the change in National Security Adviser to a well-known hawk made an escalation in conflict more likely – pushing up oil prices already jittery by a surprise fall in stockpiles.

**Possibly volatile cocktail**

On top of this new news from Trump came a seemingly autopilot rise in rates from the FOMC. On its own the rate rise would have been necessarily a concern as the slow ramp up in NGDP growth during 2017 has been relatively untroubled by the rate rises. The yield curve had flattened somewhat, but at higher levels – a good sign and perfectly normal. However, rate rises on autopilot seemingly oblivious to the threats to growth from politically inspired shocks is a less welcome move.

**Not enough evidence from Powell of his views, competence or power**

We would expect Powell ultimately to be very pragmatic and ease back on rate rises and thus send a message he was aware of events outside of "highly uncertain" projected inflation rates. Whether he can command a consensus inside the FOMC is less clear given the fact that 4 out of 7 Fed Board seats are vacant and that the usually loyal NY Fed chief could be replaced by something of a wild card, chosen for reasons of political correctness rather than competence or market expertise.

**Contagion limited, limiting impact on our forecast**

Our NGDP Forecast for one year out will have fallen further on Friday due to the equity market retreat. It is unlikely to have fallen below 4%, however, due to the relatively little contagion to bond markets, the USD or the broader commodity index.

**Money supply growth falling**

Other types of monetarists are more concerned about current trends. The narrow money monetarists are seeing some sharp reductions in growth that is worrying them. Broad money monetarists also seem worried.

Undoubtedly, many market participants will also be looking at these trends and positioning their portfolios accordingly. These investors and traders are not yet dominant or we would be seeing greater moves in markets and thus greater impact on our NGDP Forecast. Still, we have enough respect for our monetarist colleagues to share some of their concerns. Things are fragile perhaps, as illustrated by the equity market reactions to this week’s political and economic (FOMC) news.

**What happens to velocity also matters**

Market Monetarism is distinct from mainstream monetarism in that it believes velocity of money circulation can vary in the short term and impact NGDP too. In addition, Market Monetarists think that markets are a good guide to the interaction between actual money supply growth and velocity.

Confidence that a central bank would dampen any fluctuation in actual money demand (velocity) will help keep NGDP growth constant.

**Economic news to take a back seat**

Data was quiet as expected but the coming week will see more data. We will welcome the third estimate of 2017Q4 GDP as it brings the GDI version we prefer. Also released will be the February PCE data, in particular the PCE Price Indexes, headline and core, that the new Fed Chair says is what he will pay more attention to than those highly uncertain projections. A continued low reading will lead directly to questions as to why he raised rates last week.

China’s response to the major tariff changes will be one of the near term drivers for markets. Equally, any sign that National Security Advisor John Bolton is influencing actual policy that could lead to greater conflict will also have a big impact. The soon to be retired Dudley and Powell could be active on CNBC if things turn ugly.

Frustratingly, we will have to start watching and listening more to regional Fed chiefs because the centre, i.e. Powell, is a weak leader or just in a weak position given the Board vacancies.