

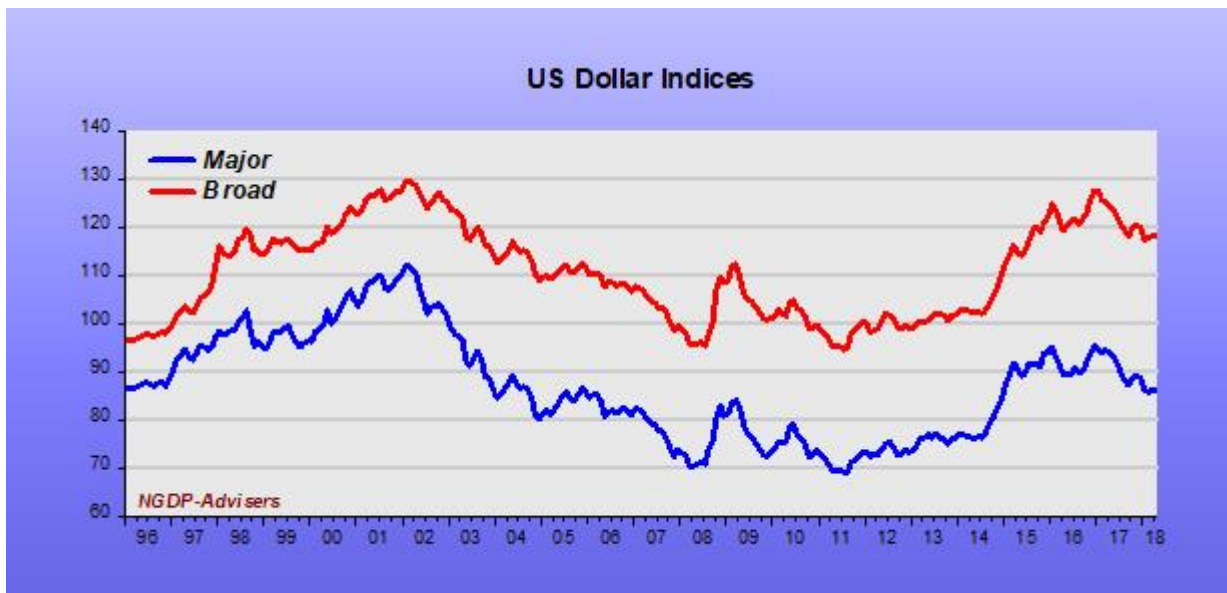
Fed keeps its “asymmetry of bias” stance intact – more’s the shame

The Week Ending Friday May 4th 2018

Last week we speculated about a potential negative surprise from a combination of FOMC meeting and data releases. While there were no dramatic moves in markets on any particular day or news release, the newswires were full of an apparent Emerging Markets crisis. Well, on closer examination what they were referring to was EM currency weakness. On a little more examination, many countries, both EM and Developed Markets, show currency weakness versus the USD. When so many countries are seeing “weak” performance of their currencies against the USD, it really means that the action was in the USD and in the US. The USD has gained a sudden and seemingly surprising strength.

Why is this? FX is notoriously difficult to predict and seemingly easy to analyse ex-post. Also, measuring the value of the USD against the rest of the world is tricky. There are (at least) two popular indices, both trade-weighted. One is “Broad” against a wide range of other countries’ currencies, the other against only “Major” currencies. The key difference being that the Broad index includes countries that more or less peg their currencies against the USD, specifically China. Hence, the Broad index is more stable than the Major index because of these official and unofficial linkages.

It means that the USD was much weaker in the run-up to the Great Moderation and much stronger in the period after the Great Recession (or Long Depression as we at NGDP Advisers sometimes call it).



Although the recent move up in the USD Major Currencies index is not that significant versus the huge swings seen earlier, it is a trend that needs monitoring. In the circumstances of modest nominal and real growth, it must indicate monetary tightening. Our chart from FRED is only up to the end of April, last week the Major Currencies Futures index (a bet on the future of the red line) hit 92.4, a 3% rise in a few weeks off the 2018 lows, a sharp move in such a short period.



Why the USD strength?

What has changed has been a mix of the incoming new Fed chief Powell, and his robot-like rate rises, plus some essentially modest outperformance of nominal growth over the last 6-9 months – and a modest outperformance of a dismal trend at that.

Last week the data was not indicative of any strengthening of nominal growth, but the trends of modest outperformance were consolidated. There was no major pullbacks in YoY growth in the wage data from payrolls even if Average Hourly Earnings growth modestly disappointed for the month.

The projected path of rate rises in themselves won't harm growth, except as indication that the FOMC wants to see a slowdown in nominal growth and will thus be seen by markets to be asymmetrical in its response to inflation – tightening when inflation threatens to approach its targets but looking through any misses on the downside as temporary. This “asymmetry of bias” is exactly the opposite of what it claims, thus keeping a lid on growth, both nominal and real.

Next week we get the CPI data for April, which the Fed says it ignores but doesn't really plus plenty of post-FOMC meeting Fed speakers doing the rounds.
