Weekly Market Insights

December 24, 2018

Jerome Powell, China and Happy Holidays

As most of you are aware, we wrote a special edition this past Friday. In it, we gave our view on what was roiling the financial markets. Therefore, today's piece will be short and sweet, well perhaps not so sweet.

As we all know, the Federal Reserve voted this past week to raise short term interest rates by 25 basis points (0.25%). Not particularly earth shaking. Alas, investors, in our view, misread both the move and Chairman Powell's remarks and the market had an awful day, ending an equally awful week. Old news. Mr. Trump, having tweeted his views concerning interest rates and what he thought the Fed should do, is now rumored wanting to fire Chairman Powell. No one is quite sure whether he can do this or not, but it is very disturbing. The question is, can he be fired as Chair of the Fed? Perhaps, but he can't be fired as Chair of the Open Market Committee, which is the committee that sets interest rates. The Federal Reserve was constructed in such a way as to prevent it from becoming politicized. History has shown an independent central bank is the best way to go. In fact, one reason the RMB, China's currency, is not an important trading or reserve currency is the concern that it is subservient to Mr. Xi. Having said that, we can take a step back and see the difficult position in which Mr. Trump has put Mr. Powell. If he did as the President so publicly wanted, he would put the Fed's independence in doubt. This would cause far more concern than a 25 basis point move in interest rates. We will see how investors react to this new provocation, but it cannot help investor confidence.

China, as we wrote on Friday, is suffering an economic slowdown. No one, of course, knows by how much, but we have written for some time that China's economy couldn't maintain the rapid growth path of the past two decades. There are many reasons for this and we have written about them. But an interesting problem they face may be their President, Mr. Xi Jinping. When Mr. Xi took office many, including us, felt he would move China to the next level of democracy and an open economy. Nothing was further from the truth. Rather than restraining the State Owned Enterprises (SOE) and restricting the enormous inflow of funds to unprofitable companies, he increased it. But perhaps what he did that was most discouraging to China watchers was start to dismantle some of the brilliant, hard fought economic and political changes by Mr. Deng Xiaoping, the leader of China after Mao, 1978-1987. The reinserting of the Communist Party (CP) into the economy and reducing the influence of markets has seriously damaged China's growth picture. Of course, there are other reasons, which we will write about later. But, it is possible we are seeing weakness in the armor. Disagreements are becoming more public and China is, of course, facing a trade war, which it would find very difficult to come out of unscathed. This is not something Mr. Xi needs at the moment.

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