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US Recession Jitters Stoke Fears of Impotent Fed and Fiscal Paralysis

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An ominous paper by the US Federal Reserve has become the hottest document in high finance.
It was intended to reassure us that the world's hegemonic central bank still has ample firepower to overcome the next downturn. But the author was too honest. He has instead set off an agitated debate, and rattled a lot of nerves.
David Reifschneider's analysis - 'Gauging the Ability of the FOMC to Respond to Future Recessions' - more or less concedes that the Fed has run out of heavy ammunition.
The Federal Open Market Committee had to cut interest rates by an average of 550 basis points over the last nine recessions in order to break the fall and stabilize the economy. It could not possibly do so right now, or next year, or the year after. Quantitative easing (QE) in its current form cannot compensate, and nor can forward guidance. They are largely exhausted in any case.
"One cannot rule out the possibility that there could be circumstances in the future in which the ability of the FOMC to provide the desired degree of accommodation using these tools would be strained," he wrote.
This admission is painfully topical as a plethora of data suggest that the US economy may have hit a brick wall in August. The ISM gauge of manufacturing plunged below the boom-bust line to 49.4, and the services index dropped to a six-year low, with new orders crashing nine points.
My own tentative view is that these ISM readings are rogue surveys. The Atlanta Fed's 'GDPNow' tracker points to robust US growth of 3.6pc in the third quarter. The New York Fed version is coming in at 2.8pc.
Yet the US expansion is already long in the tooth after 87 months, and late-cycle chemistry is notoriously unpredictable.
Warning signs certainly abound. Corporate profits have been slipping for six quarters, the typical precursor to an abrupt slump in business spending. "The only thing keeping the US out of recession is the US consumer. If consumption stalls then we really are in trouble," says Albert Edwards from Societe Generale.
I am willing to bet against him for now. The M1 money supply - often a good leading indicator - has picked up after a weak patch earlier this year and is now surging at a rate of 10.1pc. This pace would normally signal a burst of torrid growth a few months later. It is in stark contrast to the monetary contraction before the Lehman crisis.
My presumption is that the day of reckoning has been pushed well into 2017, but in the dead of the night I have a horrible sweaty feeling that Mr Edwards may be right. It is not a time to be chasing stock markets already at vertiginous levels.
And:
History will judge that those nations best able to weather the next global downturn are those that grasp the essential character of our desperate deflationary age, and can cast aside deeply-ingrained and totemic beliefs about debt. The losers will be those spooked by shadows on the wall.
The winners - or survivors - will be those most willing to seize on the cheapest borrowing costs in history to fight back, preferably combining fiscal and monetary in a radical fashion. Call it helicopter money if you want, or 'overt monetary financing' of deficits. The accounting terminology is irrelevant.
Since no country can risk watching its precious national stimulus leak away to free riders in the austerity camp - at least in a crisis - this may imply some degree of calibrated protectionism. The twin liberal pieties of progressive public policy and global free trade may ultimately come into conflict. That is tomorrow's battle.

David Fuller's view
Yes, the Fed would like a cushion in terms of higher interest rates as a defence for limiting the next recession. However, we do not live in an economic environment which would make that possible at this time. Moreover, we can only guess as to when and to what extent circumstances are likely to change in future. So far, the Fed has wisely held off on raising rates, which could make a soft economy even weaker, particularly if the Dollar Index rose, as it most likely

would.
However, it would be mistaken to think that the Fed is in charge of the economy, beyond its role as the regulator of US monetary policy. The traditional three engines of economic growth are consumer, corporate and government spending.

EU Retreat From US Trade Deal Leaves the Field to Britain

They've managed it. The naysayers have succeeded in killing off what would have been the first trade deal signed between the world's two biggest economic blocs.
"TTIP", or the Transatlantic Trading and Investment Partnership between the EU and the US, was meant to be part of the plan for a renewed, competitive Europe, helping its indebted economies to carry the deadening weight of the euro. Instead, it is becoming a potent symbol of EU dysfunction.
After years of protests, petitions and successful peddling of terrifying myths about the deadly threat this deal posed to rights, democracy, safety and the environment, European politicians are capitulating. EU mandarins are trying to keep it together in the face of a tough US stance and competing demands by 27 countries but, in the crystal clear estimation of French trade minister Matthias Fekl, the deal is "dead".
The Eurocrats will continue to insist that, like a convalescent dictator, it is very much alive and well. But to be sure, it is simply resting! Taking the air! But they know as well as anyone else that TTIP - and the useful €120 billion boost they said it would bring the EU economy - is at best being put into a long, deep freeze.
The good news, of course, is that this clears that enormous "queue" for trade deals with the US that Barack Obama was warning us about when he visited Britain before the EU referendum. A post-Brexit UK, he said, would be "at the back" of this queue, and at the G20 last week, he again declared that a UK-US deal won't be a priority. With TTIP dead, however, there is no queue. Saying that Britain is at the back of it is rather like saying that Mr Obama is at the back of the queue of lame duck US presidents leaving office: he's also at the front of it.
Any decision on trading terms between the US and its allies will be down to Mr Obama's successor. Pessimists argue that the anti-globalisation mood taking hold across the pond will preclude any deal making. Donald Trump has demonised trade and even Hillary Clinton has gone lukewarm. But although there is a worrying rise in such hostility, there are reasons to think that Brexit Britain can slip around this roadblock.
The multilateral, sprawling agreements currently running into problems, like TTIP and its Pacific equivalent, are totemic, regional pacts with explicitly geopolitical aims. They are agreed only after torturous negotiations between dozens of countries with different cultures and priorities. They establish remote - and therefore scary-sounding - new regulatory and legal systems and the backlash against them feeds on the idea of a faceless, nationless technocratic class taking over the levers of power at the expense of citizens.
By contrast, a single-country deal with a reliable ally, whose legal system and economy already have much in common with the US, is a less threatening prospect and is unlikely to worry former car workers in Detroit. That is one of the reasons that Mr Trump can insouciantly declare that Britain would certainly not be "at the back of the queue" for a deal, as he did in May.
Mr Trump might not be the most reliable ally. But there are geopolitical reasons why it would make sense for the US to consider a deal, especially if Mrs Clinton wins. It would signal that the UK, a useful US ally in Europe, is not out in the cold. It would help, in a less ostentatious way than TTIP, to expand the sway of economic relations based on the rule of law and regulations, rather than the rule of might favoured by Russia and China. It would also establish a framework to which the EU would hopefully be added in future decades.

David Fuller's view
The global region of greatest uncertainty right now is in the EU. It gives me no satisfaction to point this out but the EU's leaders have brought it on themselves, although the real cost is borne by the citizens of their countries, particularly in the Mediterranean nations.
Today, we can forget all about forecasts of tortuous Brexit negotiations over several years, designed to ensure that the EU was an alliance which countries could join but never leave. The EU's political programme to create 'a United States of Europe' has been derailed because it had no popular support. The absence of border controls in Europe seems like a nice idea but makes no sense in a world where traffickers will swamp countries by bring the world's poor from different cultures to richer democratic nations. A political backlash is underway, not least within Germany and France.

The Weekly View: The Danger of Looking Back: Lessons From Lost Decades
My thanks to Rod Smyth for his ever-interesting letter, published by RiverFront Investment Group. Here is the opening

paragraph:
Our industry's most ubiquitous disclaimer, "Past performance is no guarantee of future results," is good advice. Despite this advice, many investors make decisions based on the emotional journey of past performance - money follows performance. US investors are now pulling money out of international stocks following a decade of flat returns and 6 years of underperformance relative to US stocks; meanwhile, at RiverFront, we are adding to our international holdings.

David Fuller's view
Rod Smyth is a very good contrarian thinker. This is a fascinating issue - a collector's item for students of stock markets.

Draghi Dialing Down the Drama May Mark Wane of Monetary Activism

Take European Central Bank President Mario Draghi, who on Thursday talked up the effectiveness of his institution's stimulus policies to date, but damped expectations that he'll load up with fresh asset-buying soon. His only new announcement after again downgrading euro-area growth forecasts was that officials will look into how to ensure the current program overcomes a worsening scarcity of bonds.

Even with the scheduled end of the 1.7 trillion-euro ($1.9 trillion) plan just six months away, Draghi said policy makers meeting in Frankfurt haven't yet discussed what they'll do when that day comes. If a new laissez-faire tone is creeping in to replace years of hyperactivity, it may be a signal that the division of labor between central banks and governments in providing economic support is shifting.

"Draghi doesn't sound like a central banker who's in any hurry to ease further," said Tim Graf, head of European macro strategy at State Street in London. His stance "fits in with the G-20 statements about using all actors to support growth, including the fiscal side. Taking ever-easier monetary policy for granted is becoming less valid."

Eoin Treacy's view
The ECB faces a number of obstacles to employing a US style quantitative easing program within its jurisdiction. Among these are the relative depths of the respective markets. The ECB has self-imposed rules about how much of any particular issue it can own and how much debt of any one country it can purchase. Additionally, the EU's corporate bond and asset backed markets are not nearly as liquid as their US equivalents, which represent a challenge for the size of purchases the ECB needs to make to have an influence on the market.

Duterte Outbursts Taking Toll as Philippine Stock Losses Mount
This article by Ian C Sayson for Bloomberg may be of interest to subscribers. Here is a section:
"The latest incident raises concern that President Duterte's unpredictable behavior in politics will be disruptive and could eventually spill into economics and business," said Jonathan Ravelas, chief market strategist at BDO Unibank Inc., the Philippines' biggest lender. It's "further weakened a market that's already been made vulnerable by uncertainty over U.S. interest rates, elevated valuations and overseas fund withdrawals," he said.

The Philippine index is trading at 18.3 times 12-month estimated earnings. While that's down from 19.6 in July, it's still the highest in Asia and at a 32 percent premium to the MSCI Asia Pacific Index. The country's economy expanded 7 percent last quarter from a year earlier, after 6.8 percent growth in the first three months of 2016.

Investors may be better off holding cash in the near term as the index could test its 7,500 support level, said BDO Unibank's Ravelas. The gauge could fall as low as 7,330 in the next two months over concerns the budget deficit will rise when taxes are cut and spending raised, April Lee-Tan, head of research at COL Financial Group Inc. in Manila, said Monday.

"Smart investors should take advantage of the weakness and accumulate because this is all sentiment-driven," said Rizal's Palma Gil. "Other than incendiary statements and killings related to the drug war, investors like Duterte's economic and fiscal policies or at least what has been communicated so far," he said, adding that he expected the index would go back up to 8,000.

Eoin Treacy's view
Duterte was elected on a law and order and anti-corruption ticket and admitted in his inaugural address that his methods were unorthodox and would not be approved of by many observers. Here is a link to a video of that address.

Email of the day on bitcoin prices
Regarding Bitcoin, after a summer lull it looks like it is coming into form once again - would welcome another update on the charts/ medium term view which hopefully is of interest to other subscribers. I must say it does have elements that remind me of the 90's tech bubble (volatile, illiquid, devoted followers etc) and I have been following it closely. Many thanks

Eoin Treacy's view
Thank you for this reminder that Bitcoin is a market where fully committed advocates contrast sharply with those who doubt it will ever become a viable medium of exchange. The blockchain foundation on which the market for bitcoin rests has significant potential in recording transactions and reducing the cost and inefficiency of banking, accounting and record keeping over the next few years before it is eventually superseded by quantum computing.

GW Pharmaceuticals Jumps on Report It May Be Acquisition Target
GW Pharmaceuticals Plc jumped after Reuters reported that the company had hired Morgan Stanley as an adviser after being approached by several drugmakers interested in an acquisition.

GW gained 20 percent to $101.47 at 3:31 p.m. in New York trading, its biggest intraday gain since March. Reuters cited people familiar with the matter in its report.

The U.K. company, with a market value of $2.56 billion, develops drugs derived from cannabis. Its leading asset is an experimental treatment for epilepsy, and it's also working on candidates for cancer, type 2 diabetes and schizophrenia. GW has one approved drug, Sativex, which is used to control involuntary muscle spasms from multiple sclerosis.

Insys Therapeutics Inc., which develops drugs based on synthetic cannabis, rose 5 percent to $15.67.

GW, based in Cambridge, England, isn't currently interested in a sale, Reuters reported, citing people familiar with the matter. A representative for GW declined to comment.

Eoin Treacy's view
Cannabis is increasingly being recognised for its uses as a pain reliever and mood stabiliser; confirming what millions of users in the illicit market have testified to for decades. With the tide of public opinion turning there is a race on to secure interests in the sector as companies bet on the potential for further legalisation to be approved in the USA, not least during the November ballot.

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