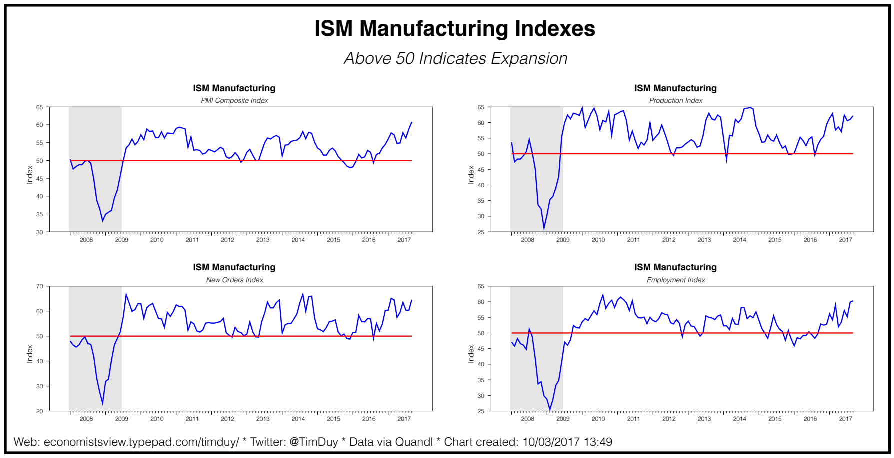
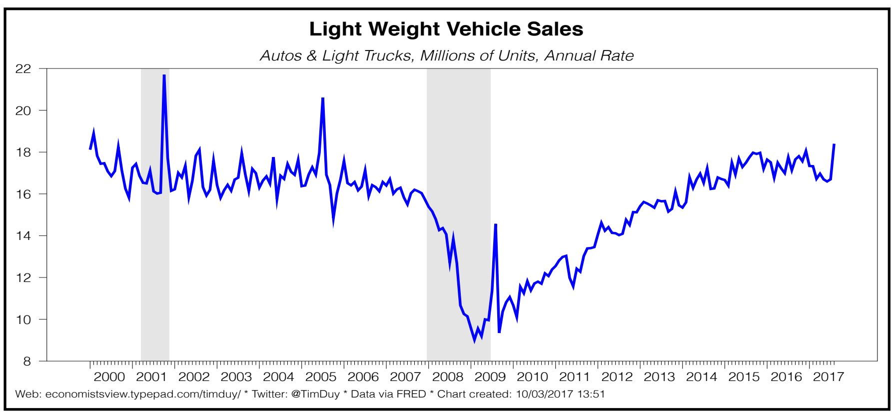
Tim Duy's
Fed Watch
OCTOBER 4, 2017

Hurricanes Help Boost Data While Powell Reportedly Rises to The Top of The Pack

The ISM manufacturing report for September came in stronger than expected. To be sure, hurricane impacts accounted for some of the boost, particularly in supplier deliveries and prices; anecdotal responses made this clear. **But it isn't all hurricanes. Manufacturing has been gaining steam since last year.** The sector continues to throw off the 2015/2016 weakness associated with the oil price decline and rise in the dollar. I often feel this improvement has been overlooked.





The Fed, however, will not overlook this data. The strong showing is consistent with the Fed's belief that the underlying pace of activity remains sufficient to support further improvement in the job market, and thus is supportive of a December rate hike. But it doesn't at this point support a faster pace of rate hikes. The Fed will see some of the improvement as temporary and expect that it will fade as supply chains disrupted by the hurricanes gradually revert to normal. And then there is that pesky low inflation problem as well.

Speaking of hurricane-impacted data, auto sales jump in September to an estimated annual rate of 18.4 million. While again likely only temporary (eventually households will replace the vehicles damage by the storms), the sales came at a good time for the industry. Car makers had been struggling with high inventories after sales slowed this year; presumably the extra activity will help correct that problem.

Fedspeak this week has tended toward the dovish side. Minneapolis Federal Reserve President Neel Kashkari fretted in a blog post that inflation expectations had fallen and would like to see rate hikes put on hold until they see clear and convincing evidence that inflation will return to target. Meanwhile, Dallas Federal Reserve President Robert Kaplan is also looking for stronger data to justify a rate hike. From Reuters:

> *"We've got room to raise rates, but not as much as people might think," Kaplan said. "We are going to have to look hard at whether we should take further action in December. I have an open mind about it."*

Now, let's do the math here. Vice Chair Stanley Fischer resigned, effective later this month. That leaves eight FOMC members. By my count four members – Kashkari, Kaplan, Chicago Federal Reserve President Charles Evans, and Federal Reserve Governor Lael Brainard – all have or are getting very cold feet about a December hike. That's an even split.

But assume nominee Randal Quarles is confirmed by December, and further assume he sides with the more hawkish side of the committee. That leaves a divided committee, but one that still supports a rate hike.

That said, I don't think that a large subset of the committee would dissent en masse if Federal Reserve Chair Janet Yellen was pushing for a rate hike. Not at a meeting that would conclude with likely her last press conference. Moreover, even if some members have cold feet now, they would likely be warmed by solid data on jobs and the economy, even if inflation remains weak. So, bottom line, odds still favor a rate hike at the December meeting.

Separately, Politico reports **that they:**

> *...spoke to a couple of other sources close to the Fed Chair selection process and they confirmed Kevin Warsh and Jerome Powell as the current front-runners with Treasury Secretary Steven Mnuchin said to be favoring Powell. That's something of a head scratcher to outside observers of the process who did not have Powell on short-lists before the process began. Warsh was always viewed as a top contender though he does not really know President Trump.*

Rumor mill has it that Wall Street doesn't want Warsh. I think many market participants are understandably wary of the possibility of a Fed chair who appears at odds with the current regime at the Fed. Not only does it call into question Warsh's analytic ability, but also Wall Street tends to loath uncertainty. Even if Warsh is just putting on a show to garner speaking fees and will come back into the fold once he is back at Constitution Avenue, we don't know that will be the case.

In contrast, Wall Street, I think, would welcome Powell's nomination. He might be viewed as somewhat more hawkish than Yellen, but also as reasonably hawkish in that likely to be data dependent and will shift dovish should the need arise. **Of all the candidates reportedly under consideration, excluding Yellen, Powell would be the most likely to maintain policy consistency.**

TIMOTHY A. DUY
PROFESSOR OF PRACTICE
OREGON ECONOMIC FORUM, SENIOR DIRECTOR
DEPARTMENT OF ECONOMICS
UNIVERSITY OF OREGON

Professor Duy received his B.A. in Economics in 1991 from the University of Puget Sound, and his M.S. and Ph.D. in Economics in 1998 from the University of Oregon. Following graduate school, Tim worked in Washington, D.C. for the United States Department of Treasury as an economist in the International Affairs division and later with the G7 Group, a political and economic consultancy for clients in the financial industry. In the latter position, he was responsible for monitoring the activities of the Federal Reserve and currency markets. Tim returned to the University of Oregon in 2002. He is the Senior Director of the Oregon Economic Forum and the author of the University of Oregon Statewide Economic Indicators, Regional Economic Indicators, and the Central Oregon Business Index. Tim has published in the Journal of Economics and Business and is currently a member of the Oregon Governor's Council of Economic Advisors and the State Debt Policy Advisory Commission. Tim is a prominent commentator on the Federal Reserve. MarketWatch describes his blog as "influential," the Huffington Post identified him has one of the top 26 economists to follow on Twitter, and he is listed on StreetEye as one of the top 100 people to follow to discover finance news on Twitter. Major national and international news outlets frequently quote him, including the *New York Times*, the *Washington Post*, the *Financial Times*, the *Wall Street Journal*, and *Bloomberg*. He also writes a regular column for *Bloomberg Prophets*.

Notice: This newsletter is commentary, not investment advice.

duy@uoregon.edu
541-346-4660
@TimDuy

COLLEGE OF ARTS + SCIENCES
ECON Economics

oregon economic forum