EXTRA EDITION !! FISCAL/MONETARY UPDATE - DISINGENUOUS FED !!

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It should be no surprise that "officials", in this case Fed Chairman, Jerome Powell, massage the facts to provide whatever agenda they are trying to promote.

Jerome Powell, in yesterday's news conference, was asked about how far the final stage of balance sheet shrinkage would go, before being "normalized" in late 2019. Recall that the $900 billion of assets owned by the Fed back in 2008, bought with newly printed currency, expanded to a maximum of $4.5 trillion during and after the 2008-2009 financial crisis to keep the banking system from imploding and to support the economic recovery. Most economists like to think that the possible unintended consequences of this unprecedented monetary experiment are worth the ongoing risks because the financial system was saved by the intervention. Over the last decade, fed officials have come to the conclusion that the balance sheet should be shrunk, but the normalized level would be about $2.5 trillion based on an economy that has grown over the last ten years. Of course, the economy has grown nothing like the 177% increase that the balance sheet would have grown, but that's been the working objective until just recently.

It's important to put the Fed's current forecast in context. Starting in late 2017, the Fed has shrunk the balance sheet steadily by selling some securities and letting others maturing in a "run off". It was hoped that this reduction of monetary accommodation would not hurt the economy. However, with the reduction of Fed participation as a buyer of fixed income securities, and a planned series of fed fund rate increases, market interest rates immediately started to rise in late 2017, and that has contributed to economic growth slowing from the 3% rate of 2018, now expected to be in the low 2% area in 2019. Predictably, by the fourth quarter of 2018, as the stock market was collapsing, the Fed "caved", and said they would back off from the balance sheet reduction, as well as reducing the number of interest rate increases planned in 2019.

It is now assumed that the rate increases are over for the moment, and the Fed is watching carefully, "data dependent", yadayada. As far as the Fed balance sheet goes, it stands, as of the last report on 3/13/19, at $3.97 trillion, down 12% from the high of $4.5. Our estimate, provided just last week, was that the balance sheet reduction would go to about $3.7T, down about 18% from the high. As we said, a quintuple in the balance sheet, from $900B to $4.5T, is necessary in hard times to avoid a financial calamity, but the "good times" only allow for an 18% reduction, not exactly a balanced situation, as John Maynard Keynes economic principles would have required.

You have to read between the lines if you are interested in the facts from which to make an informed judgement as to what the future holds. Jerome Powell, Fed Chairman, is extremely articulate, perhaps the best that we can remember in this respect. However, he has his "agenda", and we can't resist the temptation to clarify just a couple of of his press conference comments of yesterday. Naturally, he claims that the economy is doing just fine, everything is under control, the Fed is watching carefully and has lots of flexibility to respond to any foreseeable situation. We can't help pointing out the similarities to the Fed's outlook in '07.

In yesterday afternoon's press conference:

Chairman, Jerome Powell, was asked whether the Fed balance sheet reduction was a form of "tightening", which could be hard for the already slowing economy to absorb. He claimed that reduction of the balance sheet is not tightening, as it is not a part of "monetary policy", just a separate planned reduction back to an appropriate level as part of a natural process. He can call expansion of the balance sheet from $900B to $4.5T whatever he wants, but *it wasn't done for no reason.* $3.6T of fresh currency was created, out of thin air, inserted into the financial markets, helped keep interest rates low and finance our operating deficit, and the higher stock and bond prices created the wealth effect that Ben Bernanke predicted. *If expansion was a big help, contraction can't be of no consequence.*

Secondly, he was asked how much further the balance sheet reduction would be taken by the termination as of 9/30/19. After a bit of "dancing", he said "you are no doubt looking for a number, so that would be 'a bit' over $3.5T". *He no doubt wanted to provide the impression that the balance sheet reduction is continuing, automatic as presented originally, wouldn't be a problem for the economy, and the $3.5T is an acceptable objective.* Here's our interpretation: If we assume "a bit" over $3.5T would be $3.55T, that would require a reduction over the next 6.5 months of $421B from the $3.971T at 3/13/19, or an average of $64.7B per month. That pace of reduction would be higher than any level during the peak pace of reduction. Q3 of '18 averaged $37B per month. Q4'18 averaged $39B per month. So far in '19 the average has been 35B/month. If we assume $30-$35B/month over 6.5 months, that would be 195-228B, which would leave the balance sheet at $3.74-3.77T (still $70B or so above our target), and we don't consider $250B "a bit", though a quarter of a trillion dollars is admittedly not worth what it used to be.

It remains to be seen how the worldwide economy responds to the end of the largest monetary experiment in the history of the planet.

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