Powell and the Markets Weigh Potential Virus Impact

Earlier this week, Fed Chairman Jay Powell, in a two-part Congressional testimony on the state of the economy said the FOMC’s current monetary policy stance is appropriate, but emphasized that policy is “not on a preset course.” Powell believes the domestic economy “is in a very good place.” Most of what the Chairman said this week sounds a lot like recent canned Fed talk: hope with a dose of caution. On the coronavirus, Powell believes the effects will show up in the global data soon, but reiterated that “it’s too uncertain to even speculate” on the ultimate impact. If the Fed is forced to cut in the coming months, this will be the likely impetus. The number of infected jumped by 15,000 to 60,000 global cases yesterday as Chinese officials revised their counting method by including those diagnosed by doctors, but not testing positive.

As the virus spreads, the potential impact to the U.S. economy becomes more apparent. The International Energy Agency said yesterday that global demand for energy will decline for the first time in a decade as a result of the widespread shutdown of the Chinese economy and virus-related travel restrictions. Lower energy prices are a mixed bag, benefiting consumers to the detriment of producers. Other information is more disturbing: According to the Department of Commerce, 97% of all antibiotics in the United States are imported from China, while Bloomberg News reported more than 30% of U.S. factory inputs come from China.

As the global economy struggles relative to the United States, the dollar continues grind higher with the dollar index (USDX) approaching a three-year high. This unwelcome currency appreciation will generally make U.S. exports more expensive and imported goods cheaper. Lower cost imports will push overall inflation lower and make it even more challenging for domestic producers to compete. More expensive U.S. exports mean foreign buyers will be forced to reduce their purchases, or will find alternate sources. The higher relative cost of U.S. goods will also make it more difficult for the Chinese to adhere to their ambitious purchase pledge under the phase one trade agreement.

This morning, the January consumer price index (CPI) signaled benign price pressure with a +0.1% advance in overall CPI and a +0.2% core increase. On a year-over-year basis, headline CPI climbed from +2.3% to +2.5% …but this was a one-off energy-related increase likely to reverse itself in February. Core CPI, which excludes food and energy prices, held steady at +2.3% year-over-year. Of course, the Fed is more focused on the personal consumption expenditures (PCE) index, which is rising at a +1.6% annual pace and +1.3% annualized in the fourth quarter, well below their +2.0% target. The recent strength of the U.S. dollar and the global slowdown is likely to push consumer prices lower in the coming weeks. If prices continue to retreat and the dollar continues to climb, the Fed will be hard-pressed to continue their pause. The possibility of a rate cut has risen while there are few reasonable scenarios arguing for a rate hike in 2020 or 2021.

Bonds have rallied in early trading while stocks have retreated from yesterday’s record highs.

Please see disclosure on page 2.
Market Indications as of 11:45 A.M. Central Time

DOW                  DOWN 58 to 29,492 (HIGH: 29,552)
NASDAQ            DOWN 1 to 9,725 (HIGH: 9,726)
S&P 500             Up 1 to 3,380 (NEW HIGH)
1-Yr T-bill        current yield 1.48%; opening yield 1.49%
2-Yr T-note        current yield 1.43%; opening yield 1.44%
5-Yr T-note        current yield 1.44%; opening yield 1.45%
10-Yr T-note       current yield 1.61%; opening yield 1.63%
30-Yr T-bond      current yield 2.07%; opening yield 2.09%