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Economic Commentary

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The latest news from Fed Chairman Powell is that the Fed is keeping a watchful eye on the negative impact of trade wars on the relevant current economic data as it is revealed. Specifically he offered, "We do not know how or when these issues will be resolved. We are closely monitoring the implications of these developments for the US economic outlook and, as always, will act as appropriate to sustain expansion with a strong labor market and inflation near our two percent target."

Fed Chair Powell did not say specifically that the Fed would lower interest rates, but the financial press and media in general ran with that assumption, which caused equity and bond markets to rally significantly. Many read into his comments the implications that the Fed could act if the impact of tariffs, which we will discuss later, have a diminishing effect on the current economy.

> "If the proposed Chinese tariffs… are allowed to stand the Fed estimates that the bill to consumers will rise to $831 per household…"

Recent economic data releases suggest that the condition previously described continues. The consumer is employed, job growth has exceeded forecasts, unemployment continues to be at historical lows, wage growth while not robust continues, personal savings is constant, consumer confidence strong and the PMI Index well above recessionary levels. To help the consumer, energy prices (other than holiday driving periods) remain low and inflation is benign (unless an individual is forced into being a consumer of health care and college tuition).

The environment that I described above, which I believe accurately describes the data released, would normally send any Federal Reserve Chairman and collective body of Fed Governors into a fairly defensive position and produce cautionary comments with respect to risks of "overheating" and therefore inferences of imminent tightening. While that was the case through February of this year, it is clearly not the case now. It is normal to assume that a very mature expansion with consistent growth and very tight labor market has implied recession risk in the near term. The data simply does not confirm any downward trend in employment, retail spending, consumer activity or yield curve inversion. Absent of those signals, what had tipped the Fed in the direction of signaling an appetite for easing rather than tightening with respect to the Fed Funds rate?

The answer I think is in the comments offered by Fed Chairman Powell when he stated, "We do not know how or when these issues will be resolved." He is of course referring to the trade war with China and the newly announced tariffs to be imposed upon Mexico beginning June 15th (5%) and escalating by 5% per month to a maximum of 25% should Mexico not meet an as of yet unspecified benchmark of immigration and asylum seeker traffic decline across Mexico.

While I do not think for a moment that the Fed Governors believe that a potential tariff of 25% would be imposed upon all goods crossing the Mexico border it is still clearly on their mind. It is also on the mind of the Senate, whose Republican caucus had a tough meeting with Mick Mulvaney, current White House Chief of Staff, where they delivered the message through majority leader Senator Mitch McConnell that they had no appetite for the tariffs as described and could not guarantee the President that they had enough votes to deter the rescinding of or termination of the tariffs.

Through his comments, the Fed Chairman has now inserted the Fed in the tariff dialogue, a move that has some Fed observers and analysts a bit perplexed. The Fed is an independent body and theoretically unaligned with administrative economic and public policy decisions. It is well known that this President has attacked the Federal Reserve and its current Chair through his now ever-present "tweet barrage." Through their insertion into specific language about tariffs, the Fed may have moved a step closer to the political than it may be comfortable with in the future.

The Fed does collect and analyze data and publishes many reports on the economy, almost all of which are available to the public on their website. According to a report released by the Fed in early 2019, tariffs imposed in 2018 cost the average household $419. If the proposed Chinese tariffs imposed by the President on May 10, 2019 are allowed to stand, the Fed estimates that the bill to consumers will rise to $831 per household or about 1.3% of the median household income per year.

Foreign goods do not simply arrive in the US. There is always an importer of those goods. While many are consumer discretionary items, many are also parts, vegetables, processed and unprocessed food products, automobiles, as well as pharmaceutical and medical device products. The exporting government does not pay the import duty created by the tariff and neither does the exporting company that produced the product. The importer of the goods pays for the duty. The importer of the goods passes on the cost of the tariff to distributors and end users of the final finished goods who then pass on the cost of the tariff to the end buyer, who in this case is the US consumer. For the president to suggest that China or Mexico will pay for the tariffs is disingenuous and certainly intellectually bankrupt.

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Consumers avoid the "tax" implications of tariffs only when there is competition of goods in the marketplace that allows producers and suppliers of goods other than in this case China and Mexico to meet the demand of the consumers. One need only examine the price increase in tariff-related products to realize that this competition does not exist. I have long argued that trade policy must be fair to all and, in the main, designed to protect and promote our country's intellectual property and product advantages as experienced by global consumer demand. Tariffs are not best utilized to solve other geopolitical issues, but can be the leveraged opportunity to translate to constructing detente relationship building. As currently utilized, they raise consumer costs, disrupt supply chains, place mid-size country-specific exporters in excessive risk scenarios, dampen business investment, prolong business capital decisions and invite retaliation. My role places me in constant contact with manufacturers and business owners who must utilize commodities and component parts to develop, create, manufacture, market and distribute their final finished goods. These manufacturers are currently in a very difficult position and that may well be reason that the Federal Reserve Chairman has taken the political risk to enter the discussion on tariffs.