US: Jerome Powell to become next Fed Chair

After a prolonged period of speculation, US President Donald Trump has nominated Jerome Powell to become the next Fed Chair. If confirmed by the US Senate, he will replace Janet Yellen when her Chairmanship expires in February 2018.

As things stand, there will be four vacancies on the Federal Open Market Committee (FOMC) Board of Governors, including one Vice Chair and three governors.

The selection of Jerome Powell signals policy continuity. His views on the current state of the US economy and how to conduct monetary policy are very similar to those of Yellen’s. However, as a Republican, he is more relaxed about financial deregulation than his predecessor.

As a result, we have not altered our asset class views. The current macro environment of good growth and benign inflation should favour risk asset classes over bonds. For US equities, relative valuations and fundamentals suggest a neutral positioning. In developed markets, we prefer Japan and eurozone equities. We also remain underweight US Treasuries, where stretched valuations make them vulnerable to any gradual inflation pressures.

Powell to become the next Fed Chair

After a prolonged period of speculation, US President Donald Trump has nominated Jerome Powell to become the next Fed Chair.

Currently on the Federal Open Market Committee (FOMC) Board of Governors, Powell represents a more conventional choice among the candidates considered. He is likely to be confirmed by the US Senate, and therefore expected to officially replace Janet Yellen when her Chairmanship expires in February 2018.

This is the second nomination to the FOMC by President Trump. In July, he nominated Randal Quarles as Fed Vice Chair responsible for regulatory supervision. Similar to Powell, Quarles is supportive of relaxing financial regulation.

So what next…the 2018 line-up

Fed Chairs normally step down when their leadership roles end. The last Chair who stayed on the Board of Governors after losing their position was Marriner S. Eccles, in 1948. Following this tradition, it is unlikely that Yellen will remain on the Board. However, her 14-year term as governor does not expire until October 2024, and therefore cannot be completely ruled out.

As things stand, there remain four vacancies left on the Board – one Vice Chair and three other governors. Figure 1 depicts the expected line-up of 2018 FOMC rate setters and their subjective policy bias (hawkish/dovish) based on their recent speeches.

Investment implications

The selection of Jerome Powell signals policy continuity for the Fed. His views on the health of the US economy and how the central bank should conduct monetary policy going forward are in line with those of Yellen’s and the consensus on the FOMC. In particular, he thinks that low inflation in the US is “kind of a mystery” but “there are good reasons to expect inflation will assume its gradual rise”.

A base case scenario would see a Powell-led Fed continue to raise policy rates gradually and shrink its balance sheet “gradually and predictably”. It will also maintain the current inflation target of 2%.

However, Powell is slightly more relaxed about financial deregulation than his predecessor. In June, he remarked that “there is room for eliminating or relaxing aspects of the implementing regulation in ways that do not undermine the Volcker rule’s main policy goals”. A larger risk to the Fed policy outlook is the possibility of hawkish entrants filling the FOMC’s current vacancies. John Taylor, one of the hotly tipped candidates for Chair and famous for his rules-based approach to setting interest rates, is a potential option for Vice Chair.

For now, we have not altered our asset class views at this juncture. US equities benefit from a broadly robust economic backdrop and prospects of fiscal stimulus. But the risk-reward profile is not as attractive as other developed equity markets (Japan and eurozone). We remain neutral.

We also retain our underweight positioning in US Treasuries. As the US labour market tightens further, there is a risk for inflationary pressures to build, weighing on fixed income assets. In addition, Treasuries’ prospective returns still look relatively low compared to other asset classes within our investment universe.
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