



Condensed from the Winter 2017-2018 issue.

Growth Continues Through 2019

Recoveries end either due to seriously flawed policy decisions (as only these are big enough to matter) or the economy fully absorbs built up excesses. Our view of when the current recovery ends is a moving target as we monitor these two factors. Each day we wake up to the status quo — without a change in outlook for flawed policy or an absence of excesses — the end moves out one day further.

As to a major policy error, the current administration is unable to make major policy decisions, so we are seemingly safe in this regard. And as to Fed policy errors (common growth killers), raising the short rate by an additional 100 bps only gets it up to about the rate of inflation. This is not problematic because any reasonable estimate of where the short rate should be is 50-100 bps above inflation. It is only as the Fed pushes this rate an additional 150-250 bps above its natural rate that policy danger arises, so we are easily safe for another 250 bps of Fed increases.

At the start of November, President Trump announced that Jerome Powell, a current member of the Fed, would succeed Janet Yellen as Fed Chairman. While this appointment is solid, it is highly disappointing to those of us who believe the Fed's role is to interfere with markets as little as possible while maintaining price stability. The Yellen Fed maintained price stability, but did so while being an unprecedented interventionist Fed. Mr. Powell has been a key member supporting this interventionist approach of "we know better than markets". This Fed mindset has created a prolonged period of low growth relative to what market-driven growth rates would have been. This amounts to a cumulative real GDP shortfall in excess of \$20 trillion (\$160,000 per household over the past 9 years). Instead of realizing that this growth shortfall was the result of their interventions, the Yellen Fed viewed it as a clarion call for even more intervention. This in

spite of the fact that historic analyses of policy and growth, such as those by John Taylor of Stanford, indicate that much higher growth would occur with less intervention.

We expect only minor policy changes under Mr. Powell's leadership, with the Fed only grudgingly allowing rates to rise near market rates, along with a very slow return of the ownership of nearly \$4 trillion of financial assets to private players. It is a safe choice that will cost the U.S. economy perhaps \$1 trillion over the next decade, a price which is too large to be entrusted to a mandarin rather than markets.

As to market excesses, they are still not to be found in single family housing, commercial construction, or autos. As a result, we do not see an end to the recovery in the next 2 years, but stay tuned!

A sample of articles available in the complete version of *The Linneman Letter*. To subscribe to *The Linneman Letter*, contact Doug Linneman at dlinneman@linnemanassociates.com.

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