

US tax cuts must take the blame

Market slump is Trump's not Powell's

by Desmond Lachman in Washington

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If there is one person who will undeservedly be publicly dragged over the coals by US President Donald Trump for the bursting of the stock market bubble, it surely will be Federal Reserve Chairman Jerome Powell after Wednesday's latest interest rate increase.

Never mind that it was not under Powell's watch, but under those of Ben Bernanke and Janet Yellen, his predecessors, that the conditions for the stock market bust were set, through too many years of overly easy monetary policy.

Never mind, too, that it was Trump who introduced a large unfunded tax cut that made unavoidable the interest rate increases that have now brought down the stock market.

Perhaps, at the end of last year, Powell should have known better than to accept the poisoned chalice of Fed chairman that Trump offered him. After all, it was not so long ago, in 2006, that – soon after being appointed chairman – Bernanke found out he would have to clean up the mess of an epic housing bust wrought by years of easy money under Alan Greenspan's stewardship.

Powell's long experience as a successful investment banker should have made him realise he would take over the Fed's reins after an extraordinarily long period of ultra-easy monetary policy that had both artificially boosted asset prices and distorted credit markets. He should have been mindful that his two immediate predecessors' policies had increased US equity valuations to lofty levels experienced only twice before in the past 100 years.

Powell cannot have escaped noticing that the Trump administration's irresponsibly expansive budget policy would highly complicate the Fed's task of controlling inflation. He should have known that the widening of the budget deficit to around 5% of GDP at this late stage in the economic cycle would leave the Fed with little choice but to raise interest rates to prevent economic overheating. He would have known that this might provoke the bursting of the stock market bubble.

Perhaps Powell's biggest mistake in accepting the Fed job was to underestimate the president's proclivity to take all the credit for good economic news, but to distribute freely all of the blame for the bad tidings. This was all too evident in the first year of his presidency when Trump took all the approbation for stock market buoyancy that was more the result of Yellen's easy money than of his economic policy initiatives.

Now that the stock market is swooning, and if the president's past behaviour is prologue to his future actions, Powell is about to get the blame for the Trump stock market slump. Powell will face the flak even though the stock market rise and fall stems largely from the consequences of Trump's procyclical fiscal policy.

Despite all this, Powell made a mistake on 19 December when, after announcing the Fed's latest rate increase, he disappointed the markets by an unduly hawkish policy statement that seemed to disregard financial market turbulence and the marked weakening in the international economy. However, if Trump really wants to discover the main culprits for the stock market bust, he might examine the records of Bernanke and Yellen – and take a long look in the mirror.

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