

Fed Won't Raise Rates This Week -- Is Trump to Blame?

As recession and Brexit risks fade, only 'political risk' is left -- you know what that means. Here are some of the big-name companies affected, from GE to Marriott.

By Tim Mullaney July 26, 2016

It's no surprise that the Federal Reserve probably won't raise interest rates at this week's monetary policy committee meeting. But what many haven't considered is that Donald Trump may be a big reason why.

Futures markets see only a 2.4% chance that the committee will announce a quarter-point boost in short-term rates when its meeting ends Wednesday afternoon, only a 20% chance of a September rate hike, and a little less than even odds for a hike in December. About all that's expected to happen this week is some minor tweaking of the Fed's economic-outlook statement.

What's notable from major banks' assessments is how many of the perceived obstacles to a rate hike are falling away as the economy moves into the midyear growth groove that has marked each year since 2012 -- and yet, still no hikes.

Goldman Sachs reports financial conditions have actually eased since before the United Kingdom's vote to leave the European Union, indicating that worries over Brexit will soon pass (if they haven't already). The economy probably grew during the second quarter at a rate somewhere between the 2.4% prediction of the Atlanta Fed's GDPNow model and the 2.8% range forecast by models at Goldman and Moody's Analytics.

If Friday's report on second-quarter growth shows a figure in that range, it should finish off arguments about a 2016 recession.

What's left is what analysts call "political risk." And U.S. political risk this year is spelled T-R-U-M-P.

"The Fed won't raise rates this summer, though it should," **Economic Outlook Group chief economist Bernard Baumohl** said. "Blame the election for the delay."

To **Baumohl**, Trump's economic plans are a double-barreled forecasting problem: Some, like a promised imposition of hefty tariffs (45% on Chinese goods, 35% on many goods from Mexico), point to an early, sharp recession during Trump's first term.

Others, like the giant tax cut skewed toward high-income families that he has proposed, could add as much as \$9.5 trillion to the deficit over its first decade on the law books. That would point to inflation, and higher interest rates, especially since it would rain helicopters of money on an economy that is already close to full employment.

Or so say **Baumohl**, Oxford Economics, Moody's Analytics and a long list of other banks and experts, notably a survey of investors by Morgan Stanley.

If you accept the premise of Trump's campaign, none of this matters. Every criticism confirms that elites rig things for themselves. Trump himself has promised to balance the federal budget by his second term, with or without the extra \$1 trillion a year in revenue.

But for CEOs, whose reticence about investment is the remaining difference between the expansion we have and the stronger one we'd like to see, elite opinion actually does matter, **Baumohl** says. And it does for the Fed, too.

"Given the closeness of the race at this time and the unusual (to be diplomatic) proposals that have been articulated, many CEOs are simply sitting out the campaign storm," he wrote in a note to clients last Friday. "Why invest billions of dollars into capital and labor when this election brings so much uncertainty about the return on those investments? It's not that the hurdle rate [slang for the expected return needed to justify risk] is too low. It's the difficulty of even estimating what that hurdle rate may be if Trump gets into the Oval Office."

By contrast, modeling Clinton's agenda isn't difficult. **Baumohl** sees it as Obama plus, with growth rising from 2.4% each of the last two years to about 2.9% next year if Clinton wins, slowing to 2.6% in 2018.

That reflects only incremental changes in policy, letting current trends basically play out. A little more defense and infrastructure spending, which would benefit construction companies like Fluor (FLR) and defense contractors Lockheed Martin (LMT) and Northrop Grumman (NOC) , adds only marginally to short-term growth, he says. The real economic edge Clinton presents is that she's not Trump.

Most evidence of this is anecdotal, but not all, **Baumohl** said. A June hotel-industry conference featured a number of CEOs voicing worry about Trump, mostly over whether his crackdowns on the flow of people across borders will cramp what they otherwise think is an unusually strong outlook for companies like Marriott International (MAR) and Expedia (EXPE) .

Likewise, a June survey by the National Association of Business Economists said 60% think election-driven uncertainty is hurting growth this year.

For instance, American Airlines (AAL) , the largest U.S. carrier, said this month it had reached an agreement to delay delivery on 22 Airbus A350 twin-aisle jets for nearly two years. Delivery is when planemakers typically receive the bulk of their payments, and the airline said it would save about \$500 million in 2017 and \$700 million in 2018.

All this is why the Fed will keep standing pat even after this week's meeting -- probably until December, when the world knows the winner.

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