

Farewell to Data Dependence

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist

Until recently, Fed Chair Jerome Powell sounded a consistent theme: the Fed is data dependent and will stay that way, unswayed by noise or pressure from politicians.

When the FOMC released its rate decision last month, it got as dovish as it could without actually cutting short-term rates. It downgraded its assessment of economic growth from “solid” to “moderate” while noting that “market-based measures of inflation compensation” have declined.

However, the Fed added that “uncertainties...have increased” and it will “closely monitor” incoming information and “act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent (inflation) objective.” It removed the reference in prior statements to being “patient” about changes in policy.

This statement, as well as comments made by Powell at the press conference after the meeting, suggested a 25 basis point rate cut was all but in the bag for the next meeting at the end of July. But with six weeks between June and July’s meetings, and a full economic data cycle, what we have seen so far shows that - if the Fed really is data dependent - they shouldn’t cut rates. And if they do, they should lose credibility.

Personal income and spending numbers came in strong for May. Income grew 0.5% while spending grew 0.4% (and was revised higher for April). Nonfarm payrolls increased 224,000 in June, well above expectations, and initial unemployment claims remain near historically low levels. And then auto sales also beat consensus, coming in at a 17.3 million annual rate in June.

Its true consumer prices were up 1.6% for the twelve months ending in June, while producer prices were up 1.7%, both below the Fed’s 2% target. But “core” consumer prices – which strip out the volatile food and energy categories to give a better picture of trend inflation - are up 2.1% from a year ago while

“core” producer prices are up 2.3%. There is no sign of aggressive disinflation, and certainly not deflation. So now in addition to their dual mandate of “employment and inflation,” the Fed has added “uncertainties” about weakness in foreign economies to its list of actionable items.

There are still several important data points due out before the Fed’s decision on July 31. These include retail sales and industrial production, both released Tuesday morning. Next week, look for a report on second quarter real GDP growth in the 1.5 – 2.0% range, held down temporarily by a slowdown in the pace of inventory accumulation. And then more personal income and spending numbers for the month of June to cap things off.

Combined, this data will not show any significant slowdown in the U.S. economy. But the Fed seems obsessed by developments abroad, including slower growth in China and Europe. This is neither “data dependent” nor logical.

China is a communist country, and communism has never worked at creating wealth in the long run. China grew rapidly for decades by importing foreign technologies, exporting to the West, and lately, stealing intellectual property from abroad. These shortcuts have now run their course.

If anyone thinks monetary policy in the U.S. can solve China’s problems, they’re dreaming. Given the size of China’s economy, is US contagion a concern? Hardly. The last time the second largest economy in the world collapsed (Japan in 1990), the U.S. boomed. How about Europe? Do you really think the Fed can fix slow economic growth caused by the socialist policies across the sea? High taxes, regulations, and spending can’t be fixed by the ECB’s negative rates, so how the Fed thinks it can help is a mystery.

The Fed is not tight, there are still \$1.4 trillion in excess reserves in the banking system. Most importantly, “data dependence” seems to be out the window.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-15 / 7:30 am	Empire State Mfg Survey – Jul	2.0	6.0	4.3	-8.6
7-16 / 7:30 am	Retail Sales – Jun	+0.1%	+0.1%		+0.5%
7:30 am	Retail Sales Ex-Auto – Jun	+0.1%	0.0%		+0.5%
7:30 am	Import Prices – Jun	-0.7%	-0.6%		-0.3%
7:30 am	Export Prices – Jun	-0.3%	-0.3%		-0.2%
8:15 am	Industrial Production – Jun	+0.1%	+0.1%		+0.4%
8:15 am	Capacity Utilization – Jun	78.1%	78.1%		78.1%
9:00 am	Business Inventories – May	+0.3%	+0.3%		+0.5%
7-17 / 7:30 am	Housing Starts – Jun	1.260 Mil	1.260 Mil		1.269 Mil
7-18 / 7:30 am	Initial Claims Jul 14	216K	216K		209K
7:30 am	Philly Fed Survey – Jul	5.0	2.8		0.3