Fed’s Stance Raises Risks for Economy, Research Affiliates’ Rob Arnott Says

By Leslie P. Norton  Aug. 1, 2019 7:15 am ET

The interest-rate cut on Wednesday shows the Federal Reserve wants to avoid damaging financial markets with its policy moves, but Jerome Powell, the central bank’s chief, “is dangerously at risk of creating a recession” nonetheless, says Rob Arnott, founder of the asset manager Research Affiliates.

Campbell Harvey, Arnott’s partner at Research Affiliates, did pioneering work in 1988 at the University of Chicago that showed that yield-curve inversions—when short-term rates are higher than long rates—foreshadow economic downturns.

“I don’t think yield curve inversion predicts a recession: It causes a recession if you have people unwilling to commit their money to risky projects and wanting to keep their money safe by putting it in bonds,” Arnott said in an interview. “If they want to do so badly enough to accept exceptionally low interest rates, it tells you growth expectations are really pretty bad. It tells you the Fed isn’t paying attention to the message of the long bond market.”
A risk-averse bond market is “a message the central bank should pay attention to.” But by indicating that this week’s cut wouldn’t be part of a long-term pattern, Powell is suggesting he sees no signs of serious weakness, he argued.

“If the Fed waits, they’ll be so far behind the curve they can’t do a darned thing,” Arnott said. “The National Bureau of Economic Research announces recessions often six to 12 months after they’ve started. If you wait six to 12 months, you’re too late.”

Powell’s stance may partly be an effort to demonstrate the Fed’s independence following President Donald Trump’s recent tweets urging the bank to cut rates, he said. “Ironically, Trump’s tweets may have reduced the likelihood of Powell moderating rates as much as Trump would like.”

After the rate cut, Trump tweeted that the Fed “let us down.”

Write to Leslie P. Norton at leslie.norton@barrons.com

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