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Macro Market Insights

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Doubt

In a week and a half, the US Federal Reserve is expected to cut interest rates. The question that many (including myself) seem to be hung up on is, why?

Relations between the United States and China have been going back and forth between hot and cold for the past year. The initial shock of a trade war seems to have been absorbed by financial markets and the downside impact to global economic activity and GDP outlooks seems to be realized, for now. Global manufacturing data (a forward-looking indicator for economic growth) for certain Western economies have deteriorated, but other metrics, such as the strong and robust performance of the US labour market seem intact.

Some Bay and Wall Street economists seem to be interpreting and anticipating this move from the Fed as an insurance cut. If this is the case, parallels can be drawn to when the Bank of Canada cut rates in January of 2015 and then again in July of that same year. This was in reaction to the impact of an oil price shock on the Canadian economy and economic devastation in oil producing provinces led by Alberta. Ultimately, they reverted to their path of higher interest rates as what would be deemed a transitory shock worked its way through the economy. Thus, the question whether a US-China trade war may be interpreted in a similar way.

There are certainly examples of pockets of the US economy that are struggling. Economists that align themselves in the bearish camp point to indicators related to trade and manufacturing data, or shipments of semiconductors. The challenge with that is the US Federal Reserve adjusts interest rate policy based on their mandate of price stability and maintaining low unemployment, both measures that seem not to fully prompt any action.

Relating to this, the question may be asked how much further room the labour market has to run and whether the inflation data may be pointing to a disinflationary scenario (when inflation is muted and gravitates towards zero, but not negative or deflation). Longer term, this may be a picture we are looking at, and may be the reason the Fed is no longer talking of raising rates.

It’s hard to take a myopic approach to the markets, and especially gold and precious metals when we participate in a market where the belief in physical gold is in its long-term store of value and its role as a way of adding diversity to one’s financial assets and mitigating exogenous risks. With that said, it seems justifiable that the anticipated action from the US Fed to immediately move to the dovish camp may be hard to justify, and for the financial markets and investors to digest.

For this reason, we see the month end meeting of the Federal Reserve as another possibility for a period of market volatility. Potentially, any interpretation of a ‘hawkish’ rate cut could see gold prices attempt to re-test their breakout of the $1,360 US/oz. Certainly the dovishness of the Fed has been priced in. Anything short of this may provide an entry point for investors that missed this rally.