

ECONOMY

Of interest rate hikes
and fiscal plans



Think Strategically: Tribulations of Capitalism

Fed Chairman Hosts His First Jackson Hole Conference

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The Week in the Markets: Opportunities plentiful in retail sector

Market indicators closed with solid results. The Dow Jones Industrial Average stood at 25,964.82, a gain of 164.47 for the week; the S&P 500 closed at 2,901.52, a gain of 53.85 for the week; and the Nasdaq closed at 8,109.59, up 163.55 for the week.

The Fed's Jackson Hole meeting is an annual event hosted by the Federal Reserve Bank of Kansas City, and is the gathering that in many ways marks the official fiscal year. The meeting is often described as the root of what Fed officials, central bankers and other monetary policy experts perceive hints as to the direction of U.S. monetary and economic policy. This will be Fed Chairman Jerome Powell's first Jackson Hole Conference and an opportune time to set

his tone and message. As a reminder, Powell has been in office north of seven months, and the Fed has continued to implement interest rate increases in line with the precedents set during Chairwoman Janet Yellen's era. The Fed raised interest rates in March and June, and Powell signaled one or two more interest rates increases for 2018. In the calendar of interest rate increases and forecasts shown below, note that on Sept. 26 another 0.25 percent increase is widely expected, as the economy continues to grow.

Over the course of the economic recovery, the United States has experienced since the Great Recession of 2008, we must highlight that unemployment is at a 20-year low of 3.9 percent. The Fed is expected to implement sharp monetary policy action to avert an overheating economy and inflation. Job creation is now in its 93rd month of consecutive growth, with more than 600,000 new jobs in 2018 alone. Another benchmark the Fed watches is inflation, which is currently rising at a 2 percent clip and the Fed continues to implement its balance sheet reduction, a policy that began when the Fed stopped its asset purchase program in 2015.

One thing that must concern most of us is the message Powell alluded to, and it was shifting stars. On the surface this might seem like the typical

romantic rhetoric; however, in a more detailed review, we note that the Fed chairman said, "Guiding policy by the stars in practice...has been quite challenging of late because of our best assessments of the location of the stars have been changing significantly."

While the stars might be part of the most romantic seaman's way of sailing at night, we find that, nowadays, using a GPS gets you there correctly if you avoid rocks and other hazards. In economic policy, the stars are not the way to go.

As most investors continue to watch U.S. stocks advance to record highs and now up more than 7% year-to-date, we note that the current bull market is now the longest on record: more than 3,450 days. We must caution investors to utilize defensive

stocks in their portfolio to curtail any downturn in the current bull market.

On the tariff war debate, the United States and Mexico reached a bilateral trade deal last week; the accord sent Wall Street stocks to all-time highs. After the announcement, Canada decided to enter the discussions to try to work out a deal with the United States, but were not able to by the Friday deadline set by President Trump—it is rumored that Canada's dairy products stance, combined with how any trade dispute will be resolved, stalled the talks, which resumed this week.

In other tariff-related news, Trump wants to move ahead with an additional tax on \$200 billion worth of Chinese goods as early as this week.

On the earnings front, we saw solid quarterly results from several retailers, well-known brand names that have been in turmoil due to the flux in internet sales, but their year-to-date performance has been outstanding.

The Final Word: Fiscal oversight board requests changes to the certified fiscal plan

The Financial Management & Oversight Board (FOMB) required changes and explanations of the government's projections in Puerto Rico's fiscal plan. We highlight some of the findings:

- **Disaster Pass-through:** The government's plan includes a pass-through rate of 18 percent across Federal Emergency Management Agency (FEMA) Public Assistance, U.S. Housing Department Community Development Block Grant (CDBG) program funding, FEMA Individual Assistance, other federal funding, and private insurance. They all must be segmented.
- **Projections for U.S. Growth and Inflation Rates:** The proposed plan uses U.S. GDP growth rate and inflation rate estimates from the International Monetary Fund, but also references Congressional Budget Office (CBO) projections. Considering the

importance of U.S. growth projections on forecasts for Puerto Rico, and the need for the fiscal plan to be anchored in projections consistent with those that U.S. policymakers use, the proposed plan should be updated to use the CBO forecasts for both U.S. GDP growth and inflation.

- **Population:** The government's proposed plan includes population numbers that come from the fiscal plan certified in June, instead of projections that align with the proposed plan's gross national product (GNP) growth trajectory. The proposed plan should be updated to adjust the population accordingly.
- **Damage Assessment:** The proposed plan uses the original damage assessment from the Planning Board and should share the agency's methodology for reaching the figure.
- **Major General Fund Categories (income taxes, sales & use taxes):** The proposed plan must provide additional information on the rationale for incorporating recovery-related revenues into fiscal year 2019 tax base that then grows with GNP versus those revenues that relate to a tax base that exists only during the 10- to 15-year reconstruction.
- **Long-term Medicaid projections:** The plan contains several new assumptions in the baseline per capita inflation rates and must provide its methodology.
- **Pensions:** Pension expenses must incorporate the contribution from municipalities of \$11.2 million in Employee Retirement System administration costs, rather than assuming the Commonwealth will cover municipal pension costs.
- **Payroll Expenditures:** The proposed plan assumes \$4.09 billion in necessary baseline payroll expenditures.
- **Parting thought:** During a recent keynote at the Ponce Chamber of Commerce, FOMB Chairman José Carrión requested support from the private sector toward its work and progress. As much as many of us would gladly provide advice and support to the board, many of us have offered this help and support via email, letters, discussions or commentaries. If the board needs a more concentrated effort, it must summon a group of select professionals to help in this endeavor.

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Date	Actions	Actual Rate	Previous Rate	Consensus Rate	Forecast
5/2/2018	Fed Interest Rate Decision	1.75%	1.75%	1.75%	1.75%
6/13/2018	Fed Interest Rate Decision	2.00%	1.75%	2.00%	2.00%
8/1/2018	Fed Interest Rate Decision	2.00%	2.00%	2.00%	2.00%
9/26/2018	Fed Interest Rate Decision		2.00%		2.25%
9/26/2018	FOMC Economic Projections				