

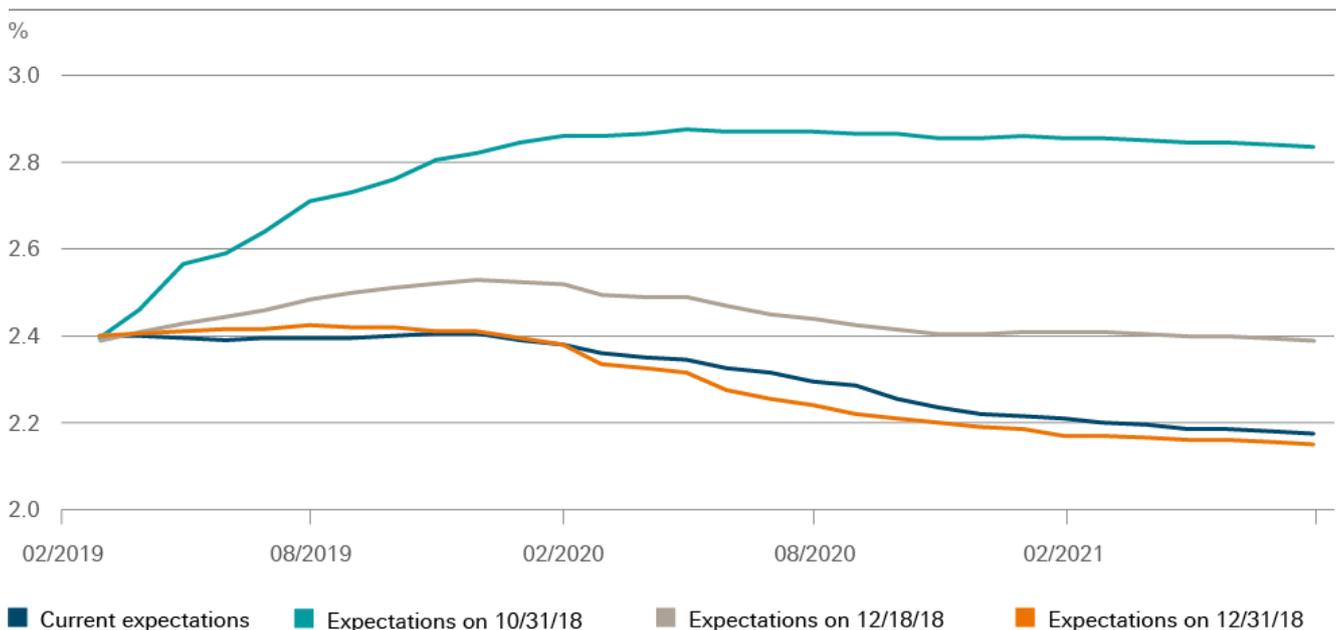
DON'T GET TOO EXCITED ABOUT THE POWELL PUT

Markets may have been a little too quick to price out any further rate hikes

Global markets have recovered nicely from last year's panic attack (see [Chart of the Week of February 1, 2019](#)). This is all the more remarkable as neither the microeconomic perspective of corporate earnings nor the macroeconomic perspective of economic data point to a significant improvement in the economic outlook. In another respect, however, the situation has changed: last year, the U.S. Federal Reserve (Fed) was following a steady path of interest-rate hikes. The key policy rate was raised by 0.25% promptly at every meeting at the end of the quarter. In addition, the Fed let its balance sheet shrink at a predefined rate as communicated in 2017. In other words, the Fed was slowly but surely depriving the system of liquidity. As economic data began to weaken, criticism of the "monetary policy on autopilot" increased. To the delight of markets, the Fed listened to these concerns and promised a more "flexible approach" for the future. Our "Chart of the Week" shows the sharp change in market's assessment of the future path of monetary policy. At the end of October 2018, investors still expected the federal funds rate to rise in the direction of 3% by the beginning of 2020. By contrast, derivatives markets are currently expecting interest rates to remain unchanged

for a while. At the beginning of the next decade they even see a decline in the key policy rate.

Dr. Jöm Wasmund, Head of Fixed Income at DWS, believes that the truth might lie between the two extremes: on the one hand, the federal funds rate is currently only marginally above the core inflation rate. At least on this measure, monetary policy can hardly be called restrictive. This should lessen the risk of stalling growth. On the other hand, U.S. unemployment is unusually low and neither the Fed nor markets can know for sure where it might be a year from now. Against this backdrop, it is reassuring that the Fed is responding pragmatically to a change in the economic situation instead of dogmatically following a pre-defined course. "Data dependency" is another term for such a pragmatic approach. Of course, there is no guarantee the resulting decisions will always satisfy investors.



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 2/19/19

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GLOSSARY

Balance sheet

A **balance sheet** summarizes a company's assets, liabilities and shareholder equity.

Derivatives market

The **derivatives market** is the financial market for derivatives.

Federal funds rate

The **federal funds rate** is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

Inflation

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Liquidity

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

Monetary policy

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Powell-Put

The term "**Powell put**" derives from the more flexible monetary policy announced by Fed Chairman Jerome Powell to lower key interest rates in the light of declining capital markets.

U.S. Federal Reserve Board (the Fed)

The **U.S. Federal Reserve Board**, often referred to as "**the Fed**", is the central bank of the United States.

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