



Wait, so, why is the Fed cutting rates, exactly?

David Goldman

July 31, 2019

The economy is strong. Unemployment is historically low. Consumer confidence is high. So why, exactly, is the Federal Reserve expected to cut rates Wednesday?

One argument: By cutting rates, the Fed could grow the supply of money, which has been growing too slowly for the past few years. That, more than any tool at the Fed's disposal, will help keep the economy growing.

"Everyone is focused on interest rates, and that's the wrong thing to focus on," said Steve Hanke, an economics professor at Johns Hopkins and a director of the Troubled Currencies Project at the Cato Institute. "It's all about the growth in the money supply. That's what drives changes in nominal GDP."

The number of notes and coins in circulation plus bank accounts is growing at 4.8% per year. Although that's up from its low of 3.5% per year in October, "a bit more would probably do some good," Hanke argued.

He argues that the economy is not overheating, which gives the Fed wiggle room to loosen its grip on monetary policy ahead of "international storm clouds" on the horizon — which include uncertainty about trade, a potential no-deal Brexit and slowing growth in China.

Hanke said the US-China trade war and an increase in tariffs, in particular, could damage the global economy, backfiring on the United States.

"The US thinking on this thing is completely wrongheaded," Hanke said. "We have a president who is a businessman and most businessmen have no clue about international economics."

To counteract the slumping global economy, Fed Chairman Jerome Powell has hinted that rate cuts are coming at the conclusion of the Fed's two-day policy-setting meeting Wednesday.

Cutting rates would weaken the dollar, potentially making US exports more attractive to foreign buyers. That's why the Trump administration has been advocating for devaluing the dollar.

But Hanke cautioned against any intervention on the part of the Trump administration.

"Unilateral interventions are useless unless they're well planned and well coordinated, otherwise you're just burning up foreign currencies," he warned.

Hanke will discuss the Fed and the economy on the next "Markets Now" live show, which streams live from the New York Stock Exchange every Wednesday at 12:45 pm ET. Hosted by CNN Business correspondents, the 15-minute program features incisive commentary from experts.