January 26, 2019

Trump Cuts His Losses; Gold: QT's End & Venezuela

Government Reopens: Democrats are citing the closure of La Guardia Airport due to TSA work stoppages as the tipping point for President Trump's decision to reopen the Federal government yesterday. But the president's decision likely occurred sometime Thursday, soon after GOP Senators began to revolt on the shutdown.

Several senators reportedly told VP Mike Pence the shutdown strategy was failing, and the government must soon reopen. According to one source quoted by the Hill, "[Senate Majority Leader Mitch] McConnell talked about how we need to bring this process to a close; we should never have had a shutdown; they don't work; I've said this numerous times; I don't know how many times I've told you there's no education in the second kick of a mule."

McConnell was right.

Trump's threat of another government shutdown by February 15 if no bipartisan deal is reached sounds hollow. Wall construction is unlikely to go anywhere without House support and shutting down the government will not persuade House Democrats otherwise, let alone chastened Republicans.

According to the **Washington Post**, Trump has only recently recognized former Speaker Paul Ryan's role in squandering every opportunity he had to finance a wall during the previous two years, including just a month ago.

With many Democrats confident they have the high ground on both issues, the wall and healthcare could soon become 2020 presidential-cycle issues. On the wall, Pelosi Democrats believe most Americans reject it. And on healthcare, the Democratic call for improving Obamacare and/or moving to Medicare for All may prove more popular than the GOP's confused message.

Still, we would not completely rule out a compromise on border security.

A few moderate Democratic defections were seen in the Senate during the shutdown. And in the House, freshman Democrat Elaine Luria gathered 30 Democratic signatures this week in support of voting on border security funding by the end of February, so long as the shutdown ended.

Outside of Congress, the only viable option for President Trump to obtain enhanced border security is to reach an agreement with Mexican President Lopez Obrador on the mutual need for a well-regulated border, including a wall. Even more, Trump and the Mexican leader could seek a mutual understanding on DACA and other undocumented Mexican citizens living in the US that respects the dignity of human life, while reinforcing law and order between both nations.

The populist case for a wall between the US and Mexico is there for Obrador to rally behind. For too long Mexican elites have enjoyed the porous northern border as a political steam valve for their bad policies at home, allowing those policies to dominate by default. But with Obrador reaching a deal with Trump, he would be making good on his campaign promises to help all Mexicans. Especially helped would be the poor migrants who see no better alternative than to make the dangerous trek North because their plight has been left unaddressed under all previous Mexican administrations in memory.

Once Trump reaches an agreement in principle with Obrador, we believe Speaker Pelosi and Senate Majority Leader Chuck Schumer would come along.

Gold: QT's End & Venezuela: On Friday, gold broke out to the upside, closing at $1302/oz from $1279 the day before. Since its August low of $1176.20, gold is nearly 11% higher.

QT's End. Some of the Friday rally in gold may have been spurred by a 5:30 am **WSJ article** by beat reporter Nick Timiraos that Fed officials are considering an early end to its program of balance sheet normalization. In effect, much of the temporary increase in the Fed's balance sheet since 2008 would become permanent.

Although such a move has been hinted in drips and drabs since the middle of last year, Fed officials, such as Neel Kashkari, have become increasingly public in suggesting a strategy shift is afoot.

In mid-2018, balance sheet normalization estimates by Fed officials suggested the balance sheet of $4.5 trillion could be reduced to $3 trillion, or even $1.5 trillion in the long term. Today, with the balance sheet at $4 trillion, it's possible the end of quantitative tightening may be around six months away. Veteran Fed-watcher Lou Crandall of Wrightson ICAP has suggested a balance sheet level of $3.7 trillion might be enough, which would suggest QT ends by July.

Of course, given how most Fed governors have viewed the policy of QT taking place in tandem with rate increases, an early end of QT could mean an early end to the current rate-hiking cycle.

Larry Kudlow suggested this week the White House will be looking to fill the two vacant seats on the FOMC with governors who think more like President Trump and reject the notion that growth leads to inflation, i.e., hawks. The lapsed nomination of hawk Marvin Goodfriend was never mentioned, but we believe he is out of contention.

If at his post-FOMC press conference on January 30, Chairman Powell acknowledges Fed governors are leaning in the direction of ending QT early, it would be a strongly dovish signal for rate policy going forward. Equities could have more upside.

Venezuela: Noriega 2.0? The other factor sending gold higher is likely geopolitical, especially with recent developments surrounding Venezuela (for a more detailed account see our **treatment earlier today**).

On Wednesday, President Trump recognized the leader of the opposition-controlled National Assembly Juan Guaido as the "interim president" of the Venezuelan government, disavowing Nicolas Maduro. According to The New Yorker, Guaido, a 35-year-old former George Washington University graduate student, joined the General Assembly in 2015. Until the assembly elected him as leader three weeks ago, he had been a virtual unknown to the wider public.

On Thursday, Venezuelan military leaders went on TV to express their loyalty to Maduro.

But numerous countries followed the US recognition of Guaido as the interim president, including Canada, Argentina, Brazil, Chile and Peru. Mexico, China and Russia continue to recognize Maduro for now, with Moscow's foreign ministry warning of "catastrophic consequences" if the US intervenes directly. Today, the UK, Germany, France and Spain announced they will recognize Guaido as president unless new elections are called within eight days. The 2018 elections won by Maduro were not recognized by the US and the Lima Group.

As BWR contributor Ken Rapoza suggests, if comparisons between Colombia's former terrorist group FARC (Revolutionary Armed Forces of Colombia) and Maduro's PSUV (United Socialist Party of Venezuela) are made by the Trump administration, it could cement Maduro's pariah status with the rest of South America. With US allegations of narcotics trafficking, even terrorist aid, Maduro could soon become Manuel Noriega 2.0.

Yesterday, Mike Pompeo announced Elliot Abrams would oversee the Venezuela portfolio. Abrams, of course, was among the chief advocates of the US invasion of Panama during the Noriega years. If Maduro opts for new elections as the EU suggests, there may be a diplomatic firebreak available. Otherwise, we believe tensions are coming to a head. The risk of conflict involving US troops and Maduro's loyalist military has likely increased. We believe this risk is contributing to the weakening of the dollar in gold terms.

Bretton Woods Research