<u>The Outlook: Sept. 20, 2019</u>

In India, something more exciting than "the target rate on excess bank reserves."

Nobody wants a headache on a Friday afternoon, so here in "The Wizards of Oz, Part II" let's really try reducing things to their essence:

- Following the European Central Bank's (ECB's) action a few days ago, the U.S. Federal Reserve (Fed) cut short-term interest rates by 0.25% this week, to a new target of 1.75% - 2.0%.

- As with the ECB's action, not just "the markets" but the whole investment world obsessed about the action and its meaning. Any normal human being trying to make sense of the ocean of words spilled about the Fed and ECB was in for a headache. It's been jargon, on steroids.

- The essence of all the jargon was that the Fed's rate cut was intended to protect the economy from trade-war anxiety—because *as everyone knows*, lower interest rates encourage economic growth.

- Now the Wizard arrives. His cue was the term, "as everyone knows," which to lots of people (who've been around the block for a few decades) means, ""Don't believe a word of it!" <u>Like the ECB, our Fed is pretending it can do something which it can't</u>. Just as we remarked about the ECB, though, total cynicism isn't called for. Both central banks can do a lot of good sometimes: stopping bank runs and financial panics, first and foremost; giving economies a helpful nudge when credit is truly "tight" (costs too much); giving economies a helpful bucket of cold water over the head when they're giddy with optimism and nobody who wants a loan gets turned down.

  But those nudges and shoves are <u>not</u> the engines of genuine growth. The engines are human invention, and risk-taking, competitive businesses and individuals—when they're not forced to carry crippling burdens of rules and taxes; and when, due to their environment and culture, they're generally <u>inclined</u> to take risks and compete.

  The central banks do their pretending because they live in the political world, and they're <u>expected</u> to talk and act as if they can spark a lot of growth, when needed, rather than simply provide little nudges and shoves.

If we've gotten this far without a headache, very good. Unfortunately it gets worse—mainly because the markets and the overwhelming mass of the investment world <u>don't appear to believe one word above</u>. They are fixated on the central banks—and it does feel, as we experience the ups and downs of daily life in the markets, as if everyone else thinks those banking Wizards of Oz indeed see all, know all, tell all, and can do nearly anything with their economies.

It feels that way in the short run, because <u>whatever</u> most of the speculating crowd believes will come true . . . for a little while. As always, though, the only thing which comes true in the long run is whatever is actually going on with real cash, earned on Main Street. The engines creating that kind of cash are competition, risk-taking and invention. America's "market share" of those items, so to speak, is pretty stunning compared to the rest of the world . . . which is exactly why the U.S. economy has performed so well this decade compared to Europe.

That's nice for the long run, but not all that cheery right at this moment, in the face of a market willing to believe we're teetering on the edge of global stagnation, and even the central banks mightn't be able to save us. Here's a single headline, though, which might help:

India Surprises with $20 Billion Tax Cut: Stocks Soar

It was a genuine political surprise, over in India this morning. The government announced a major cut in corporate tax rates, from 30% to 22%. There had been no leaks, no prior hints, no discussion of the possibility. It was a news bombshell—but a good one. Prime Minister Modi, who was reelected this summer, had somewhat cautiously pushed pro-growth policies during his first term. This action was a good deal less cautious. "Bold" was the word which showed up most, as Indian business chiefs and bankers commented upon it.

The Indian stock market behaved a lot like the U.S. market did, when Mr. Trump's emphatic corporate tax cut package passed: it "soared." Why? That really is simple arithmetic: smaller business taxes mean more profits for investors, instantly; and smaller taxes also mean something more powerful, as growth engines go. They mean the "expected rate of return" for business investment projects suddenly gets a lot higher. All businesses have a laundry list of ways they might invest capital: new or remodeled factories; new product lines; new employees. They guess the rate of return on money spent in each possible way . . . and start at the top of the list, working down until the expected returns don't seem high enough to justify the risk.

An 8 percentage-point tax cut instantly makes a lot of potential projects look good enough to risk money on, when they were questionable before. Their projected return rates just went up by that 8%. It's not hard to understand; it's not jargon; it's got nothing to do with central bank wizards fooling around with the "target rates on excess bank reserves" and such stuff.

Finally, India's action matters, right away, to the global business community—not just India's. Foreign firms investing—or thinking of investing—in India suddenly found their own laundry lists of possible Indian spending look much more tempting. And just maybe they'll find themselves a little less inclined to worry about the risks of "trade war stagnation" and more inclined to . . . yes . . . take risks and compete.

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