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TRENDMACRO LIVE!

On the January FOMC

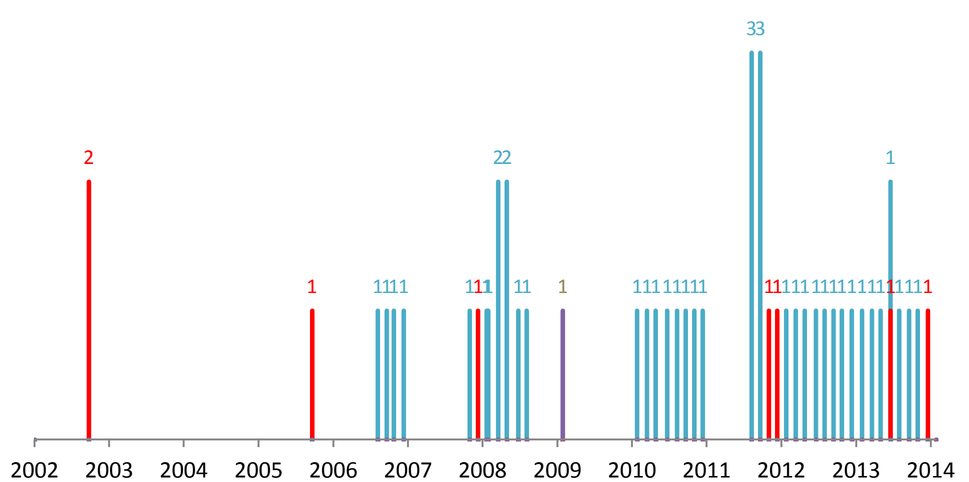
Wednesday, January 29, 2014
Donald Luskin

The emerging markets currency crisis doesn't even get a mention. Tapering is now the trend.

As we expected (see "Bernanke's Last Big Call" January 21, 2014) -- indeed, as the consensus had come to expect -- outbound Fed Chair Ben Bernanke's last FOMC today announced the continuation of its "measured" asset tapering program, reducing purchases by $10 billion per month, split evenly across Treasuries and MBS.

- The newly constituted FOMC membership gave Bernanke a goodbye kiss by voting with no dissents -- the first time in years (please see the chart below, and "Data Insights: Federal Reserve" January 29, 2014). The Boston Fed's Eric Rosengren, who dissented against last month's first taper, is no longer a voter on this newly hawkish committee.
- This unanimity makes it all the more likely that Bernanke's successor Janet Yellen will have to accept "measured" tapering as a policy *fait accomplis*, an established regime that could only be changed for very good reason.
- We thought that today's tapering decision would be a close call, given the tumultuous global markets and currency environment (see "I Shall Fear No Taper" January 27, 2014).

FOMC dissenting votes **Dovish** **Hawkish** **Procedural**



Source: Federal Reserve, TrendMacro calculations

Update to strategic view

US FED, US STOCKS: As we expected, the Fed continued its "measured" tapering. Thus Bernanke has handed Yellen a *fait accomplis*, an established policy trend that will be difficult for her to contradict, especially with a more hawkish voting composition of the FOMC. Today's statement was utterly silent on emerging markets turbulence, indicating that the Fed doesn't see it as a systemic threat worth acknowledging. As Bernanke departs the stage, this signals his belief -- like ours -- that the world is a less risky and more growth-friendly place, and it's time for Fed policy to go back to normal.

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- But you'd never know it by comparing the language in today's statement versus December's statement (see the marked-up comparison in "Data Insights: Federal Reserve").
- The eruption in emerging markets last week gets no mention at all in the statement.
- The December jobs report -- such a downside surprise, with only 74,000 net payrolls (see "On the December Jobs Report" January 10, 2014) -- gets dismissed from the worry list as the labor market showing "further improvement."
- Perversely, with December's surprise drop in the unemployment rate to 6.7% -- just 20 bp above the so-called "Evans Rule" threshold of 6.5% -- the FOMC states, "The unemployment rate declined but remains elevated."
- Other than the generally cheery assertion that "growth in economic activity picked up in recent quarters," there are no changes in the statement.

At first reaction as of this writing, stocks have fallen to new lows for the day, and for this correction from all-time highs.

- Since today's tapering was well-embedded in the consensus, that's not likely the cause.
- More likely, the market doesn't seem to think the world is such a benign place as the FOMC does at the moment of Ben Bernanke's departure from the stage.
- Perhaps it would have been more comforting for the FOMC to have admitted that the turbulence in emerging markets indicates possible remaining systemic fragilities, and that the Fed stands ready to do whatever it takes should intervention become necessary.
- But no. Not even a mention.
- If markets believe the FOMC is saying, "Sorry folks, you're on your own now," we think that's a serious mistake.
- Instead, we think the Fed is saying that there's no particular systemic risk here. Indeed, the world has become so free of systemic threats -- so normal -- that we're going to continue to move our policy posture back to normal, too.
- We think that's the wisest course. Once the markets have worked through this long-overdue correction, we think they'll realize that a less-risky world is a more growth-friendly world -- and the Fed's attempts to fine-tune it have long ago outlived the usefulness.

Bottom line

As we expected, the Fed continued its "measured" tapering. Thus Bernanke has handed Yellen a *fait accomplis*, an established policy trend that will be difficult for her to contradict, especially with a more hawkish voting composition of the FOMC. Today's statement was utterly silent on emerging markets turbulence, indicating that the Fed doesn't see it as a systemic threat worth acknowledging. As Bernanke departs the stage, this signals his belief -- like ours -- that the world is a less risky and more growth-friendly place, and it's time for Fed policy to go back to normal.