

TRENDMACRO LIVE!

On the July FOMC

Wednesday, July 30, 2014

Donald Luskin

Yellen's first hawkish dissent. But under her "optimal control," it couldn't matter less.

There are several intriguing nuances in today's FOMC [statement](#). But all you really need to know is 38 words -- the 38 words we've called "The Yellen Rule," repeated verbatim just as in the the [March](#), [April](#) and [June](#) FOMC statements (see "[The Yellen Rule is Taylor Minus Two](#)" May 19, 2014). Here are those 38 words, with the critical policy intention called out in red:

The Committee currently anticipates that, even **after employment and inflation are near mandate-consistent levels**, economic conditions may, for some time, warrant **keeping the target federal funds rate below** levels the Committee views as **normal** in the longer run.

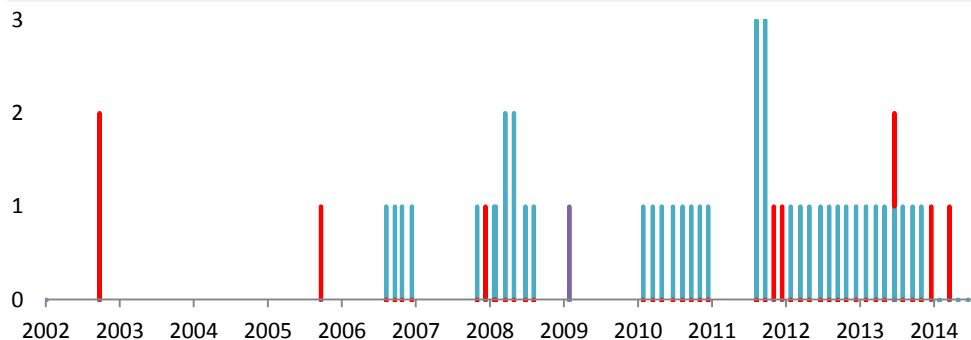
- There was a dissent today from Philadelphia Fed President Charles Plosser, the first hawkish dissent since Kansas City Fed President Esther George's at the [October FOMC](#) (and the first of any kind since Minneapolis Fed President Narayan Kocherlakota's dovish dissent at the [March FOMC](#) -- please see the chart below).
- Plosser objected that the FOMC's oft-repeated plan to keep the funds rate at zero for "a considerable time after the asset purchase program ends" doesn't "reflect the considerable economic progress that has been made."
- He has a point. Today's unemployment rate, and today's core

Update to strategic view

US FED: "The Yellen Rule" -- 38 words that promise accommodative policy even with maximum employment and stable prices -- was repeated today verbatim, for the fourth FOMC meeting in a row. Today's meeting saw the first hawkish dissent for the Yellen Fed, from Philadelphia's Plosser. He might as well not protest that the FOMC isn't sufficiently recognizing the progress the economy has made. It is recognizing it. It just doesn't matter, and under Yellen's doctrine of "optimal control" it won't matter until the economy overshoots the Fed's dual mandate.

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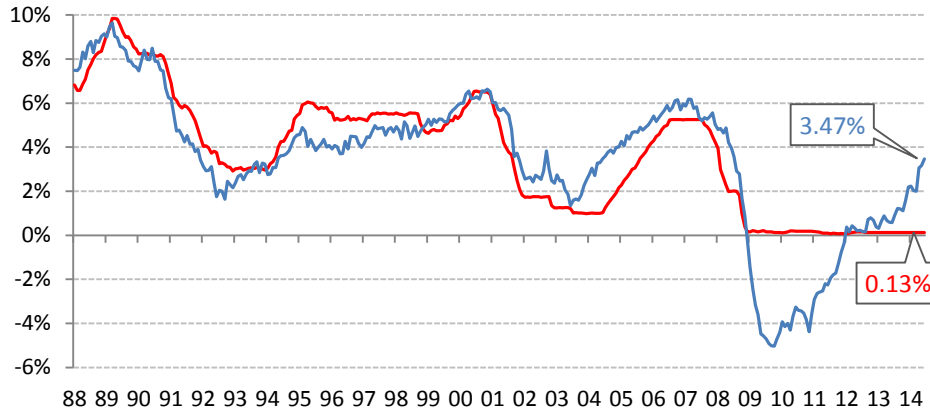
Dissents at FOMC meetings ■ Dovish ■ Hawkish ■ Procedural



Source: Federal Reserve, TrendMacro calculations

Personal Consumption Expenditures inflation rate, point to a funds rate -- right here and right now-- of 3.47%, using the version of the Taylor Rule that chair Janet Yellen prefers (please see the chart below).

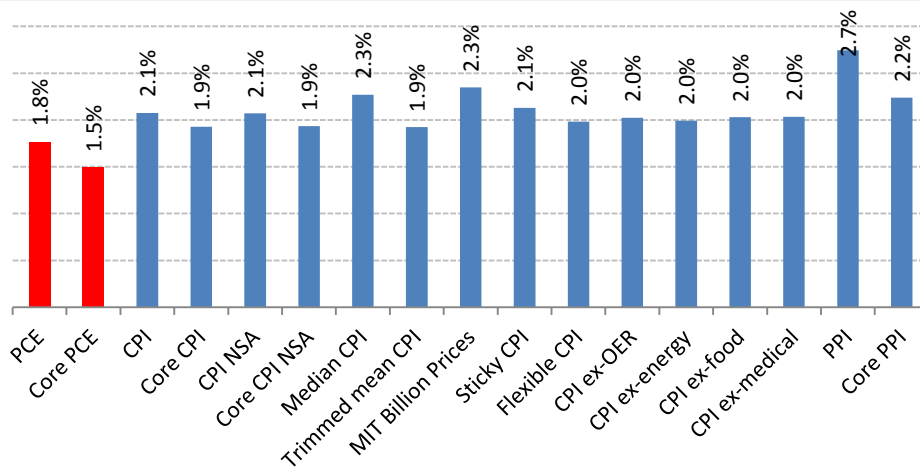
— Fed funds rate from Yellen's Taylor Rule — Actual fed funds rate



Source: San Francisco Fed, Bloomberg, TrendMacro calculations

- Indeed, the most notable changes in today's statement versus June's (see ["Data Insights: Federal Reserve"](#) July 30, 2014) were to acknowledge the pick-up in inflation.
- June's statement included a long sentence noting that too-low inflation is harmful to the economy -- all that's gone, replaced by the judgment that "the likelihood of inflation running persistently below 2 percent has diminished somewhat."
- Elsewhere, the statement notes that "Inflation has moved somewhat closer to the Committee's longer-run objective."
- In fact, it is above it by almost every measure, except the two the Fed happens to use (please see the chart below).

Various measure of US inflation YOY



Source: Various, TrendMacro calculations

- Looking at the labor market, the statement downplayed the

**Contact
TrendMacro**

On the web at
trendmacro.com

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Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Lorcan Roche Kelly
Agenda Research
Sixmilebridge Ireland
617 600 6969
lorcan@trendmacro.com

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Reading**

[How Virginia Became the Oil Patch](#)
Holman W. Jenkins, Jr.
Wall Street Journal
July 26, 2014

[The Growth Impact of Discretionary Fiscal Policy Measures](#)
Maria Grazia Attinasi And Alexander Klemm
European Central Bank
July 2014

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continued improvement in the unemployment rate, but added new language to demote its importance -- noting that "a range of labor market indicators suggests that there remains significant underutilization of labor resources."

- Plosser is no doubt wondering why his colleagues aren't celebrating labor market improvement well beyond headline unemployment. As we have noted, there has been profound progress in reducing long-term unemployment, raising the "inflow rate to employment," and a general resurgence of dynamism (see ["The Low Hanging Fruits of Our Labor"](#) July 15, 2014).
- But for new Chair Yellen, all that is splitting hairs. Under [her doctrine of "optimal control,"](#) improvement in the economy is irrelevant. She won't be done until she's locked it in by overshooting (see ["It's Yellen's World, and We're Just Living In It"](#) June 18, 2014). That's what the 38 words are all about. And that's all you and Charles Plosser need to know.

Bottom line

"The Yellen Rule" -- 38 words that promise accommodative policy even with maximum employment and stable prices -- was repeated today verbatim, for the fourth FOMC meeting in a row. Today's meeting saw the first hawkish dissent for the Yellen Fed, from Philadelphia's Plosser. He might as well not protest that the FOMC isn't sufficiently recognizing the progress the economy has made. It is recognizing it. It just doesn't matter, and under Yellen's doctrine of "optimal control" it won't matter until the economy overshoots the Fed's dual mandate. ▶