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TRENDMACRO LIVE!

On the December FOMC

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Donald Luskin

From "considerable time" to "patient." It doesn't matter -- lift-off is still on for mid-year.

The FOMC's statement today introduced the code-phrase "patient" to describe its attitude toward waiting for "lift-off" from zero policy rates -- but deliberately linked it to the prior code-phrase "considerable time," saying these two expression were "consistent." This is the sixth transformation of "considerable time" since September 2012 (please see the table below).

FOMC dates	"Considerable time" language
September 2012 October 2012	**considerable time** after the economic recovery strengthens… at least through mid-2015.
December 2012 January 2013 March 2013 May 2013 June 2013 July 2013 September 2013 October 2013	**considerable time** after the asset purchase program ends and the economic recovery strengthens… at least as long as the unemployment rate remains above 6-1/2 percent.
December 2013 January 2014	**considerable time** after the asset purchase program ends and the economic recovery strengthens... at least as long as the unemployment rate remains above 6-1/2 percent… well past...if projected inflation continues to run below the Committee's 2 percent longer-run goal.
March 2014 April 2014 June 2014 July 2014 September 2014	**considerable time** after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal.
October 2014	**considerable time** following the end of its asset purchase program this month, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal... faster progress...then increases in the target range for the federal funds rate are likely to occur sooner... slower than expected...likely to occur later.
December 2014	**patient** in beginning to normalize the stance of monetary policy. The Committee sees this guidance as consistent with its previous statement that it likely will be appropriate to maintain the…federal funds rate for a **considerable time** following the end of its asset purchase program.

Source: Federal Reserve, TrendMacro calculations

Update to strategic view

US FED: "Considerable time" has become "patient" -- and Yellen says the two expressions represent no change. She says "lift-off" from zero won't come until after "at least the next couple of meetings." This is consistent with all prior statements and use of code-phrases, and indicates the first rate hike will come at mid-year. "The Yellen Rule" of below-normal rates forever is intact, and that's the key message here. Despite another dissent from Kocherlakota, the FOMC has not been deceived by falling oil prices into thinking that inflation is dangerously low.

[Strategy Dashboard home]

- In the post-meeting press conference, Yellen said in her prepared remarks -- and again in response to the first question she was asked -- that this new language means the FOMC is "not likely to begin policy normalization for at least the next couple of meetings."
- That puts "lift-off" at mid-year, likely at the June FOMC meeting -- exactly as we've been saying for a very long time -- and, as it happens, exactly what the Fed said all the way back in the September 2012 FOMC statement, the first time it ever used the expression "considerable time."
- It's also consonant with what Yellen blurted out at her first press conference in March, that "you know, it probably means something on the order of around six months or that type of thing."
- For that matter, mid-2015 is roughly consistent with what the Alan Greenspan Fed did when it started using the word "patient" in the January 28, 2004 FOMC statement, when the funds rate was 1%. Hikes started at the June 30, 2004, meeting.

But does the exact date of lift-off even matter? We don't really think so, if the question is simply when the funds rate goes from the zero to 25bp range -- where it has been for six years -- to a range of 25 to 50bp.

- Even if the economy continues to improve only gradually, then with each little notch of improvement the Fed gets implicitly easier and easier by doing nothing. So almost whenever it notches up rates by 25bp, policy will still be easier after the hike than it is today.
- *What matters is the trajectory of policy after the first hike.* And we've known what that would be since the March 2014 FOMC statement, Janet Yellen's first as chair. That's where she laid down what we call "The Yellen Rule" -- 38 words that promise to keep rates below normal forever (see, most recently, "The Fed's Growth-Friendly 'Dot' Gap" September 19, 2014, and originally "The Yellen Rule is Taylor Minus Two" May 19, 2014). Those 38 words are below, with the essence of the policy message 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.**

- *These 38 words were repeated verbatim in today's statement, and in our view that's really all that matters here.*
- In the post-meeting press conference, Yellen was at pains to underscore the supremacy of this policy vision over anything the market may infer from the new "patient" code-phrase. In 2004, "patient" was followed by a relentless regime of small rate hikes characterized by Greenspan with the code-phrase "measured." *Yellen said today "there will be no repeat of that" -- we believe this is the most definitive statement she has ever made to draw the distinction between "The Yellen Rule" and a garden-variety hiking regime.*

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Wall Street Journal Real-time Economics
December 16, 2014

The oddly subdued optimism about falling oil prices
Cardiff Garcia
FTAlphaville
December 15, 2014

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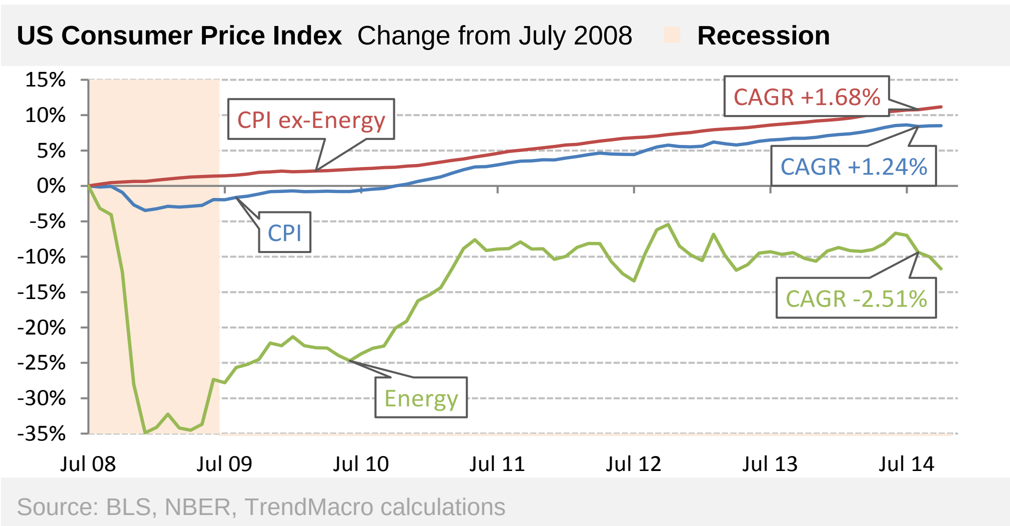
- This is borne out by the small down-ticks in the weighted average values of the "dots" that represent the FOMC participants' estimates of the optimal funds rate in 2015, 2016 and 2017 (see "Data Insights: Federal Reserve" December 17, 2014).

We note with some relief that today's statement, like last month's, avoided falling into the trap of worrying too much about too-low inflation, when -- as the statement acknowledged twice -- that is so clearly the consequence of the sharp drop in oil prices over the last six months (please see the chart below, and "Don't Let a Good Oil Crisis Go to Waste" October 21, 2014). With outright deflation reported this morning in November's Consumer Price Index (see "Data Insights: CPI/PPI" December 17, 2014) this was a risk.



The FOMC explained twice today that it understood the oil dynamic in inflation.

- That didn't stop Minneapolis Fed President Narayan Kocherlakota from dissenting again, for the second time in a row -- because he can't tolerate not aiming hell-bent-for-leather for the Fed's 2% inflation target, no matter what the reason for missing it.
- With hawkish dissents by Dallas Fed President Richard Fisher and Philadelphia Fed President Charles Plosser, there were a total of three dissents.
- That's the most so far for Yellen, tying the number scored at the August 2011 and September 2011 meetings chaired by Ben Bernanke. The same three regional presidents dissented, all in the hawkish direction, including Kocherlakota. At least they're consistent -- and in Kocherlakota's case, we think consistently wrong.

Bottom line

"Considerable time" has become "patient" -- and Yellen says the two expressions represent no change. She says "lift-off" from zero won't come until after "at least the next couple of meetings." This is consistent with all prior statements and use of code-phrases, and indicates the first rate hike will come at mid-year. "The Yellen Rule" of below-normal rates forever is intact, and that's the key message here. Despite another dissent from Kocherlakota, the FOMC has not been deceived by falling oil prices into thinking that inflation is dangerously low.