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TRENDMACRO LIVE!

# On the January FOMC

Wednesday, January 28, 2015

**Donald Luskin**

**It's an upgrade. It's unanimous. Despite "international conditions," lift-off is still on for June.**

The FOMC's statement today reflects a strong upgrade to the Fed's economic outlook. It's a bit of a surprise and a disappointment for those who thought that the downbeat risk-off tone in world markets this week ought to be dictating a more pessimistic -- and more dovish -- stance.

And the upgrade is unanimous. This is the first FOMC in five with no dissenting votes, now that chronic grumblers Narayan Kocherlakota (Minneapolis), Richard Fisher (Dallas) and Charles Plosser (Philadelphia) are no longer voting. Apparently today's policy decision was acceptable to new voters, including both super-hawk Jeffrey Lacker (Richmond) and super-dove Charles Evans (Chicago).

- At the December FOMC economic activity was said to be "expanding at a moderate pace" -- *now the pace is "solid."*
- "Solid" is no longer good enough to describe job gains -- *now they are said to be "strong."*
- Last meeting low inflation was "partly reflecting declines in energy prices" -- *now energy is "mostly" responsible.*
- This is very correct, and it's good that the FOMC isn't going to make a policy error by ignoring it (see "The Deflation Hoax" January 8, 2015). Consumer Price Index inflation has fallen to only 0.7% year-on-year -- but ex-energy it is at 1.9%, right at the Fed's target (see "Data Insights: CPI/PPI" January 16, 2015).
- *And now there's a new bullish factor: "recent declines in energy prices have boosted household purchasing power."*

The only glimpse of new downside risk is the addition of "international conditions" -- presumably Greece, or perhaps the strong US dollar -- to the list of reasons why the FOMC was able to repeat, verbatim, the prior meeting's cautious promise that the Fed "can be patient in beginning to normalize the stance of monetary policy." This time, reasons now include "international conditions."

- With this otherwise unqualified repetition of this mode of forward guidance, the expression "considerable time" is totally gone from FOMC statements for the first time since September 2012.

**Update to strategic view**

**US FED:** Today's FOMC statement is a major upgrade to the Fed's economic outlook -- and it's unanimous, for the first time in five meetings. Markets in risk-off mode this week might feel disappointed that the only sour note is the addition of "international conditions" to the list of reasons to remain "patient." The 38 words of "The Yellen Rule" -- the pledge to keep rates below normal forever -- is there again, as it has been at every Yellen FOMC. We still expect the first tiny and tentative rate hike at the June meeting. Given ongoing growth, policy will be effectively easier then at more-than-zero than it is now at zero.

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- But for us, what matters most -- the first thing we look for now every time a new FOMC statement comes out, and we compare it to the prior one (see "Data Insights: Federal Reserve" January 28, 2015) -- is the sentence that encodes what we have come to call "The Yellen Rule." *It's here again today, as it has been verbatim ever* since the March 2014 FOMC statement.
- The 38 words of "The Yellen Rule" 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.**

We think the Fed's upgraded outlook is basically right. To be sure, the sharp decline in oil prices is destabilizing in many ways, and this first quarter of the new year will no doubt reflect a lot of adjustments -- some of them painful (see "2015: Oil Change for the Global Economy, US Edition" December 31, 2014).

- If the pain is sufficient, the Fed can keep being "patient" as long as it needs.
- But we think the adjustments will likely be minor and brief, and offset by the factor that the Fed itself has acknowledged -- the immense boost to discretionary spending afforded by cheaper energy.
- We expect this will all sort itself out, and the Fed will end up making the first tiny and tentative rate hike at the June FOMC meeting.
- And when it does, with the economy having grown between now and then, policy will effectively be easier then than it is today (see, again, "The Fed's Growth-Friendly 'Dot' Gap").

## Bottom line

Today's FOMC statement is a major upgrade to the Fed's economic outlook -- and it's unanimous, for the first time in five meetings. Markets in risk-off mode this week might feel disappointed that the only sour note is the addition of "international conditions" to the list of reasons to remain "patient." The 38 words of "The Yellen Rule" -- the pledge to keep rates below normal forever -- is there again, as it has been at every Yellen FOMC. We still expect the first tiny and tentative rate hike at the June meeting. Given ongoing growth, policy will be effectively easier then at more-than-zero than it is now at zero.

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