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TRENDMACRO LIVE!

On the March FOMC

Wednesday, March 18, 2015

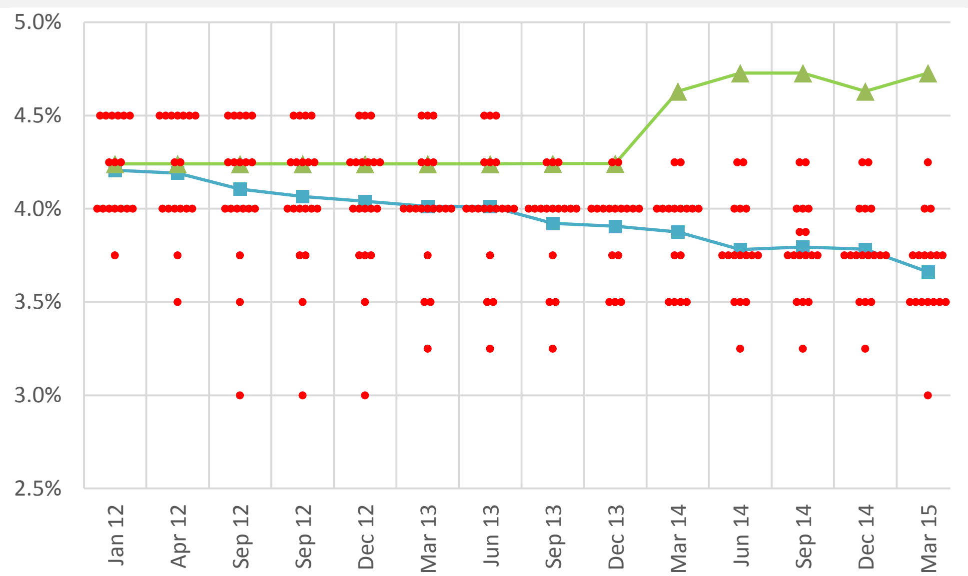
Donald Luskin

"Patient" (the word) is dead. Long live patience (the concept).

The consensus was right and we were wrong. We thought the FOMC's statement today would not drop the word "patient" from its guidance about "liftoff" from the zero bound on the funds rate (see "'Patient' is a Virtue" March 16, 2015). _*But the word "patient" is gone. That said, it's been replaced by words that mean the same thing, will broadening the Fed's options. We still think liftoff will be at the June FOMC meeting, and -- more than ever -- that the virtually permanent policy environment will be one of a funds rate well below normal, even if no longer zero.*_

- Much attention has been paid this afternoon to the sharp drop in the average value of the "dots" indicating FOMC participants' notions of the ideal funds rate at the end of 2015 -- to 0.77% from 1.13% at the December meeting (see "Data Insights: Federal Reserve" March 18, 2015).
- The gradualism implicit here is seen more strongly in the layout of "dots" for the "longer run" (please see the chart below) -- an

"Longer run" funds rate • Each FOMC participant ■ Average
▲ Taylor Rule with participant's "longer run" UE and inflation projections
Rule: 2.07 + 1.28 x 12-mo core PCE inflation - 1.95 x (UE - 5.4% full emp.)



Source: FOMC, TrendMacro calculations

Update to strategic view

US FED, US BONDS: "Patient" is gone, replaced by language that means the same thing, while maximizing the Fed's freedom of action. The key development is not the guidance language, but rather the "dots" -- which show a lower funds rate for end-2015, and more important, in the "longer run." Even as "longer run" economic projections have strengthened, the necessary funds rate to support them has fallen. Long-term TIPS yields have responded dramatically to this growth-friendly reduction of expected discount rates all along the curve.

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abstract concept of a steady-state or equilibrium economy. Here we see revealed the FOMC's long-term vision. The average funds rate has fallen to 3.66% -- down from 4.21% three years ago, and from 3.78% in December. At the same time, estimates of inflation and unemployment have improved. So the equilibrium economy is now thought to be stronger, yet it requires a lower funds rate (see, "The Fed's Growth-Friendly 'Dot' Gap" September 19, 2014).

- This is the quantitative instantiation of the 38 words that we've called "The Yellen Rule" (see "The Yellen Rule is Taylor Minus Two" May 19, 2014). These words were first given at Yellen's first FOMC meeting a year ago, and have appeared verbatim in every meeting since, including today's. 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.**

- *The removal of the word "patience" allows the market to focus on this longer-term policy environment, which we've been arguing all along is far more important to bond valuation than the exact moment of liftoff.*
- *We note that in the immediate aftermath of the FOMC statement's release, long-term Treasury yields overall fell sharply -- but as of this writing, the move in 10-year TIPS yields is twice that of the already quite large move in nominals. This is exactly what you'd expect if the market were rapidly appraising a long-term lowering of discount rates all along the curve, with some concomitant upward influence on inflation.*
- This is the main event. But if we wish nevertheless to worry about liftoff, we can obsess on the new guidance language that has replaced "patient":

> *Consistent with its previous statement, the Committee judges that an increase in the target range for the federal funds rate remains unlikely at the April FOMC meeting. The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term. This change in the forward guidance does not indicate that the Committee has decided on the timing of the initial increase in the target range.*

- We don't see how this has added to the world's stock of knowledge about the Fed's intentions. It wants to preserve its options -- which this does. But clearly nothing has changed in the long-held intention to achieve liftoff in "mid-2015," as the FOMC said all the

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Recommended Reading

Hillary's Emails and the Law
Ronald D. Rotunda
Wall Street Journal
March 16, 2015

The Billion Prices Project Thinks Inflation May Have Turned a Sharp Corner
Josh Zumbrun
Wall Street Journal Real Time Economics
March 13, 2015

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way back in September 2012 when QE3 was launched. Liftoff is still on for June.

Bottom line

"Patient" is gone, replaced by language that means the same thing, while maximizing the Fed's freedom of action. The key development is not the guidance language, but rather the "dots" -- which show a lower funds rate for end-2015, and more important, in the "longer run." Even as "longer run" economic projections have strengthened, the necessary funds rate to support them has fallen. Long-term TIPS yields have responded dramatically to this growth-friendly reduction of expected discount rates all along the curve.