TrendMacro

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TRENDMACRO LIVE!

# On the April FOMC and Q1-15 GDP

Wednesday, April 29, 2015

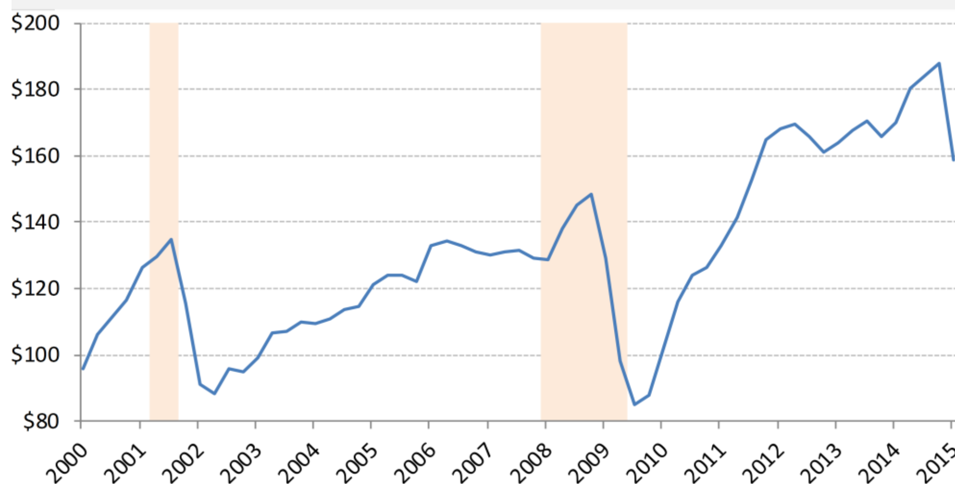
**Donald Luskin**

### The oil shock hits CAPEX and imports -- "transitory" or not, June liftoff is off the table.

Today's FOMC's statement sits in the shadow of this morning's Q1 2015 GDP report, which missed estimates and came in at a mere 0.2% at a seasonally adjusted annual rate (see "Data Insights: GDP" April 29, 2015). The markets' reaction to the news -- stocks sharply lower, bond yields sharply higher -- would seem to imply that the quarter was actually *better* than expected, and insufficiently awful to stay the Fed's hand from "liftoff" from the zero bound on policy rates.

- *The quarter's weak growth is very much about the blow to the US economy that we believe has spread in concentric circles of pain from the domestic energy sector* (see, among others, "Oilmageddon" December 16, 2014, and "Houston, You're the Problem" March 9, 2015).
- Fixed investment in mining, exploration shafts and wells fell $28.8 billion, or 48.7%, at an annual rate in the first quarter (please see the chart below), which we estimate lopped 50 bp from overall US output.
- At the same time, exports of goods fell at a 13.3% annual rate in the first quarter, no doubt driven by a 9% increase in the exchange

**Fixed investment in mining, exploration shafts and wells**
USD billions, SAAR **Recession**




Source: BEA TrendMacro calculations

**Update to strategic view**

**US FED, US MACRO:** Q1-15 GDP reflects the pain radiating from the domestic energy sector, with energy production CAPEX slashed, and the oil-related strong dollar damaging exports. The Fed sees the weakness, and calls it "transitory." But today's statement is a dark parade of horribles, and June liftoff is now absolutely off the table. We're inclined to agree that this soft-patch is transitory, but are respectful that last year's oil crash creates the greatest recession risk in six years. An abundantly cautious Fed at least takes itself off the list of things to worry about.

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value of the trade-weighted dollar on top a 5% increase the prior quarter -- increases which we believe are linked to the deep drop in oil prices since last June (see "Dollar Strength: A Crude Connection" April 23, 2015). This lopped another 1.26% from overall output.
- And inflation in core personal consumption expenditures -- the Fed's closely watched indicator of contemporaneous price stability -- fell to 0.9% at an annual rate, the lowest since Q4-2010. Crude prices fell only 10% over the first quarter -- so this drop in core inflation from an already low 1.1% in Q4-2014 suggests that the sharper drop in oil prices in the prior quarter has leaked through with a lag into the general price level.

*Markets seem to have taken only moderate comfort from the FOMC's statement today, but as we read it, the many changes in the language describing economic conditions* (see "Data Insights: Federal Reserve" April 29, 2015) *all point to deferred liftoff -- and we think markets will soon grasp that.* We'd been expecting the June FOMC meeting would be *der tag* for years, and we only began to get forced off that view with last month's disappointing jobs report, and Fed chair Janet Yellen's repeated references to "later this year" for liftoff (see "On the March Jobs Report" April 3, 2015). *With today's darkening ruminations from the Fed, June has to be seen as utterly off the table.*

- The phrase that "economic conditions slowed during the winter months, in part reflecting transitory factors" could be seen as the FOMC blaming the harsh winter, and looking through it.
- But versus the FOMC's March statement, the claim that "labor force underutilization continues to diminish" is gone.
- After that it's a parade of horribles. Business investment "softened," the housing recovery "remained slow," and exports "declined."
- And low inflation is no longer being blamed exclusively on falling energy prices, but also on "decreasing prices of non-energy imports."
- *That's an awful lot of stuff to be transitory.*

Forward guidance hasn't changed. Word for word, it's the same as last month's then-new language replacing "patient," which itself replaced "considerable time." Again at this meeting, liftoff is contingent on "further improvement in the labor market" and confidence that "inflation will move back to its 2 percent objective."

- And what we have come to call "the Yellen Rule" is still there (see "The Yellen Rule is Taylor Minus Two" May 19, 2014), word for word as they have been since Yellen's first FOMC meeting a year ago. Those familiar 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,**


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> **economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.**

So what's not to love here, at least if what you want is for the Fed to not launch liftoff in June?

The larger question is not so much when the Fed will raise the policy rate from the zero bound, but when the economy will regain its footing sufficiently to allow the Fed to do so. We remain troubled that after almost six years of a business cycle recovery and a worldwide bull market in equities, the shock of the oil crash makes recession more likely now than at any time since the Great Recession ended (again, see "Houston, You're the Problem" March 9, 2015).

- We're inclined to think that this shock is "transitory" as the Fed would say, and that the worst is already over (see "From March Badness to a Monday Miracle" April 7, 2015).
- All the more so with the Fed being so hypersensitive to every downside wiggle in the data, and out of an abundance of caution, not overly hastening toward liftoff.

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**Bottom line**

Q1-15 GDP reflects the pain radiating from the domestic energy sector, with energy production CAPEX slashed, and the oil-related strong dollar damaging exports. The Fed sees the weakness, and calls it "transitory." But today's statement is a dark parade of horribles, and June liftoff is now absolutely off the table. We're inclined to agree that this soft-patch is transitory, but are respectful that last year's oil crash creates the greatest recession risk in six years. An abundantly cautious Fed at least takes itself off the list of things to worry about.