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TRENDMACRO LIVE!

On the September FOMC

Thursday, September 17, 2015

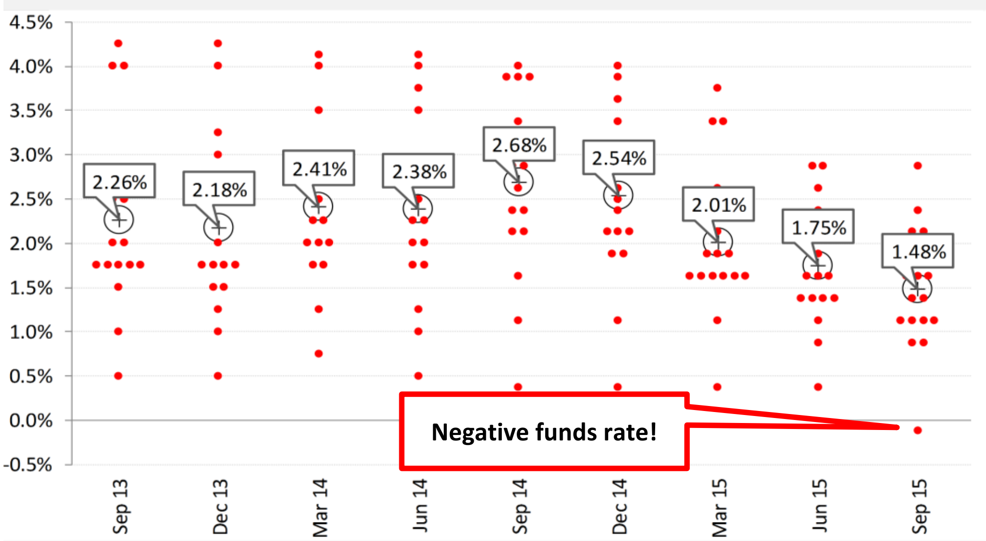
Donald Luskin

Yellen "takes note" of falling inflation expectations, and one member calls for negative rates.

Exactly as we predicted: no "liftoff" and no change in guidance in today's FOMC statement (see "FOMC: The Lady or the Tightener?" September 15, 2015).

- In Fed Chair Janet Yellen's prepared remarks at today's post-FOMC press conference, she acknowledged the "great deal of focus" on today's meeting, and that "an argument can be made" for "liftoff" now. But uncertainty about the economic outlook -- China was mentioned more than once -- and softer inflation carried the day.
- On inflation, we think it is especially significant that Yellen said that the FOMC "takes note" of the decline in inflation expectations reflected in markets. This almost feels to us like a rebuke to Vice-Chair Stanley Fischer, who in his Jackson Hole remarks last month, asserted that inflation expectations were stable, and cited as evidence the FOMC's own projections (see "On Fischer at Jackson Hole" August 31, 2015). *But its deep significance is that, when all the theorizing is done, the Fed's best indicator of future inflation is expectations -- and by any measure expectations are quite soft.*

FOMC participants' "appropriate" funds rate year-end 2016 O Average



Source: Federal Reserve Board, TrendMacro calculations

Update to strategic view

US FED, US MACRO: No "liftoff," no new guidance. Yellen acknowledges China as a risk factor, but the real news is her acknowledgement that the FOMC "takes note" of falling inflation expectations. As they were for Draghi last year, falling inflation expectations are a failing grade on central bank credibility. With on FOMC member now calling in the "dot plots" for negative policy rates, we think the Fed remains an "object at rest." There will be no "liftoff" anytime soon.

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- The "dot plots" in the [FOMC's economic projections] released today do not indicate that "liftoff" is coming any time soon, or that when it does come will be particularly aggressive (see ["Data Insights: Federal Reserve"] September 17, 2015). *The average "appropriate" funds rate fell for all the years projected.*
- *Indeed, in a unique form of dissent, there emerged today for the first time a negative projected funds rate -- negative one-eighth of one percent for both 2015 and 2016* (please see the chart on the previous page). We can't be sure, but we would assume that this comes from Minneapolis Fed President Narayan Kocherlakota, who will be leaving his post at year-end. In response to a question in the press conference, Yellen said that this option was not discussed at the FOMC meeting.
- One hawk -- Richmond Fed President Jeffrey Lacker -- dissented the old fashioned way, calling for "liftoff" today. If today's decision had really been the close call the media have been fulminating about, you'd think there would be more than one dissent (that said, Lacker is the only congenital hawk in the vote today).

The key language changes in [today's FOMC statement] were all on the inflation outlook.

- *The statement says, "Recent global economic and financial developments…are likely to put further downward pressure on inflation…" This is a much broader threat assessment than the many prior references to the transient disinflationary effects of lower energy prices.*
- *More critically, and in line with Yellen's remark that the FOMC "takes note," the statement said "Market-based measures of inflation compensation moved lower." This is an amplification of last month's admission that they "remain low."*
- For any central bank, credibility is the *sine qua non* of successful policy. Inflation expectations are any central bank's most important credibility scorecard.
- Recall a year ago when European Central Bank President Mario Draghi [declared at Jackson Hole] that falling inflation expectations in the euro area, by threatening faith in the ECB's resolve to achieve its mandate, called for an immediate and strong policy response -- negative rates, an ABS purchase program, and quantitative easing soon followed (see ["'Whatever It Takes' Comes to Jackson Hole"] August 25, 2014).
- *So among all the incoming data we'll be watching to figure out when this "data dependent" Fed will finally "lift off," inflation expectations are going to be uppermost on our dashboard.*
- Unless there is some improvement there, we're going to stick with our view that the Fed will remain ["an object at rest"].

Bottom line

No "liftoff," no new guidance. Yellen acknowledges China as a risk factor, but the real news is her acknowledgement that the FOMC "takes note" of

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