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TRENDMACRO LIVE!

On the October FOMC

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A pack of lies to save the pride of an ailing Yellen. Fortunately, nobody believes her.

We have no idea what planet today's FOMC statement was written on. Surely not on earth, but rather on some alternate world in which the highest priority is to maintain the wounded pride of an ailing Fed chair who can't back away from "later this year." *This is Janet Yellen at her worst. We warned you -- she is "dogmatic, rigid, narrow and willing to say anything -- even if it isn't true -- to defend and perpetuate her policy views"* (see "So Welcome to the Yellen Years" November 15, 2013).

- The FOMC repeated today that the criteria for "liftoff" will be "progress -- both realized and expected -- toward its objectives of maximum employment and 2 percent inflation."
- *But the prior FOMC statement had said these criteria would be applied "In determining how long to maintain this target range [i.e. zero]."*
- *Today, the statement said the criteria would applied "In determining whether it will be appropriate to raise the target range at its next meeting."*

In some sense it shouldn't matter. Based on the criteria given, there is no way "liftoff" will come at the "next meeting." *But there can be no guarantee that the Yellen FOMC will evaluate the criteria honestly -- it sure didn't do so today. There's no other term for it -- this was a pack of lies.*

- Today's statement says, "Household spending and business fixed investment have been increasing at solid rates in recent months, and the housing sector has improved further." But in fact retail sales ex-autos, and new orders for non-defense capital goods ex-aircraft -- have both fallen in both of the two most recent months. Housing starts have fallen in three of the last five months (see "Data Insights: A Few of Our Favorite Things" October 27, 2015).
- Today's statement admitted that "net exports have been soft," but then omitted the sentence from last month's statement saying that "global economic and financial developments may restrain economic activity."
- After a disastrous September jobs report, including large downward revisions to July and August (see "On the September Jobs Report" October 2, 2015), today's statement had to admit that "The pace of

Update to strategic view

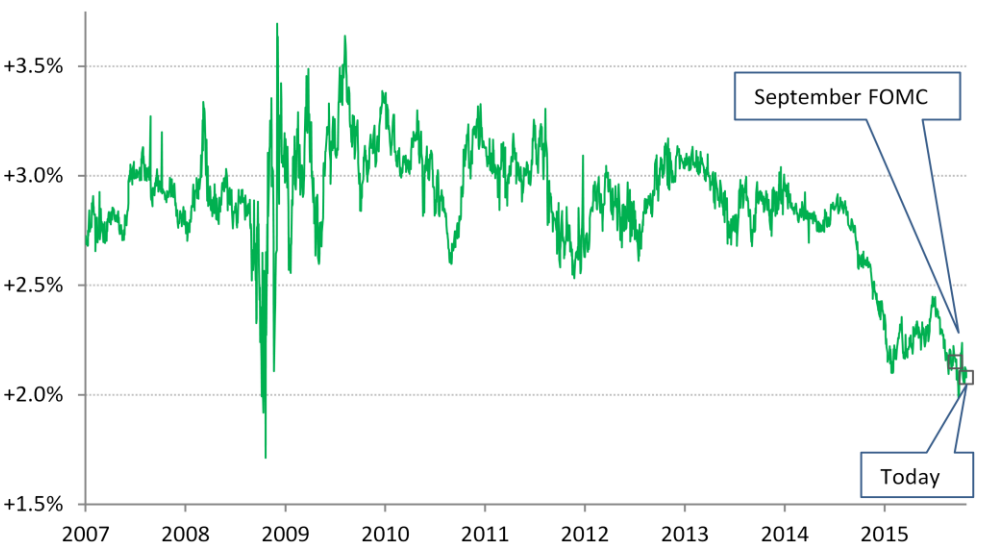
US FED, US MACRO: Today's FOMC statement was an alarming pack of lies, flagrantly misrepresenting the state of the economy to support an ailing Yellen's prideful commitment to "later this year," with an explicit warning that "liftoff" could come at the "next meeting." Markets seem reasonably confident that this is just Yellen talking her book, and that at crunch-time she won't make a grave policy error, just as the economy is slipping into the first-ever recession caused by low oil prices. That recession would be shorter and milder if we didn't have to worry about the Fed's credibility on top of everything else.

[Strategy Dashboard home]

job gains slowed." But it clung to last month's increasingly irrelevant statement that "underutilization of labor resources has diminished since early this year." In reality 754,000 persons have dropped out of the labor force since May.

- On the critical issue of long-term inflation expectations, today's statement said "Market-based measures of inflation compensation moved slightly lower" -- adding the word "slightly" to the prior meeting's language.
- "Slightly" hardly capture the situation. At the prior meeting, the drop in swap-implied 5-year forward 5-year inflation compensation to levels not seen since the deflation crisis of 2008 (please see the chart below) was, quite appropriately, a cause for alarm. Yellen

Swap-implied USD 5-year inflation compensation, 5 years forward



Source: Bloomberg, TrendMacro calculations

singled it out in the prepared remarks of her post-meeting press conference, saying the FOMC has "taken note" and "will continue to monitor inflation developments carefully."

- After three years and four months of the Fed failing to hit its 2% inflation target, for the expectations markets to have fallen even "slightly" after the FOMC specifically cited them as a risk is a catastrophic vote of no-confidence in Yellen.

So on what objective grounds, exactly, could the December FOMC remotely hope to see sufficient "progress -- both realized and expected -- toward its objectives of maximum employment and 2 percent inflation"? None.

And yet the warnings about a rate hike at the "next meeting" are there in black and white. Coming from an avowedly "data-driven" Fed, such hypocrisy is highly corrosive to market confidence.

The good news -- and the bad news, at the same time -- is that while the market *heard* Yellen today, the market didn't *believe* Yellen. Before the

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Recommended Reading

On the greatness of the great moderation
Lola Gadea, Ana Gomez-Loscos and Gabriel Pérez-Quirós
VoxEU
October 26, 2015

Low for Long? Causes and Consequences of Persistently Low Interest Rates
Sir Charles Bean, Christian Broda, Takatoshi Ito and Randall Kroszner
17th CEPR-ICMB Geneva Report on the World Economy
October 23, 2015

Why So Slow? A Gradual Return for Interest Rates
Vasco Cúrdia
FRBSF Economic Letter
October 12, 2015

Measuring the Natural Rate of Interest Redux
Thomas Laubach, John C. Williams
FRBSF Working Paper Series
October 2015

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FOMC, the fed funds futures market assigned December "liftoff" a probability of 35%. As of this writing 90 minutes later, the probability has risen to 46%. A risk premium has had to be baked in, insurance against the possibility that Yellen's pride would drive her, at the moment of decision, to actually make a grave policy error -- rather than what she did today, which was simply to talk her book.

Sadly, that risk premium will be baked into all economic activity going forward. As we enter the first-ever recession caused by low oil prices (see, among many, "Another 'Reverse Oil Shock'?" Tuesday, July 28, 2015), it's unfortunate that the struggling economy also has to process so much completely unnecessary uncertainty from the Fed.

Bottom line

Today's FOMC statement was an alarming pack of lies, flagrantly misrepresenting the state of the economy to support an ailing Yellen's prideful commitment to "later this year," with an explicit warning that "liftoff" could come at the "next meeting." Markets seem reasonably confident that this is just Yellen talking her book, and that at crunch-time she won't make a grave policy error, just as the economy is slipping into the first-ever recession caused by low oil prices. That recession would be shorter and milder if we didn't have to worry about the Fed's credibility on top of everything else.