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TRENDMACRO LIVE!

On the April FOMC

Wednesday, April 27, 2016

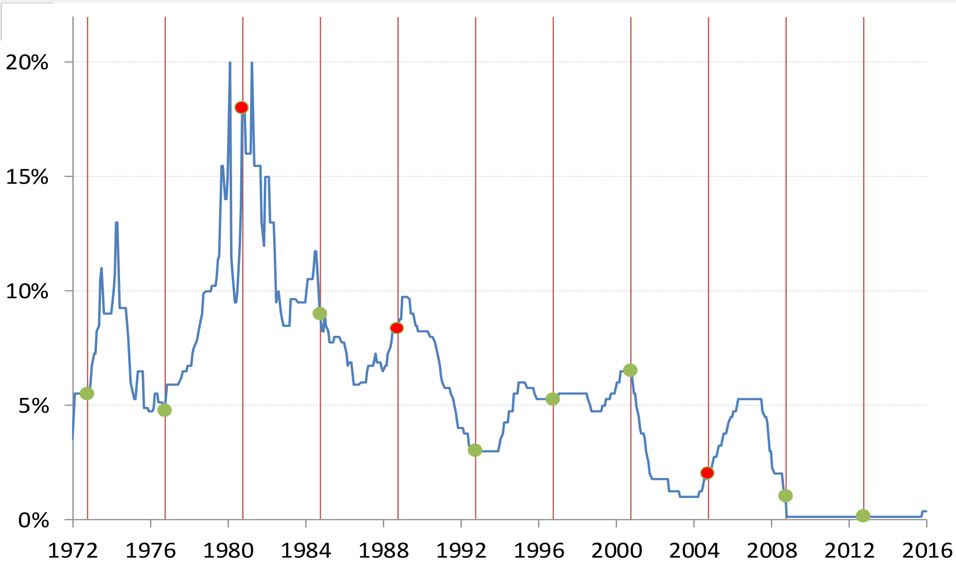
Donald Luskin

Global conditions still need monitoring. Economy slowing. Tame inflation. Any questions?

Today's FOMC gives us no reason to change our longstanding conviction that the Fed will not hike rates this year. Our view stands on five pillars:

- *Unemployment and core PCE inflation are at mandate-consistent levels*, so there is no reason to change the policy that produced that dear perfection (please see the first chart on the next page).
- Long-term steady-state inflation expectations, even with oil rallying, are at or just off their lowest levels in history, so *there is no evidence that tightening is needed to head off an inflationary threat* (please see the second chart on the next page).
- After the global market's sharp reaction to December 2015's "liftoff" from the zero funds rate, *the Fed now has a vivid new appreciation of uncertainty* around the costs and consequences of its actions (see "Yellen Adds 'Uncertainty'" March 30, 2016).
- This is an election year, and in more than four decades there have been only three times in which the Fed has hiked rates into an election (please see the chart below). All the more salient in this

Fed funds rate **Presidential elections** • ***with*** • ***without* rate hikes**



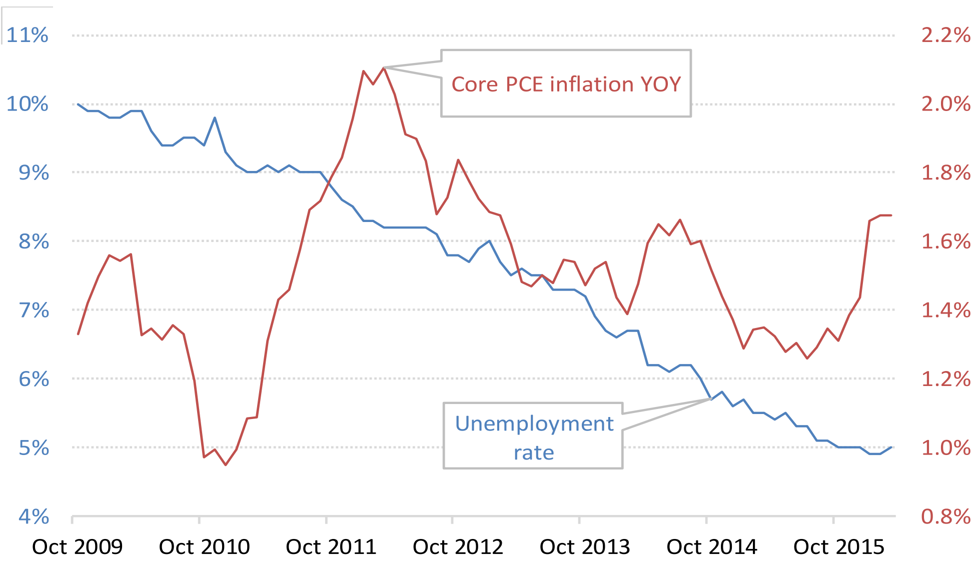
Source: Federal Reserve, TrendMacro calculations

Update to strategic view

US FED, US MACRO: The prior FOMC's sentence about risks from global developments is gone, but a chastened Fed is still watchful of them, having learned a harsh and humbling lesson about uncertainty from the way global markets reacted to "liftoff." At the same time, the Fed admits that most economic conditions have worsened with the exception of the labor market and housing. For that and four other reasons, we still have conviction that there will be no rate hike this year. Unemployment and inflation are mandate-consistent, so why tighten policy, with long-term inflation expectations at the lowest in the history of the data? A potentially tumultuous presidential election only worsens uncertainty. And with other central banks easing, tightening would risk a too-strong dollar.

[Strategy dashboard]

Evidence of achieving the Fed's dual mandate From peak unemployment

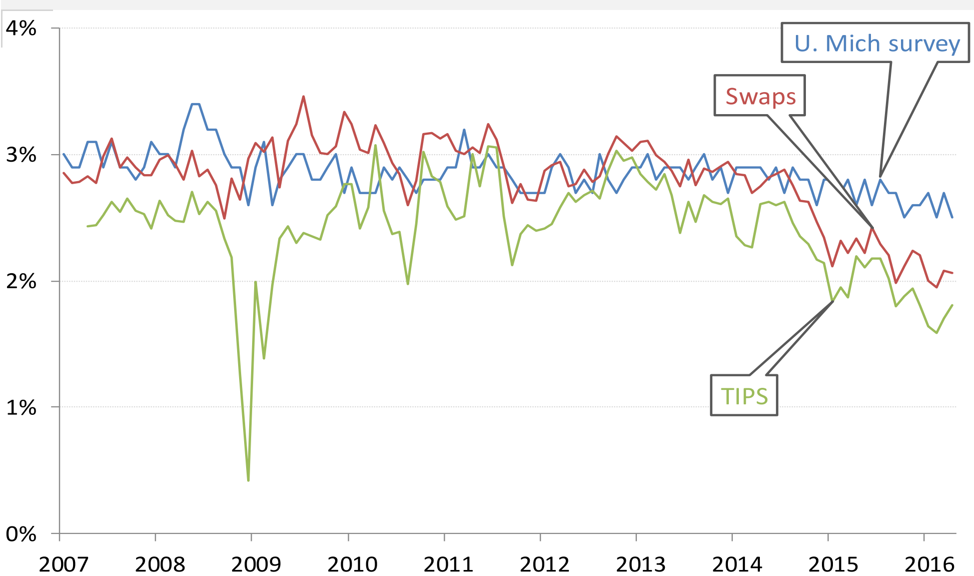


Source: BLS, BEA, TrendMacro calculations

most unusual and potentially destabilizing election year, when GOP front-runner [Donald Trump has already said] he would replace Chair Janet Yellen – and favors no more rate hikes. *So even if there is a hike in 2016, it can't possibly be until after the election, at the December FOMC.*

- Other major central banks are continuing with their easiest policy posture since the Great Recession, and some are looking to make them easier still. *For the Fed to tighten alone would risk imbalances that could lead to an unwelcome strengthening of the dollar*, which would renew the risk of turbulence in China (see

Long-term steady-state inflation expectations



Source: Bloomberg, TrendMacro calculations

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Recommended Reading

Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure
David Autor, David Dorn, Gordon Hanson and Kaveh Majlesi
April 26, 2016

Electric vehicles: The impact on oil and electricity
Ross McCracken
The Barrel
April 21, 2016

The Elusive Boost from Cheap Oil
Sylvain Leduc, Kevin Moran, and Robert J. Vigfusson
FRBSF Economic Letter
April 20, 2016

[Reading home]

"More Anbang For the Buck" April 13, 2016).

As if to confirm our vision of the Fed in stasis, today's FOMC statement varied little from that of the prior meeting. But the small variations are worth exploring (please see "Data Insights: Federal Reserve" April 27, 2016).

- *The item that has gotten the most attention in the immediate aftermath is the removal of a single sentence that had appeared in the prior statement: "However, global economic and financial developments continue to pose risks."*
- It was replaced by a much less alarmist phrase – that the FOMC "continues to monitor…global economic and financial developments."
- Fair enough – the "global economic and financial developments" that had been most worrisome at the last meeting have indeed substantially stabilized, notably China and its currency (see "Yuan Direction" February 16, 2016).
- But that stabilization doesn't put the Fed back on the path to rate hikes. It was the belief that the Fed was on such a path that caused those "developments" in the first place, and they began to stabilize as the Fed started sending signals that it new "liftoff" was a mistake.
- Surely Yellen knows – or rather, fears – that if she gets back on that same hiking path, those "developments" could recur. This is what she meant in her at the Economics Club of New York on March 30 when she elevated, at the last minute, the word "uncertainty" into the title of her speech (again, see "Yellen Adds 'Uncertainty'").
- All of us in the investment profession live perpetually with uncertainty – the wiser among us admit it, and work with it. For Yellen to have realized only in late March that uncertainty is her constant companion – and for her to elevate the idea of uncertainty into the title of her speech, as though it were a revelation to her – reveals the depth of her false certainty in December when she led the crusade to "lift off" while economic conditions were visibly declining (see "On the December FOMC" December 16, 2015).
- *Now she has learned her lesson about uncertainty. And like a cat who has just sat on a hot stove burner, in the future she won't sit even on a cold burner. The FOMC will "monitor…global economic and financial developments" for quite some time before it ventures to act again.*
- Other than that, changes to the statement language reflected slowing across the board in the economy since the last time the FOMC met, on March 16. On that day, the Atlanta Fed's GDPNow real-time estimate of Q1-2016 gross domestic product growth was 1.9%. It is now at 0.4%, having been as low as 0.1% two weeks ago (actual GDP data will be released tomorrow).
- The most positive thing today's FOMC statement could honestly say was that "labor market conditions have improved further" – and even that stretches the truth, with unemployment having ticked up from 4.9% to 5.0% at the last jobs report (see "On the March Jobs

Report" April 1, 2016).

- A less honest claim is that "the housing sector has improved further." How's that, with housing starts lower now than they were in December at "liftoff"?
- Finally, we note that with oil having rallied more than 50% from its double-bottoms in January and February (see "Oil's Bull Market in a Month" March 15, 2016), the FOMC had an opportunity to express stronger conviction that inflation would pick up.
- Instead today's statement eliminated the phrase in the March statement which noted that "inflation picked up in recent months."
- *Let's review the bidding. Global economic and financial conditions still need monitoring. Economy slowing. Nothing happening with inflation. We almost have to wonder why the FOMC would even hold any more meetings this year.*

Bottom line

The prior FOMC's sentence about risks from global developments is gone, but a chastened Fed is still watchful of them, having learned a harsh and humbling lesson about uncertainty from the way global markets reacted to "liftoff." At the same time, the Fed admits that economic conditions have worsened with the exception of the labor market and housing. For that and four other reasons, we still have conviction that there will be no rate hike this year. Unemployment and inflation are mandate-consistent, so why tighten policy, with long-term inflation expectations at the lowest in the history of the data? A potentially tumultuous presidential election only worsens uncertainty. And with other central banks easing, tightening would risk a too-strong dollar.