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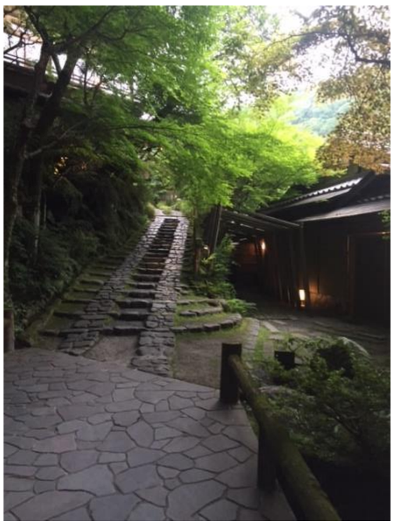
TRENDMACRO LIVE!

On the June FOMC

Wednesday, June 15, 2016

Donald Luskin

After three months of embarrassing flip-flops, the Fed did what it had to do: nothing.

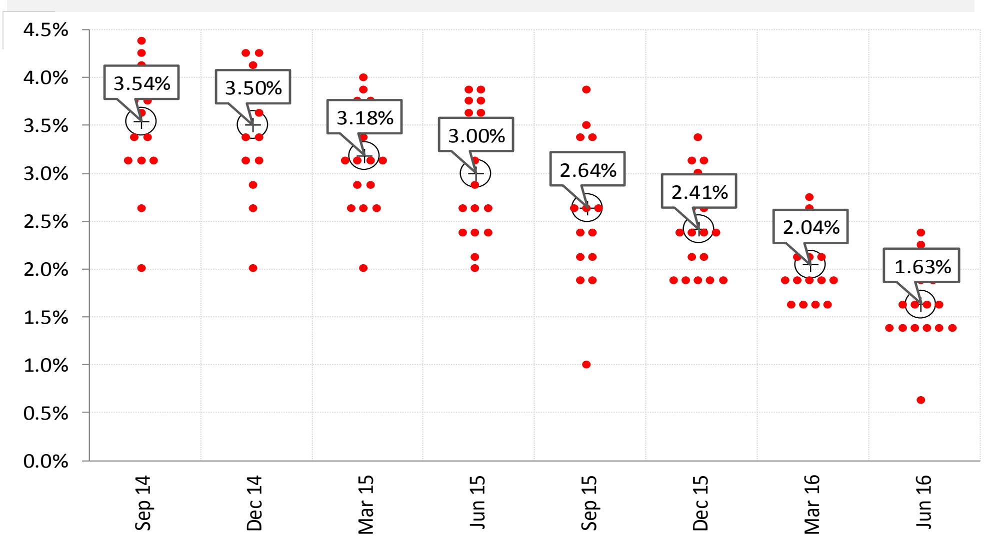


KYOTO, JAPAN Officially we are on vacation this week. But we can't resist doing a little victory lap on today's FOMC meeting. A rotten May jobs report and the present Brexit tensions have now made it pretty obvious, but for a while there it took some stubbornness to cling of our view that the Fed is not going to raise rates at least until December, and probably not even then (see "Is the Fed Stuck on Stupid?" May 20, 2016).

But before we talk about today's FOMC, just a quick word on the UK's potential withdrawal from the European Union.

- We warned several weeks ago (see "Brexit: Opening Pandora's Brox" May 23, 2016) that there would be a last-minute swing

FOMC participants "appropriate monetary policy" year-end 2017
By meeting, with arithmetic average



Source: FRB, TrendMacro calculations

Update to strategic view

US FED, EUROPE MACRO: We think Brexit risk is vastly overdone. But with fears of it driving a risk-off week, and after a disappointing May jobs report – following an embarrassing three months of policy flip-flops – the FOMC had to do nothing today. We continue to believe the Fed will not do anything this year, at least until December, and probably not even then. Today's statement took no particular note of Brexit. And it tried to put the happiest possible face on the May jobs disappointment. The "dotplot" for 2016 came down simply with the passage of time and the lost opportunity for a hike today. But estimates for the funds rate consistent with appropriate policy came down further for 2017 and 2018, and for the longer-run, reflecting the FOMC's continued belief that he natural rate is quite low, on an effectively permanent basis.

[Strategy dashboard]

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toward a "leave" vote, and that is exactly what polls are showing now.

- We have no idea how it will turn out, but we can be sure that the global political and financial elites will be pulling out all the stops over the next ten days to try to scare voters into choosing "remain." *So the atmosphere of fear is likely to continue until there is a resolution.*
- But we continue to believe that the whole thing is a tempest in a teapot, and that, in the short- to intermediate-term at least, a "leave" vote presents no particular economic risk to the UK, nor systemic risk to the world (again, see "Brexit: Opening Pandora's Brox").

Now, on to the FOMC – which didn't mention Brexit specifically, except once again to say that it watches "international developments," among other things.

- For all the Fed's flirtations with hawkishness over the last three months, once again, like clockwork, the "dotplots" fell for all tenors.
- For year-end 2016, the average funds rate associated with "appropriate monetary policy" fell from 1.02% in March to 0.83%. That's just mechanical – it reflects simply the passage of time and the loss of one press-conference FOMC (today's) at which a hike would have been possible.
- But for 2017, the average funds rate fell from 2.04% to 1.63%, taking out almost two hikes over 18 months (please see the chart on the first page). *So if these dots are telling us anything at all, it's that the FOMC's mood now is not only for a later start to resumption of hikes, but for a flatter trajectory.*
- *What's more, the "longer run" funds rate fell to a new low in the history of the data, from 3.31% to 3.14%, indicating that the FOMC now believes the steady-state mandate-consistent policy rate has moved down by almost one hike. In other words, the hike that didn't take place today never will take place.*
- This must reflect the FOMC's expanding commitment to the idea that the "natural rate" has fallen below historically conditioned expectations, and will remain low on an effectively permanent basis.
- We note with curiosity that, for 2017 and 2018, a single dot representing a funds rate of 0.625% has suddenly showed up (again, please see the chart on the previous page). We have no idea whose brainstorm that might be. **Update June 16: It was St. Louis Fed President Bullard.**
- We also note that Kansas City Fed President Esther George – a persistent hawk – chose not to dissent at this meeting as she had at the prior one, having wished for a hike in March. Perhaps her contribution to unanimity was the price she agreed to pay in exchange for Chair Janet Yellen's agreement to speak at August's Jackson Hole conference, after skipping it last year.

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Recommended Reading

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Timothy Duy
Bloomberg Markets
June 10, 2016

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Retraction Watch
June 7, 2016

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The take-away headline from today's FOMC statement is that, after the disastrous May jobs report released ten days ago, and large downward revisions to the prior two reports (see "On the May Jobs Report" June 3, 2016), the Fed has now been forced into the indicator-prediction business. Instead of being "data-dependent," the FOMC said today that "labor market indicators will strengthen."

- We suppose it had to say something, after an humiliating three months of policy flip-flops (see "For the Fed, Wrong is Better than Stupid" May 31, 2016).
- The statement today had to admit – while phrasing it as optimistically as possible – that "the pace of improvement in the labor market has slowed… Although the unemployment rate has declined, job gains have diminished."
- Ouch. The prior meeting's statement had said that "labor market conditions have improved further."
- Other than that, the language changes from statement-to-statement pretty much reflect reality as we see it. We, after all, *are* in the indicator prediction business. We think we are pulling out of the mini-recession of Q4-2015 and Q1-2016 (see "Have We Suffered Enough?" February 26, 2016).

That's the best we can do from our tranquil *ryokan* in Kyoto, where our Internet connection doesn't permit us to hear Yellen squirm under what we expect (hope?) will be less-than-polite questioning. *Suffice it to say that Yellen has learned, yet again, a lesson in "uncertainty"* (see "Yellen Adds 'Uncertainty'" March 30, 2016) *– and that future rate hikes will have a very high decision-hurdle in her mind.*

Bottom line

We think Brexit risk is vastly overdone. But with fears of it driving a risk-off week, and after a disappointing May jobs report – following an embarrassing three months of policy flip-flops – the FOMC had to do nothing today. We continue to believe the Fed will not do anything this year, at least until December, and probably not even then. Today's statement took no particular note of Brexit. And it tried to put the happiest possible face on the May jobs disappointment. The "dotplot" for 2016 came down simply with the passage of time and the lost opportunity for a hike today. But estimates for the funds rate consistent with appropriate policy came down further for 2017 and 2018, and for the longer-run, reflecting the FOMC's continued belief that he natural rate is quite low, on an effectively permanent basis.