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TRENDMACRO LIVE!

On the October FOMC

Wednesday, October 30, 2019

Donald Luskin

The Fed is no longer tight (but it's not easy, either). It took a 1.9% GDP quarter to get it.

Today's rate cut was virtually fully expected by the market, and nothing in today's post-meeting statement or Chair Jerome Powell's press conference suggested anything other than a pause at the December FOMC. The statement that "uncertainties about [the] outlook remain" is intact. The edge of urgency is blunted a bit by the transformation of the September promise that "the Committee….will act as appropriate" – a watered-down version of "whatever it takes" – to today's even blander undertaking to "assess the appropriate path" (and *this*, such as it is, is virtually the only substantive change in the statement language). And at this meeting there was no dovish dissent – St. Louis Fed President James Bullard wanted more than a 25 bp cut in September, and now apparently he has his wish (see "On the September FOMC" September 18, 2019). At the outset of the post-meeting press conference, Powell characterized this rate cut as being, in part, "insurance against ongoing risks" – suggesting he sees the realities of the world today as not, themselves, sufficient to warrant a cut. *Then at the end of his prepared remarks, he said it outright: "today's policy is likely to remain appropriate." This has "pause" written all over it.*

That has been the chatter consensus leading up to this meeting, so it should come as no great disappointment to markets. *With this rate cut, and with the onset of Treasury bill purchases to ease strains in the repo market, policy has finally been put – to quote Powell's infelicitous phrase – "in a good place," or at least not a bad one* (see "Video: What you're not hearing about this week's FOMC" October 28, 2019).

- *Finally, for the first time since late May, the funds rate target is below the 10-year yield. We have argued for many months that keeping this curve from inversion is, as much as anything can be, Powell's "policy rule"* (see, among many, (see "Video: What Jay Powell should be telling you about the inverted yield curve" April 1, 2019). *With that curve now disinverted, it is no longer signaling that the Fed is too tight. None of the more conventional spreads followed typically by markets are inverted anymore, either. This critical one was the last to go – and now it has.*
- At the same time, the funds rate target is now below every one of the many standard rules-based estimates given by the Cleveland Fed.
- For the first time in more than a year, the funds rate target – now at

Update to strategic view

US FED, US MACRO: Today's 25 bp cut was fully expected. A subtle change in the statement language, the absence of a dovish dissent, and Powell's outright statement in the presser that "policy is likely to remain appropriate" has "pause" written all over it. At 1.625%, the funds rate is below the YOY core inflation rate for the first time in over a year. It is below every rules-based estimate, and below the Fed's calculated neutral rate. Critically, it disinverts the funds rate/10-year Treasury yield curve, for the first time in 5 months, which we see as the central, perhaps the only, indicator on Powell's dashboard. Policy isn't easy, but it is no longer tight. This removes a substantial drag on growth – which, as this morning's GDP report shows, has already been penalized by the Fed's too-tight posture until now. We expect there will be no hikes unless and until inflation and inflation expectations visibly strengthen, even if higher growth re-emerges.

[Strategy dashboard]

1.625% -- is below the prevailing YOY rate of core PCE inflation – now at 1.77%.

- The funds rate target is also below the inflation-adjusted value of the Laubach-Williams model's estimate of the neutral interest rate (charts showing all these relations can be found in (see "Data Insights: Federal Reserve" October 30, 2019).
- *The regrettable element to all this is that, to achieve it, the Powell Fed apparently had to wait until the economy had lapsed back into pre-Trump era "secular stagnation" growth rates – Q3 GDP printed this morning at a secularly stagnant 1.9%* (see "Data Insights: GDP" October 30, 2019) – before fully backing off tight policy.
- If you insist on relying upon the "dot-plots" given in the FOMC's quarterly Summary of Economic Projections, then the next move is a hike – and it's coming right up in December. The September FOMC's SEP had the average year-end 2019 dot at 1.85% – and starting from where we are now at 1.625%, that's a dot-implied 90% probability of a hike. That actually tells you nothing except that the dot-plots are a hollow and foolish exercise (see "Video: What you're not hearing about this week's FOMC"). *This is a pause, not a V-shaped bottom in the funds rate path.*
- *Powell made it clear in the press conference, in response to a question, that there would be no rate hikes until there is a visible up-shift in inflation and inflation expectations.*

Bottom line

Today's 25 bp cut was fully expected. A subtle change in the statement language, the absence of a dovish dissent, and Powell's outright statement in the presser that "policy is likely to remain appropriate" has "pause" written all over it. At 1.625%, the funds rate is below the YOY core inflation rate for the first time in over a year. It is below every rules-based estimate, and below the Fed's calculated neutral rate. Critically, it disinverts the funds rate/10-year Treasury yield curve, for the first time in 5 months, which we see as the central, perhaps the only, indicator on Powell's dashboard. Policy isn't easy, but it is no longer tight. This removes a substantial drag on growth – which, as this morning's GDP report shows, has already been penalized by the Fed's too-tight posture until now. We expect there will be no hikes unless and until inflation and inflation expectations visibly strengthen, even if higher growth re-emerges.

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[About us]

Recommended Reading

China's Efforts to Lead the Way in AI Start in Its Classrooms
Yifan Wang, Shen Hong and Crystal Tai
Wall Street Journal
October 24, 2019

FCC Answers The Threat From Huawei
Ajit Pai
Wall Street Journal
October 28, 2019

Ousted Republicans plot rematches with Trump back on the ballot
Sarah Ferris and Ally Mutnick
Politico
October 28, 2019

Sixth presidential debate to take place at UCLA's Luskin School of Public Affairs
Martin Bilbao
UCLA Daily Bruin
October 25, 2019

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