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TRENDMACRO LIVE!

On the November FOMC

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Donald Luskin

A darker forecast now explains "operation twist" -- and the Fed stands ready to do more.

In the forecasts issued today ahead of Ben Bernanke's press conference, the FOMC sharply lowered its expectations for 2012 GDP, from 3.5%-3.7% down to 2.5%-2.9%, and raised its expectations for the unemployment rate from 7.8%-8.2% to 8.5%-8.7%. So why did the Fed stand pat? Why not more quantitative easing?

- These gloomier forecasts were already in the Fed's calculus at the September meeting, when "operation twist" was announced, and the post-meeting statement warned of "significant downside risks to the economic outlook." This explains what we took at the time as something of a surprise (see "On the September FOMC" September 21, 2011).
- As a result of "operation twist," *the Fed has already gotten loose -- for the first time in more than three years*.

Update to strategic view

US FED: The FOMC stands pat, despite a sharply darker economic forecast. That's because this forecast was already embedded in September's decision to implement "operation twist." Bernanke's strong pushback against political pressure, and the…

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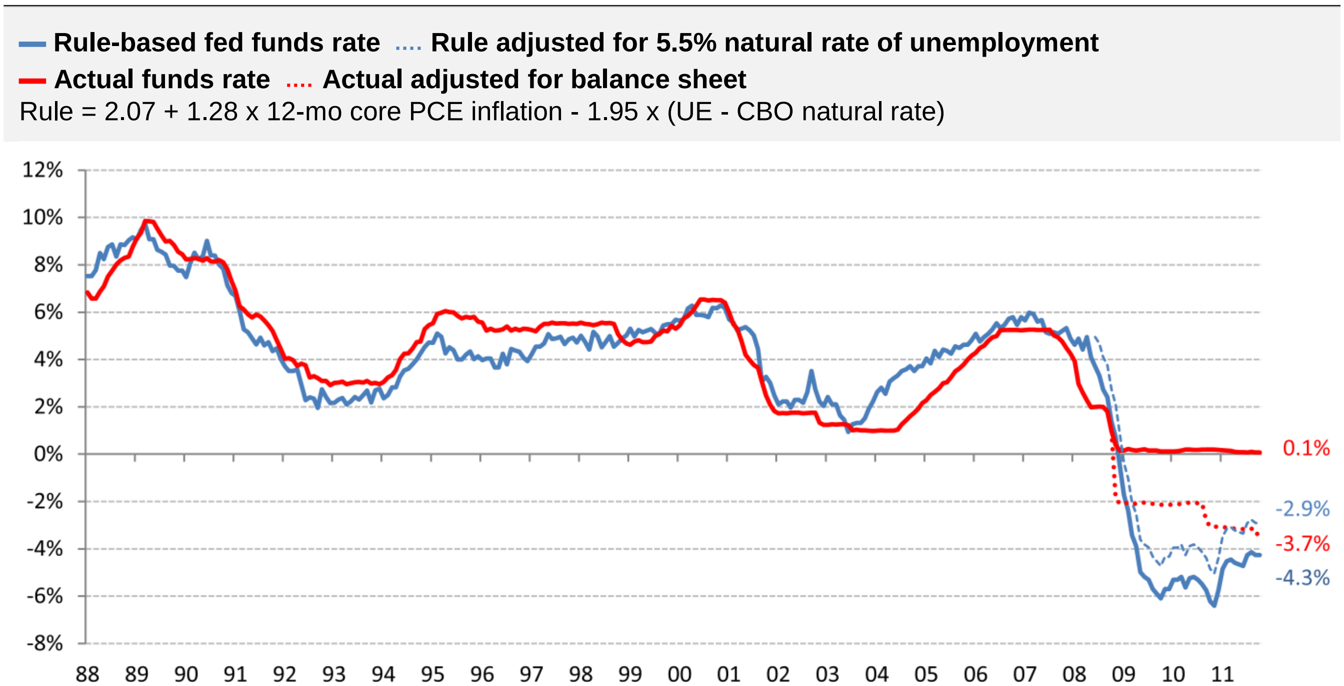

Source: FRB, BLS, BEA, TrendMacro calculations per Rudebusch (2009) , Chung et al (2011), Bernanke (2011)

- We define "loose" as having a policy rate (adjusted for balance sheet strategies) below the rate implied by the "Taylor Rule" (please see the chart at the bottom of the previous page).
- The version of the rule we know Bernanke looks at calls for a negative 2.9% funds rate, while the actual equivalent funds rate stands at negative 3.7%.

We don't expect that the Fed will ultimately ease any further. But we see it being more ready to do so today -- if that becomes necessary -- than it was at the September meeting.

- Despite a few comments about the outlook in today's statement that were slightly more upbeat than last meeting's, the warning of "significant downside risks to the economic outlook" was retained.
- There were no dissents from hawks this month -- indicating that nobody now objects to the easing measures taken in September, which inspired an unusual three dissents. Instead, there was a *dovish* dissent, from the Chicago Fed's Charles Evans, who "supported additional policy accommodation at this time." This would seem to imply that the hawks have come around -- pressure at the margin now comes from the doves.
- In his post-meeting press conference, Bernanke pointedly pushed back against political pressure not to ease further, coming primarily from Republican congressmen and presidential candidates.
- With a touch of probably unintentional humor, there was a variation on September's statement that the Fed "will continue to assess the economic outlook in light of incoming information and is prepared to employ its tools as appropriate." The words "as appropriate" were removed -- seeming to suggest on the face of it that Fed actions henceforth will be *inappropriate* -- and replaced with "to promote a stronger economic recovery in a context of price stability."

All that said, at this point, *does it even matter?* It seems that everything hangs now on the simple binary of whether or not Europe's debt crisis spins out of control and drags the world banking system down with it (see "It's This Simple" October 20, 2011). Today markets are being moved less by the FOMC, and more by every headline coming out of Europe concerning the consequences of a possible referendum in Greece (see "On the Greek Referendum Surprise" November 1, 2011, and "On the Greek Referendum Surprise, Volume 2" November 2). As markets are moved by these events, so will be the Fed. Perhaps the hawks already have been.

Bottom line

The FOMC stands pat, despite a sharply darker economic forecast. That's because this forecast was already embedded in September's decision to implement "operation twist." Bernanke's strong pushback against political pressure, and the pattern of FOMC dissents -- switching from three hawkish to one dovish -- suggests that the Fed is now institutionally more apt to ease than it was at the last meeting, should it become necessary.

[continued from page 1]

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[Strategy Dashboard home]

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