Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

TRENDMACRO LIVE!

On Fischer at Jackson Hole

Monday, August 31, 2015

Donald Luskin

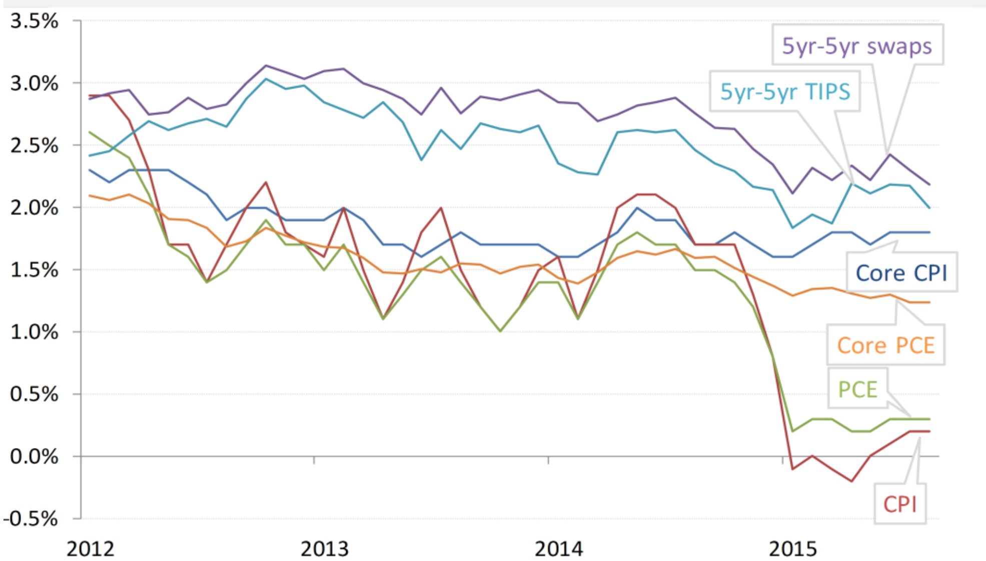
Less than three weeks to go, saying nothing, Fischer ratifies the consensus for no "liftoff."

Fed vice chair Stanley Fischer had the opportunity from his bully pulpit at Jackson Hole to confirm or kill expectations for a September "liftoff" from zero interest rates -- but he didn't do either, in his press comments on Friday or in his prepared remarks on Saturday.

- *Considering that going into the weekend the consensus in futures markets was betting against "liftoff," we see Fischer's failure to resolve the matter one way or the other as a form of ratification. As of this writing Monday morning, the consensus has not changed.*
- After all, with not even three weeks to go till the September FOMC, surely they know right now exactly what they are going to do. Are we to believe they would only decide to "lift off" if there is an especially good jobs report Friday? Or if China does *not* implode?
- *If Fischer knew to expect "liftoff," this would be the time to correct the consensus to the contrary. So we must conclude that the fact Fischer said virtually nothing one way or the other confirms our own long-standing expectation for no September "liftoff."*

The particular nothing that Fischer said was a masterpiece of mental

US inflation, statistical and expected Year-over-year



Source: BEA, BLS, Bloomberg, TrendMacro calculations

Update to strategic view

US FED, US MACRO: Fischer's Jackson Hole speech was not dispositive either way as to a September "liftoff." But considering that the market consensus has been against it, Fischer's saying nothing is a form a ratification. Surely the FOMC knows now what it will do in less than three weeks. If the decision were to "lift off," this would have been the time to correct the consensus. We are less worried about "liftoff" than about the Fed's complacency. While markets fret about "liftoff" and Fischer babbles about inflation, there seems little appreciation for the gathering threats to growth and how the Fed ought to brace for them.

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masturbation, an opaque and inward-looking disquisition on inflation, the theme of [this year's Jackson Hole symposium](#).

- *The point of Fischer's remarks, to the extent there was any point at all, is that inflation is too low, but there's nothing to worry about.* His hopeful thesis can be captured in a single sentence fragment: "… given the apparent stability of inflation expectations, there is good reason to believe that inflation will move higher as the forces holding down inflation dissipate further."
- The problem is that even the most casual glance at inflation data (please see the chart on the first page) makes it highly questionable that inflation expectations are indeed stable. They've been gently rising since their sharp drop in early 2014, but they're still pretty much right where they were last year at Jackson Hole, when ECB president Mario Draghi cited them as evidence of a deflation emergency (see "'Whatever It Takes' Comes to Jackson Hole" August 25, 2014).
- And for "the forces holding down inflation" to dissipate "further," they would have to be dissipating at all. A glance at the leading statistical measures of inflation (again, please see the chart on the first page), whether headline or core, shows no discernable incipient recovery trend.
- *Indeed, the persistence of too-low inflation jumps right out of the charts. So for Fischer to be so blasé about it -- or, more to the point, for the FOMC to be so confident about it as to hike interest rates -- he'd have to have some very good reason.* He does not. He cites the passing effects of weak oil and the strong dollar, but who is to say those effects are indeed passing? And while he notes that "the labor market is approaching our maximum employment objective," at the same time he confesses that the "ongoing role for slack in helping to explain movements in inflation…is typically estimated to be modest." *So much for the Phillips Curve.*
- The best he can do on expectations is to cite the optimistic expectations of the FOMC members themselves, which show inflation returning to target over several years. Never mind that these so-called "expectations" embedded in the FOMC Survey of Economic Projections are not expectations at all, but rather modelings of hypothetical outcomes under each member's own notion of "appropriate monetary policy." By the very definition of "appropriate," such modelings will always converge on the Fed's mandate targets over several years.
- In the end, Fischer seems to throw up his hands and admit defeat on inflation, saying: "we look beyond the rate of increase of PCE prices and define the concept [sic] of the core rate of inflation... we are mainly looking for a good indicator of future inflation, and for better indicators than we have at present."
- *From such weak evidence for a resurgence of inflation -- and with this admission of conceptual defeat -- we find it hard to believe that at today's low levels of inflation the Fed would take the manifold risks of "liftoff."*

Contact TrendMacro

On the web at
trendmacro.com

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Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

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Recommended Reading

The Myth of Normal: The Bumpy Story of Inflation and Monetary Policy [**hand-out**]
Jon Faust and Eric M. Leeper
Kansas City FRB Policy Symposium at Jackson Hole
August 18, 2015

Many Psychology Findings Not as Strong as Claimed, Study Says
Benedict Carey
New York Times
August 27, 2015

For investors in Russia, just two things matter
Chris Weafer
FT BeyondBrics
August 27, 2015

Heard of China's Fake Rolexes? Now There's a Fake Goldman Sachs
Shai Oster
Bloomberg Business
August 26, 2015

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We do not belabor these points in order to take shots at Stanley Fischer, who by Fed standards we think is a reasonable man (see "Stanley Fischer: Game of Chairs" December 12, 2013). Rather, as we face the prospect of the first-ever recession caused by low oil prices (see, among many, "Correction, Recession, or Crisis?" August 24, 2015 and "Is This the Oil Shock Tipping Point?" August 20), it's critical to understand the Fed's going-in position.

- In discussions with clients, we are constantly asked what the Fed would do -- indeed, at this point what *could* it do -- if there were a recession (whether caused by low oil prices, a China shock, or anything else).
- Obviously, the answer is that the Fed would do QE4. In mid-2012, amidst a significant correction in stock prices, when the consensus for a double-dip recession was quite strong, we were confident a recession would not come because we knew the Fed was on hair-trigger alert to initiate a new asset purchase program to prevent it -- as it did by initiating QE3 at that year's September FOMC meeting.
- If this were 2012, Fischer's remarks would not have been so ambiguous -- he would be assuring markets that the Fed stood ready to act as necessary, as Ben Bernanke did at Jackson Hole. Even with higher rates of inflation than we see today (again, please see the chart on the first page), Bernanke would have been talking about the threat of deflation. Yellen didn't even think it was necessary to attend this year.
- *But today, with all the talk centering on "liftoff" -- with the only question being "when" -- the Fed is most definitely not on hair-trigger alert. To intervene to bolster a faltering economy, it would have to fundamentally change directions.*
- *While markets are focused on the risk of "liftoff," we instead are focused on the risk of a complacent Fed that won't be oriented properly to respond to the downturn that could very well materialize here.*

Bottom line

Fischer's Jackson Hole speech was not dispositive either way as to a September "liftoff." But considering that the market consensus has been against it, Fischer's saying nothing is a form a ratification. Surely the FOMC knows now what it will do in less than three weeks. If the decision were to "lift off," this would have been the time to correct the consensus. We are less worried about "liftoff" than about the Fed's complacency. While markets fret about "liftoff" and Fischer babbles about inflation, there seems little appreciation for the gathering threats to growth and how the Fed ought to brace for them.