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

TRENDMACRO LIVE!

On the March FOMC

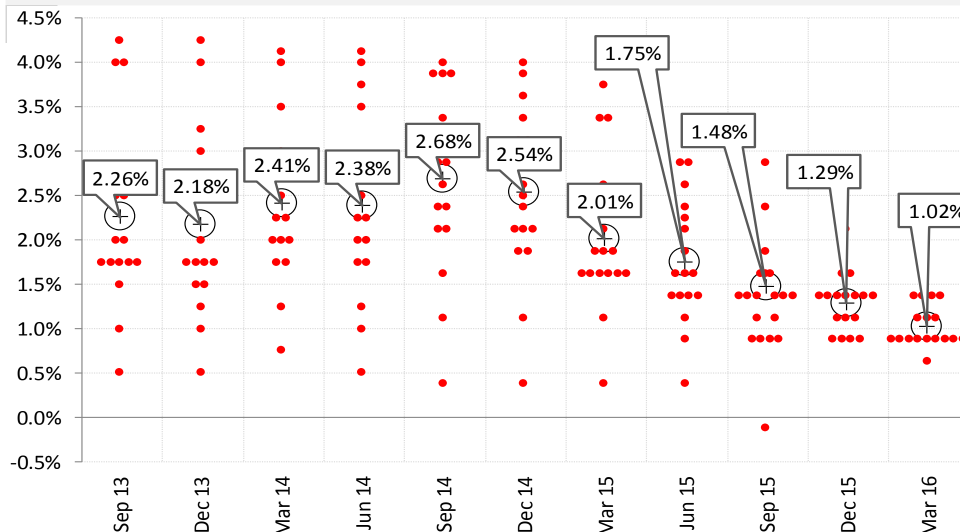
Wednesday, March 16, 2016
Donald Luskin

After all the brave talk about "first stirrings" of inflation, the "dots" come down -- again.

Today's FOMC was a dovish surprise for markets, following months of absurdly hawkish public comments by Vice Chair Stanley Fischer – who has assumed the role of the Fed's spokesmodel, with Chair Janet Yellen now having not made a non-mandatory public appearance in more than three months. We continue to think that she is not well (see "On the September FOMC" September 17, 2015). *Today's dovish turn reinforces our longstanding call that the Fed is on hold for the rest of year* (see, recently, "Will Yellen Get Trumped?" February 11, 2016).

- It was a relief to see the "dot plots" come down sharply for all tenors (please see the chart below, and "Data Insights: Federal Reserve" March 16, 2016).
- And it was good to read that the FOMC is now being candid about how "global economic and financial developments continue to pose risks."
- That said, there were still fantastical Pinocchio statements about how strong the economy is. For example, the FOMC's howler today about how "Household spending has been increasing at a

FOMC participants "appropriate monetary policy" year-end 2016
By meeting, with arithmetic average



Source: FRB, TrendMacro calculations

Update to strategic view

US FED, US MACRO: A dovish surprise after months of hawkish talk from Fischer, who has taken the lead-spokesman role from Yellen. Today's statement more frankly acknowledged global risks, and all the "dots" came down. At the same time the statement contained laughably wrong claims about the health of the economy, and again failed to state a balance of risks. We think the Fed is recovering from an institutional mania for "normalization" that set in last year. It will take a while for its rhetoric to catch up, but we continue to think that there will be no more rate hikes this year.

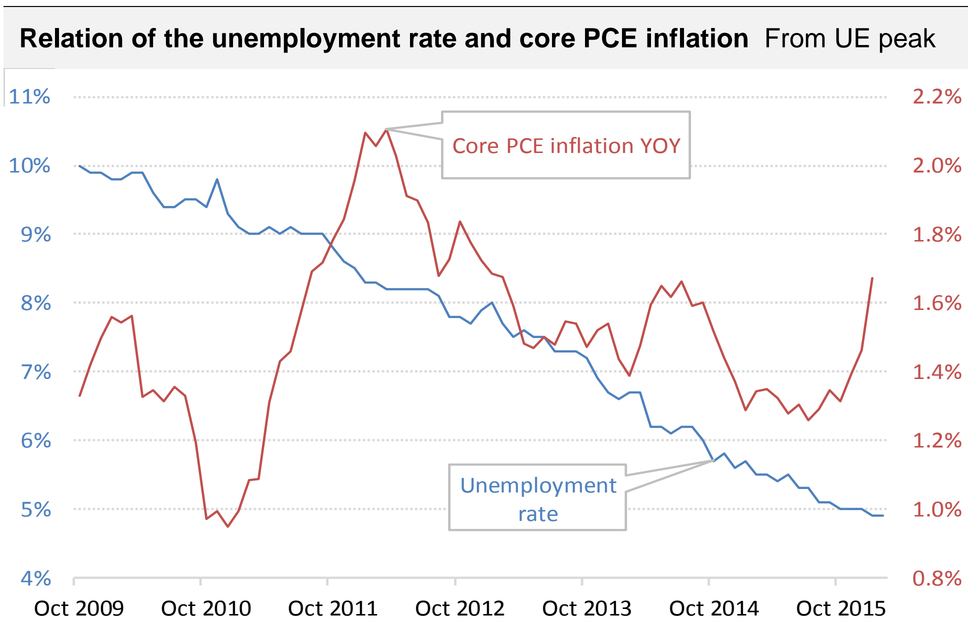
Copyright 2016 Trend Macrolytics LLC. All rights reserved. This document is not to be forwarded to individuals or organizations not authorized by Trend Macrolytics LLC to receive it. For information purposes only; not to be deemed to be recommendations for buying or selling specific securities or to constitute personalized investment advice. Derived from sources deemed to be reliable, but no warranty is made as to accuracy.

moderate rate" would seem to imply unawareness of the contraction in retail sales for both January and February.

We have no idea why the Fed would even consider hiking rates again – now, or for the foreseeable future, absent some compelling development. The unemployment rate is 4.9%. Core PCE inflation is 1.7% year-on-year. It's pretty much a mandate-consistent world for the Fed. We got to that world with near-zero interest rates. *Why would we change the policy that brought us to this state of perfection?*

- One argument might be that today's unemployment and inflation could be thought of as "normal," so we ought to have "normal" interest rate policy, too. But surely a "normal" policy rate could easily be zero in today's global environment. Why set it to some level that was "normal" for some other historical environment?
- Another argument is that today's unemployment rate arguably near full employment will trigger too-high inflation in the future – in other words, we must get "ahead of the curve." But that relies on the Phillips Curve theory that has turned out to have very little explanatory value for decades.
- Mainstream Fed thinkers cling to the Phillips Curve theory – not with much sincerity, yet still they cling. Recently Fischer said, "it is sometimes argued that the link between unemployment and inflation must have been broken. I don't believe that. Rather the link has never been very strong, but it exists."
- Really? We defy anyone to demonstrate any link at all during this cycle (please see the chart below). *Unemployment has been coming down steadily from its peak at 10% in October 2009, and core PCE inflation has been a random walk the whole time.*
- Fischer went on to say, in the same sentence, "we may well at present be seeing the first stirrings of an increase in the inflation

Relation of the unemployment rate and core PCE inflation From UE peak



Source: BLS, BEA, TrendMacro calculations

Contact TrendMacro

On the web at trendmacro.com

Follow us on Twitter at twitter.com/TweetMacro

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

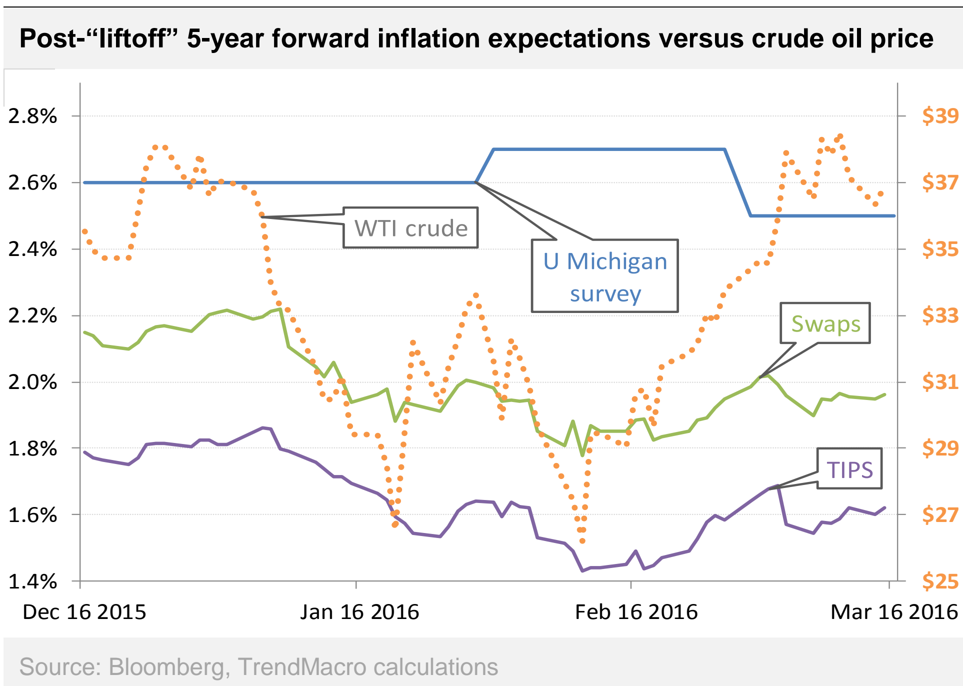
Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

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

[About us]

rate."

- Armed with only an admittedly frail theory, Fischer represents that he is able to sense "stirrings" that markets and surveys completely refute. *The best theory-free inflation forecast comes from forward inflation expectations in markets and consumer surveys which, at or near their lowest levels in history, give no indication of the risk of an inflationary break-out.*
- The dutiful and ambitious economists in the Federal Reserve System have supplied econometric "studies" that discredit these estimates of forward inflation, claiming they are so low because of technical liquidity considerations, and because of a supposed correlation with oil prices.
- Really? Consumer surveys aren't subject to liquidity effects. And the oil price has rallied almost 50% over the last month or so (see "Oil's Bull Market in a Month" March 15, 2016) – *it's now higher* that it was at the "liftoff" FOMC meeting in December. Yet survey-based and market-implied forward inflation expectations are lower (please see the chart below).



Post-"liftoff" 5-year forward inflation expectations versus crude oil price

Source: Bloomberg, TrendMacro calculations

- Finally, the same sentence uttered by Fischer concluded by saying that the supposed "increase in the inflation rate" is "something that we would like to happen." To be sure! *The Fed hasn't hit its inflation target now for almost four years. So why now, with the target in sight, should the Fed change policy?*

Well, the Fed *didn't* change policy today, and unless something in this analysis changes a lot, if likely *won't* change policy. So the only question, perhaps, is why it says all the silly things it says about how it *will* change policy.

Indeed, in the post-meeting press conference, a reporter asked Yellen how she justifies expecting any rate hikes at all this year. Yellen expended

hundreds of words dancing around it, and ended up with a stale talking point about how the FOMC doesn't want to get "behind the curve," because that would necessitate larger and more disruptive rate hikes later.

We are forced to conclude that, late last year, the Fed talked itself into a self-imposed institutional mania to "normalize" by "later this year." The stresses in global markets that emerged the moment "liftoff" happened in December have surely triggered a re-think – but it's in the nature of such manias to wear off slowly, if for no other reason than, in their aftermath, they are an embarrassment to those who suffered them.

In this state of cognitive dissonance, we have an FOMC that now, for two meetings running, has failed to even articulate how it assesses the "balance of risks." A reporter asked about that in the press conference, noting that in the December "liftoff" statement the "outlook" had been "balanced" – and having acted upon that assessment, global markets proceeded to go into crisis. And yet now, having been chastised by that reaction, the Fed is unwilling to admit that the "outlook" is anything other than "balanced." And yet no more rate hikes.

The Fed needs to time to change its public-facing narrative in a way that preserves its dignity. That's going to drag on for a while yet. No wonder Yellen doesn't want to appear in public unless she has to. We stand by our call for no more rate hikes this year.

Bottom line

A dovish surprise after months of hawkish talk from Fischer, who has taken the lead-spokesman role from Yellen. Today's statement more frankly acknowledged global risks, and all the "dots" came down. At the same time the statement contained laughably wrong claims about the health of the economy, and again failed to state a balance of risks. We think the Fed is recovering from an institutional mania for "normalization" that set in last year. It will take a while for its rhetoric to catch up, but we continue to think that there will be no more rate hikes this year.