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TRENDMACRO LIVE!

On the May FOMC

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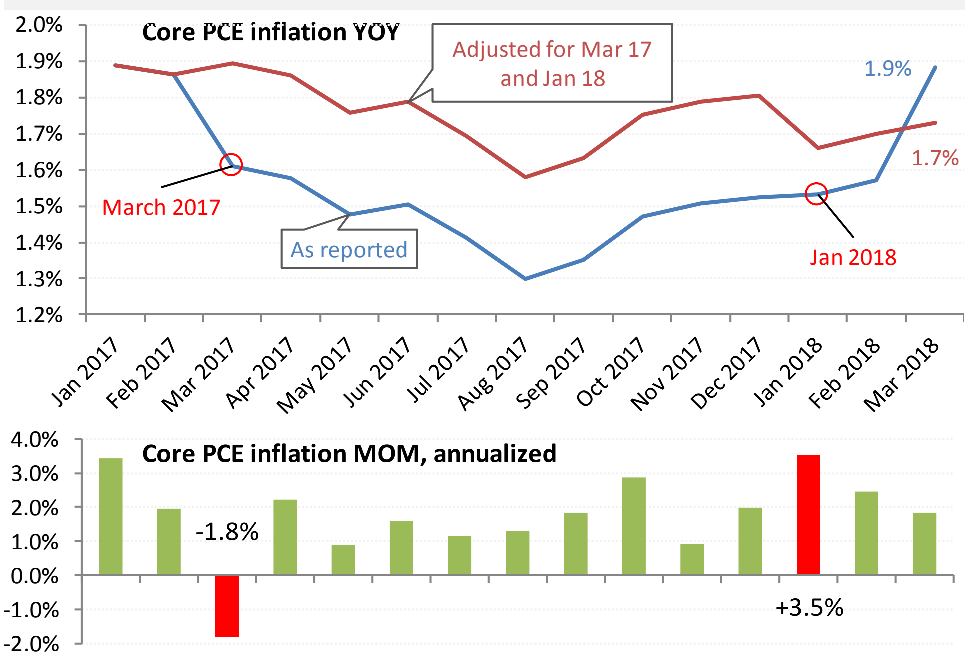
Donald Luskin

Ignore those data anomalies! Inflation doesn't even need to be closely monitored anymore!

The FOMC came into its May meeting under the shadow of a dangerous inflation illusion, and from today's statement it's not clear whether they are being fooled by it. But then again, with the Powell Fed, nothing is ever clear.

- In today's statement, inflation which at the March FOMC "continued to run below 2 percent" instead is now declared to have "moved close to 2 percent." Last meeting's assurance that "the Committee is monitoring inflation developments closely" is simply gone now (see "Data Insights: Federal Reserve" May 2, 2018).
- In this simple little world, there is no acknowledgement that a single out-of-pattern *deflationary* datapoint in March 2017 has kept year-over-year core inflation artificially low. That anomaly rolled out of the calculated reported on Monday. But a single equally anomalous *inflationary* datapoint, for January 2018, is still in the year-over-year calculation. So core Personal Consumption Expenditures inflation

Deceptive core inflation dynamics



Source: BEA, TrendMacro calculations

Update to strategic view

US FED, US MACRO: The FOMC has declared "mission accomplished" on inflation, and removed language that it is "monitoring inflation developments closely." This is despite the fact that Monday's report of 1.9% year-over-year core PCE inflation is the result of anomalously soft year-ago data dropping out, and anomalously hot January data staying in. Adjusted for these anomalies, year-over-year core inflation is actually only 1.7%. The FOMC admitted as much in the minutes of the March meeting, but ignored it today – casting further doubts on the intellectual depth of the Powell regime. Seemingly hawkish language from March about how the "outlook has strengthened" is gone. But on the other side, an exaggerated claim about business investment growth was added. Markets don't seem to care much about any of it, perhaps because they are coming to understand that the Powell Fed's communications are not sophisticated enough to deserve the usual exegesis.

[Strategy dashboard]

illusorily leapt from 1.6% for February to 1.9% for March, seemingly perilously close to the Fed's 2% target. *Taking out the anomalies, inflation hasn't been as low as it has seemed for the last year – bottoming in August at 1.6%, not 1.3% as reported. Now it is not as high as it seems – at 1.7%, not 1.9% as reported* (please see the chart on the previous page).

- *It's frustrating that the FOMC knows this.* The minutes of the March FOMC reported (see "Data Insights: FOMC Minutes" April 11, 2018):

> *"all participants expected … the arithmetic effect of the soft readings on inflation in early 2017 dropping out of the calculation; it was noted that the increase in the inflation rate arising from this source … would not justify a change in the projected path for the federal funds rate."*

- *This makes a difference to the urgency with which the Fed proceeds with normalization.* If the Fed believes the artificial 1.9% as-reported inflation figure, then the funds rate at 1.63% is about one-and-a-half 25 bp hikes below the "neutral rate of interest" as calculated by the Fed's Laubach-Williams model (with its co-creator John Williams, by the way, now the president of the New York Fed and a permanent FOMC voter). But at the anomaly-adjusted inflation rate of 1.7%, the funds rate is only half a hike below neutral.
- As of this writing about an hour after the meeting, markets don't seem to care much one way or the other. Perhaps, as we have conjectured before, they have simply given up trying to decrypt policy clues in statements by new Chair Jerome Powell, who is turning out to be insufficiently sophisticated to encrypt them in the first place (see "Risk-Back-On in a Week of Tape-Bombs" April 16, 2018).
- Perhaps it's because the statement emphasizes that the inflation target is "symmetric" – which would seem to be extra reassurance that while normalization will continue if inflation stays at-target or above-target, it can pause or reverse if it moves below-target.
- Perhaps its because today's statement entirely eliminated the sentence from the March statement that "The economic outlook has strengthened in recent months." If one insists on interpreting potentially non-existent clues, this may be one that the Powell Fed's slogan that "tailwinds are becoming headwinds" is losing some of its luster after a weak-ish Q1-2018 (see "Data Insights: GDP" April 27, 2018). This would relax fears that Powell will act on his naïve concerns about the economy "over-heating" (see "On Jerome Powell's Testimony" February 27, 2018).
- On the other hand – and Powell has more hands that Vishnu – today's statement inserted a new claim that "business fixed investment continued to grow strongly." That would seem to cut the other way, except that it isn't especially true, except for structures (see "Data Insights: A Few of Our Favorite Things" April 26, 2018). Indeed, the absence of evidence of a business investment boom is cited often to us by clients, as a possible reason why US equities

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[About us]

haven't acted better during this seemingly very postive earnings season.

We apologize to clients who dislike our somewhat sarcastic tone when we talk about Powell. We take that tone to get your attention and shock you out of an entirely understandable – but wrong – default assumption that, like Fed chairs before him, Powell comes to this role with a deeply held agenda or policy framework. He does not, so his words must not be interpreted as though he does. This may change when sophisticated players like John Williams and Richard Clarida become fixtures in Powell's world, in their roles as vice-chair of the FOMC and of the Federal Reserve Board, respectively.

- Powell was misunderstood initially as a hawk. But as a man without a firm agenda or policy outlook, he is intrinsically neither a hawk or dove.
- We believe he was appointed not for this expertise (he has none), but for his political pliability. If that is right, then as the first non-independent Fed chair since G. William Miller, he is functionally a dove, because no Treasury secretary or president hires a politically pliant man to be a hawk.

Bottom line

The FOMC has declared "mission accomplished" on inflation, and removed language that it is "monitoring inflation developments closely." This is despite the fact that Monday's report of 1.9% year-over-year core PCE inflation is the result of anomalously soft year-ago data dropping out, and anomalously hot January data staying in. Adjusted for these anomalies, year-over-year core inflation is actually only 1.7%. The FOMC admitted as much in the minutes of the March meeting, but ignored it today – casting further doubts on the intellectual depth of the Powell regime. Seemingly hawkish language from March about how the "outlook has strengthened" is gone. But on the other side, an exaggerated claim about business investment growth was added. Markets don't seem to care much about any of it, perhaps because they are coming to understand that the Powell Fed's communications are not sophisticated enough to deserve the usual exegesis.