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TRENDMACRO LIVE!

On the June FOMC

Wednesday, June 19, 2019

Donald Luskin

No surprises, no gaffes. Powell is developing a "blame Trump" story that points to cuts.

The market's expectations were correct. No rate cut at the June FOMC meeting. The post-meeting statement was sufficiently dovish to satisfy the market's need to see the Fed as not out of touch with the its demands for easing. Oh – and no big gaffes from Chair Jerome Powell.

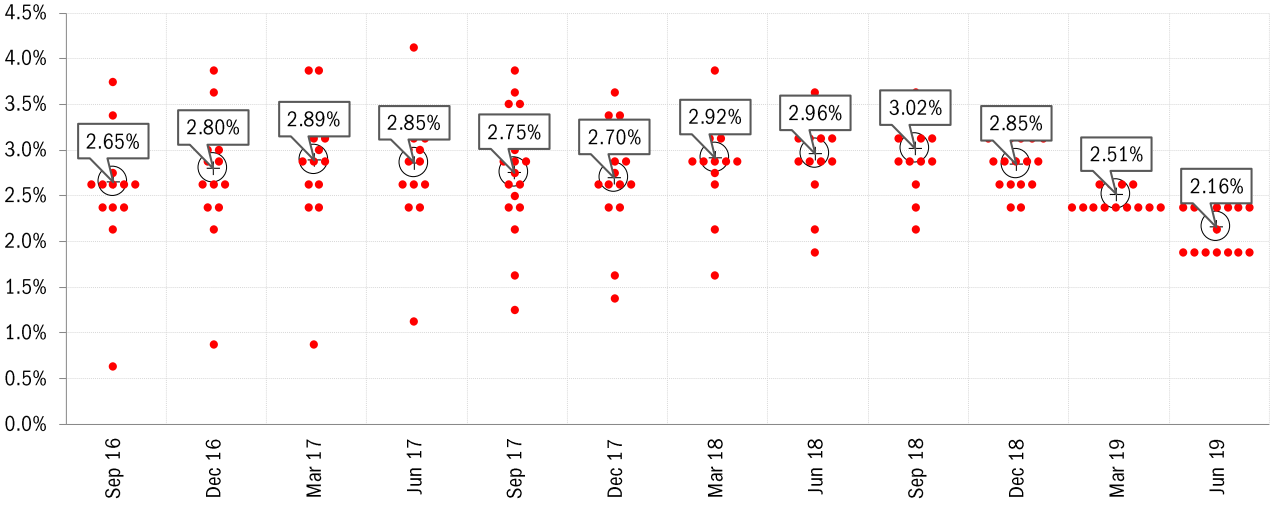
- *Notably, the word "patient" – which has been a staple of FOMC statements since Powell cut a deal with President Donald J. Trump for no more rate hikes* (see "Did Powell Just Cut a Deal?" December 23, 2018) – is gone. Its absence signifies that the Fed is *more* than patient. *It has reversed course. It is dovish.*
- *The rationale, for the most part, is that "uncertainties about [the] outlook have increased."* This is not very well concealed code for concerns about trade policy. Indeed Powell made this quite explicit in the Q-and-A in the post-meeting press conference. He laid the groundwork in his remarks earlier this month, when he previewed the Fed's dovish turn by citing "recent developments involving trade negotiations and other matters."
- *This is a missed opportunity.* With his "uncertainties," Powell introduced a "blame Trump" rationale for rate cuts. It's a nice political firewall for Powell to be able to say he is not responding to pressure from Trump, but instead is moving to protect the economy from Trump's dangerous policies. *Well, Powell will get another chance to do the right thing in July – and now he has his storyline.*
- *At least Powell didn't repeat his catastrophic error of last December – issuing a tone-deaf statement that failed to live up to market demands for Fed vigilance against the downside, after signaling that such a thing was coming.*
- And we must say – we can't help with Powell's "uncertainties" to hear an echo of former Chair Janet Yellen's seminal March 2016 speech in which she set the Fed on a more dovish course, essentially apologizing for the ill-timed December 2015 lift-off from the zero-bound, citing her failure to appreciate "uncertainty" (see "Yellen Adds 'Uncertainty'" March 30, 2016). *This echo is yet another way today's environment eerily resembles the almost-recession of late-2015 and early-2016.*
- But today's dovish turn wasn't enough for St. Louis Fed President James Bullard, who dissented, favoring a rate cut. This is the first dissent under Powell, and we hope it is the leading edge of a new consensus that will take policy-making momentum out of the hands

Update to strategic view

US FED, US MACRO: As markets expected, no rate cut. And no Powell gaffes. The statement dropped the key word "patient," signaling the next move is a cut, citing "uncertainties" – which means trade risks. This echoes Yellen's dovish turn in 2016, when she apologized for lift-off by citing "uncertainty." In Powell's hands, it introduces a "blame Trump" strategy that will allow the Fed to cut rates, even though Trump demands it, by arguing that doing so protects the economy from the president's bad policies. Bullard dealt Powell his first dissent, perhaps the leading edge of a movement to wrest policy control from him. The "dot plots" point frankly to a cut this year. While the statement language wasn't candid about the Fed's failure to restore inflation to target, the Summary of Economic Projections strongly downgraded core PCE inflation for 2019.

[Strategy dashboard]

FOMC participants' assessments of appropriate 2019 fed funds rate – by participant, and average

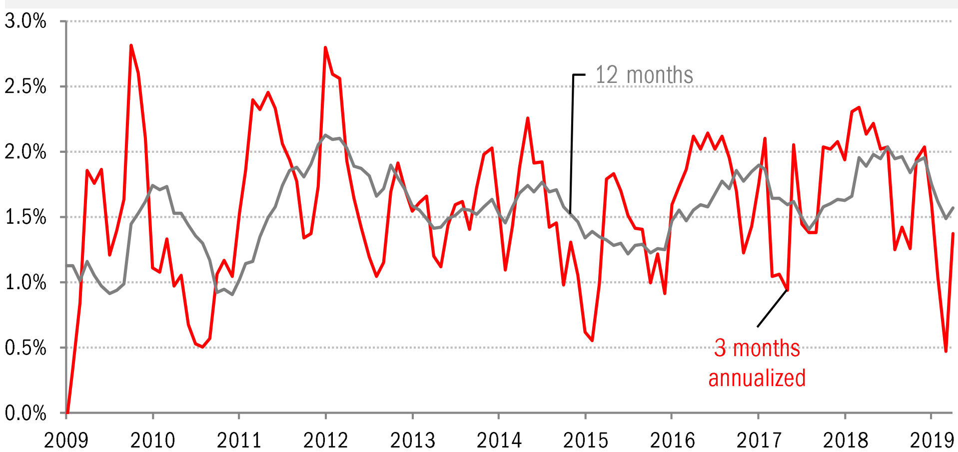


Source: FRB, TrendMacro calculations

of a man who we believe is the worst Fed chair since G. William Miller.

- *The dovish turn is reflected in what we consider an unexpectedly dramatic downgrade in the "dot plots" that reflect FOMC members' ideas of the optimal policy course.* The average of the dots for 2019 fell to 2.16% from 2.51% in March, showing a shift of judgment from half a rate hike to one rate cut (please see the chart on the following page). We don't see this move as *objectively* dramatic, just *unexpectedly* dramatic. *It is a frank admission that the next move is a cut, and we didn't expect the Powell Fed to be frank at all.*
- *Truly dramatic was the move down in the average "dot" for the "longer-run." It was downgraded today from 2.80% to 2.70% – not such a startlingly different number, perhaps, but notable for being the lowest in the seven-and-a-half-year history of this estimate. Whatever has turned the Fed more dovish here, we find it absurd*

Core PCE price index



Source: BEA, TrendMacro calculations

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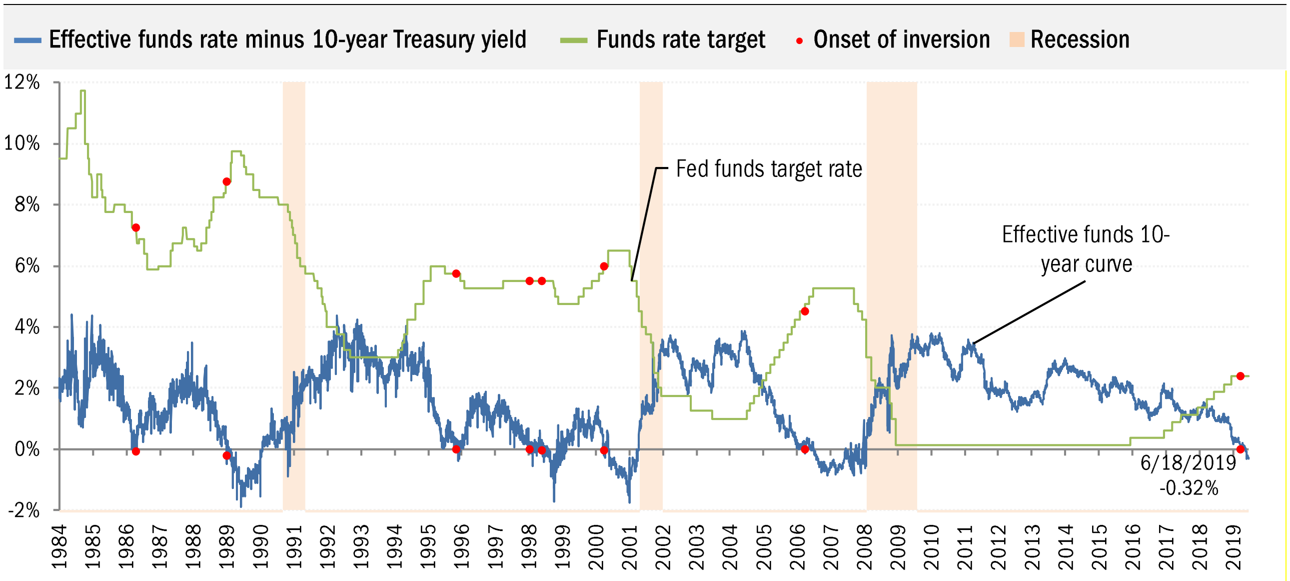
[About us]

that it should drive this degree of secular pessimism.

- The statement was not sufficiently dramatic, for our tastes, in addressing the persistent shortfall in inflation. Perhaps not in words, but the median forecast for 2019 core PCE inflation was downgraded in the [Summary of Economic Projections](#) to 1.80% from 2.00% (see ["Data Insights: Federal Reserve"](#) June 19, 2019). We are encouraged to see, at least numerically, a departure from



Source: FRB, Bloomberg, NBER, TrendMacro calculations

the tone-deaf happy-talk about inflation somehow automagically going back to the Fed's target of 2% – something that has happened rarely, and only temporarily, over a decade (please see the chart on the previous page).

- And there was complete silence in the statement on the matter of the sharply inverted yield curve between the funds rate and the 10-year Treasury, an inversion that, all else equal, would take *two* rate cuts to fix (please see the chart above).

In the immediate aftermath, markets don't seem to be reacting much one way or the other. Fair enough, as there were really no surprises here – including, critically, a statement and a "dot plot" that don't undermine market expectations for rate cuts to come.

Bottom line

As markets expected, no rate cut. And no Powell gaffes. The statement dropped the key word "patient," signaling the next move is a cut, citing "uncertainties" – which means trade risks. This echoes Yellen's dovish turn in 2016, when she apologized for lift-off by citing "uncertainty." In Powell's hands, it introduces a "blame Trump" strategy that will allow the Fed to cut rates, even though Trump demands it, by arguing that doing so protects the economy from the president's bad policies. Bullard dealt Powell his first dissent, perhaps the leading edge of a movement to wrest policy control from him. The "dot plots" point frankly to a cut this year. While the statement language wasn't candid about the Fed's failure to restore inflation to target, the Summary of Economic Projections strongly downgraded core PCE inflation for 2019.