TrendMacro™

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TRENDMACRO LIVE!

On the December FOMC

Wednesday, December 11, 2019
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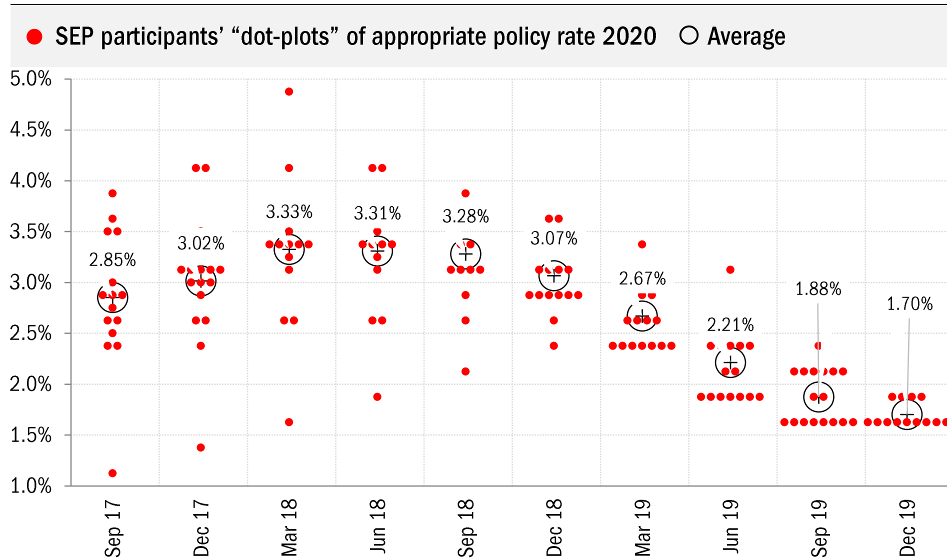
“Uncertainties” are gone. The Fed is on hold until it sees unwelcome inflation pressures.

Today’s FOMC leaves policy on hold as far as the eye can see – at least judging by the words in the statement. “Uncertainty” is gone from the language in the statement about the economy. Uncertainty is gone from the “dot plots” in the Summary of Economic Projections for the “appropriate policy rate” in 2020, too – they show a tightly clustered median at 1.6%, the current funds rate (please see the chart below). *This quiescent posture for the Fed would appear to clear one of the three great risks we think markets face through year-end* (see “Can This Year Just Please Be Over?” December 4, 2019).



Source: Federal Reserve Board, TrendMacro calculations

It’s well worth remembering where we were one year ago at the 2018 December FOMC, with the Powell Fed hiking rates one last time into the face of growing market turbulence, and prattling on about how the balance sheet was “on automatic pilot” (see “It’s Not ‘Quantitative Tightening’ – It’s Powell” December 20, 2018). Days later Powell was at breakfast with Treasury Secretary Steven Mnuchin, and made him an offer he couldn’t refuse. They cut a deal under which a more dovish Powell would be

Update to strategic view

US FED, US MACRO, US STOCKS, US BONDS: “Uncertainty” is gone from the statement language, and from the Fed’s policy outlook. The “dot plots” show near unanimity for no rate changes in 2020. Powell insists that policy now is “somewhat accommodative.” We don’t agree, with the yield curve now flat (but at least not inverted anymore). Happily, Powell is not looking to hike rates as the “uncertainties” he was focused on clear away. He thinks hikes won’t be necessary until “sustained inflation pressures” are visible – indeed, he would welcome some degree of inflation pressures. Even if policy is not actually accommodative now, if policy remains static, and the economy accelerates, policy will effectively become more accommodative. We think the market reaction has been too muted, and that the Fed definitely on hold ought to support higher stock prices and bond yields.

[Strategy dashboard]

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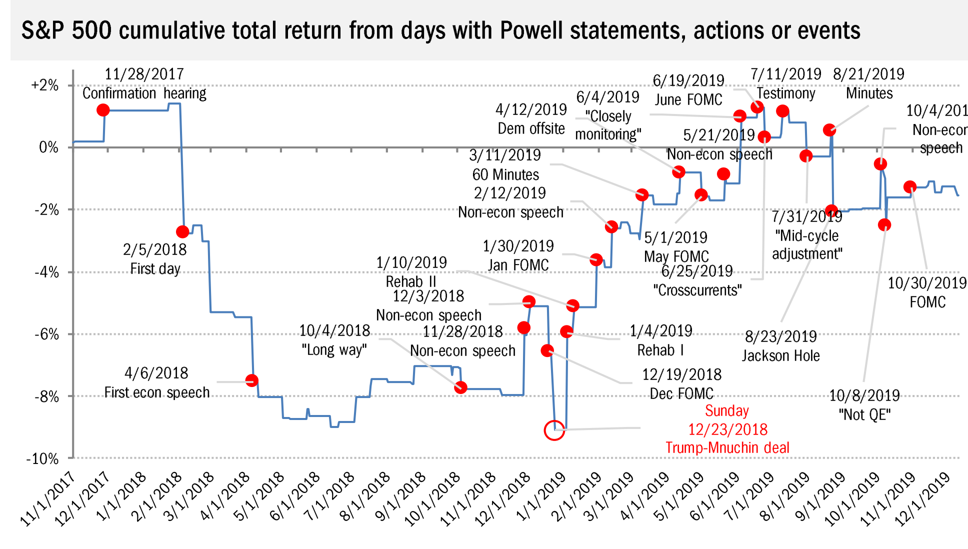
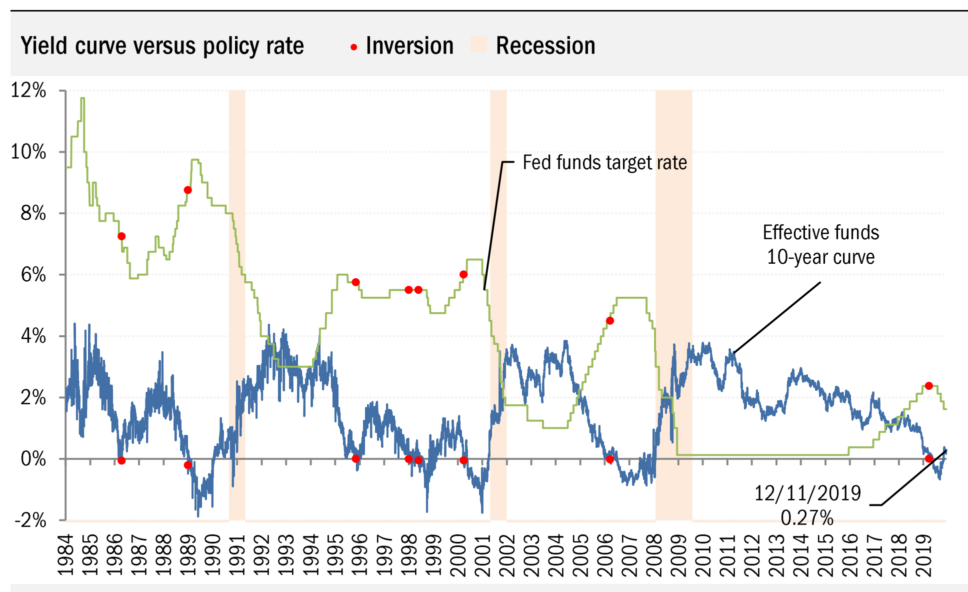
allowed to keep his job (see “Did Powell Just Cut a Deal?” December 23, 2018). Judging by stock market behavior on days when Powell spoke or acted, his mis-steps cost the S&P 500 10.2% in 2018 (enough to turn an otherwise up-year into a down one). A born-again Powell has earned most of it back in 2019, contributing 8.3% of 2019’s 27.3% gain year-to-date (please see the chart below).



Source: Bloomberg, TrendMacro calculations

It is well worth remembering that, despite no more hikes after December – and announcements from the Fed that the balance sheet would, in fact, very much not be on automatic pilot – in March the yield curve inverted. Powell himself had warned that when the 10-year Treasury yield falls below the funds rate, “your policy is probably too tight” (see “Video: What Jay Powell should be telling you about the inverted yield curve” April 1, 2019). It took him four agonizing months to respond, with the first inadequate rate cut not coming until the July FOMC (see “On the July FOMC” July 31,



Source: Bloomberg, TrendMacro calculations

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Jon Levine
New York Post
December 7, 2019

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2019). Finally, at the October FOMC, a third rate cut was enough to un-invert the curve (please see the chart below, and "On the October FOMC" October 30, 2019).

So here we are. Now Powell and the FOMC seem to believe so strongly that "the economy is in a good place" – an annoying Powell catchphrase that, ironically he didn't actually use today – that today's FOMC statement says basically nothing about the economy at all. As we said at the outset, long-standing references to "uncertainty" are gone – though, in reality, trade issues and Brexit are still live issues (there is no explanation for why, suddenly, they deserve no consideration from the FOMC, except to commit to monitoring "global developments" – for a red-line mark-up, please see "Data Insights: Federal Reserve" December 11, 2019).

- In the post-meeting press conference, a reporter baited Powell by asking him whether the present easing cycle – which would appear to have reached its end – will get "taken back" the way a similar one did in the late 1990s, when then-chair Alan Greenspan eased only temporarily in response to the "Asian flu" and Long Term Capital Management crises. We say "baited," because it would seem the reporter was giving Powell the chance to repeat his "mid-cycle adjustment" gaffe made at the July FOMC presser, when on the occasion of the first – and tardy – rate cut, Powell appeared to be saying "one and done" (see "On the July FOMC" July 31, 2019). *Happily, Powell didn't take the bait. He framed the policy outlook not in terms of crises that arise and are then handled, but in terms of inflation pressures. Powell was clear that the Fed has learned that the economy can now experience a long period of low unemployment without giving rising to inflationary pressures – indeed adding that such pressures would actually be somewhat welcome.*
- *In response to another reporter's question, Powell said that he would want to see "inflation move up on a sustained basis" before thinking it necessary to hike rates. He noted, with apparent approval, that some participants in the SEP seem to think a brief "overshoot" of the Fed's 2% inflation target would be appropriate for 2021.*

The Fed's balance sheet is growing again – albeit only with the addition of very short-term securities. The yield curve is no longer inverted – albeit its steepness is now only about 25 bp, compared to an average of about 90 bp. Real gross domestic product growth this quarter is likely to be 2% or less. *And yet our Federal Reserve chair continues to insist that "the economy is in a good place." It could be better. There's been a lot more than the Fed weighing on the economy in 2019* (again, see "Can This Year Just Please Be Over?"), *but the Fed can do more than it has so far. Fine, it's not longer obviously excessively tight. But in the absence of any inflation constraint – with core PCE still well below target – can we really say the Fed has even gotten all the way to neutral? We don't think so, yet in the post-meeting press conference, Powell insisted that policy is "somewhat accommodative."*

- *The good news for the future is if, despite lack of active support from the Fed, the economy were to accelerate, we should no longer expect the Powell Fed to immediately act to rein it in – at least until and unless unwelcome inflation pressures visibly emerge. If the economy accelerates and the Fed doesn't change policy rates, then all else equal, those unchanged policy rates become effectively more and more accommodative.*

The immediate muted effects in markets to all this don't seem to us to appreciate the good news here. All else equal, we would think today's FOMC ought to be supportive of both higher stock prices and higher bond yields.

Bottom line

"Uncertainty" is gone from the statement language, and from the Fed's policy outlook. The "dot plots" show near unanimity for no rate changes in 2020. Powell insists that policy now is "somewhat accommodative." We don't agree, with the yield curve now flat (but at least not inverted anymore). Happily, Powell is not looking to hike rates as the "uncertainties" he was focused on clear away. He thinks hikes won't be necessary until "sustained inflation pressures" are visible – indeed, he would welcome some degree of inflation pressures. Even if policy is not actually accommodative now, if policy remains static, and the economy accelerates, policy will effectively become more accommodative. We think the market reaction has been too muted, and that the Fed definitely on hold ought to support higher stock prices and bond yields.