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TRENDMACRO LIVE!

# On the April FOMC

Wednesday, April 28, 2021

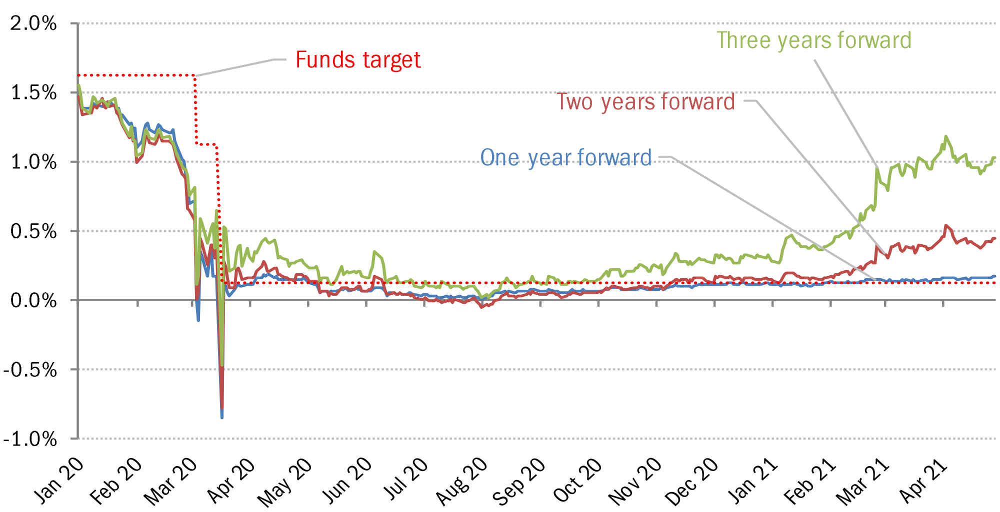
**Donald Luskin**

**Tapering not a conversation, and a seemingly silly question about the homeless isn't silly at all.**

Today's FOMC statement had a larger number revisions versus the prior meeting's than we have become accustomed to, and *they all point toward the Fed's confidence in economic recovery* (for a full red-line mark-up, see "Data Insights: Federal Reserve" April 28, 2021). *But not a word about any moderation in the Fed's policy posture.*

- March's statement spoke of "a moderation in the pace of economic activity." Today's says, "Amid progress on vaccinations and strong policy support, indicators of economic activity and employment have strengthened."
- Today's statement repeats March's language that "The sectors most affected by the pandemic remain weak," and adds: "…but have shown recent improvement."
- March's statement said, "Inflation continues to run below 2 percent." Today's says, "Inflation has risen, largely reflecting transitory factors."
- March's statement said, "The ongoing public health crisis continues to weigh… and poses considerable risks to the economic outlook." Today "considerable" is gone… but "risks to the economic outlook remain."

Funds rate target versus market-implied forward




Source: Bloomberg, TrendMacro calculations

**Update to strategic view**

**US FED, US MACRO:** In the most highly revised FOMC statement in months, the Fed has upgraded its view of the economy. Risks are no longer "considerable" yet they "remain." There were no changes to policy, and Powell was clear in the presser that the FOMC isn't even talking about it. Powell was asked repeatedly about the risks of coming inflation. His answers ranged from well-prepared arguments to stammered econobabble. But he retains his conviction that a post-pandemic rise in the price level will be transitory. Toward the end of the presser he noted that market-implied inflation expectations are still below, but getting near, mandate consistent levels. We interpret this more as his appreciation for progress in hand, rather than a warning that they are approaching dangerous levels. A question about a homeless camp near the Fed headquarters points to the Fed's abandonment of the Philips Curve, which for two generations has sacrificed the livelihoods of minorities and the less-educated to keep the economy from "overheating."

- *We think this is all an accurate appraisal, and it begs the question of when the FOMC will dare to talk about adjusting policy. There's no hurry, we think, because the Committee surely believes that maintaining the fairly obvious fiction that policy will never change is, at least for now, a "noble lie" that will itself ensure further economic recovery*.
- Markets have been buying it. Since the March FOMC, the money market curve is now, on net, unchanged with respect to the number of future rate hikes implicitly expected (it's now two over two years, four over three years – please see the chart on the first page).
- *Markets had virtually no immediate reaction to the FOMC statement. It's not a big deal, and maybe nothing more than a sigh of relief, but it's worth noting that there was a jump higher for equities as soon as Chair Jerome Powell answered the first question out of the box in the post-meeting press conference, and laid to rest worries about the onset of tapering asset purchases.*
- He was asked, just as he was in March, "Is it time to start talking about talking about tapering?" He was obviously prepared for the question, giving an emphatic assurance that "No. It is not time to have that conversation."
- He was less prepared for a question about how the Fed would react if market-implied long-term inflation expectations were to start rising. Suddenly, he was like the ill-prepared Powell of 2018, stammering out nearly incoherent econobabble to the effect that expectations won't come unhinged as long as there is slack in the labor market. *Huh? This is the same Powell who has presided over the Fed's substantive abandonment of the Phillips Curve fiction that a tight labor market causes inflation* (see "Regime Change for the Equity Risk Premium?" April 19, 2021). As recently as a speech in February he himself said, "we will not tighten monetary policy solely in response to a strong labor market."
- Later Powell was asked to respond to former Treasury Secretary Lawrence Summers' critique that the Fed is complicit in overheating the economy and triggering inflation that is not as "transitory" as the FOMC keeps saying it expects. He gave a lengthy answer with such rapidity and clarity that it can only have been scripted. He outlined, quite correctly in our view, the unique post-pandemic disjunction of supply and demand that will likely cause a rise in measured price levels, exaggerated somewhat by the low year-ago readings. He said if this rise in the price level persists, or if expectations get out of hand, the Fed won't be blind to it: "no one should doubt that we will be prepared to use our tools to guide inflation and inflation expectations back to 2 percent." Not a word about slack in the labor market.
- *Equities gave back their prior initial conference gains toward the end when Powell once more took on the question of rising inflation expectations. While clearly, we think, trying to characterize them as too low, he nevertheless said they had risen back to still-below, but near, "mandate consistent levels." This gives the impression that if the Fed is targeting expectations rather than the price level itself, there isn't much room left on the upside before the Fed would start being concerned they are too high. This hasn't been Powell's best*

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*day for clarity, but our sense is that he was more trying to say there has been progress rather than that they are getting near to signaling danger.*

- Finally, believe it or, Powell was asked whether he intends to visit the homeless encampment near the Fed's Washington headquarters. At first he said, "I've been very busy." *Wrong answer*. Then "I've met with homeless people many times." *Wrong again*. Finally, "I'll do it when there isn't so much public attention on it." *OK, we'll let it pass*.
- This seems somewhat silly on the face of it, and at the same time we don't mean to give offense by making light of it. But it is in fact not silly at all. The question, and Powell's answer, go to a new sensitivity at the Fed that the full employment mandate is a "broad and *inclusive* goal" [emphasis added]. However much this may sound like nothing more than political correctness, it in fact attaches directly to the potentially regime-changing abandonment of the Phillips Curve as a policy tool. The Fed is now aware that deliberately causing recessions in order to keep the economy from "overheating" – as the Fed has done for two generations – primarily punishes minorities and the less-educated, and doesn't even have any relationship to the inflation that it purports to control (see "Regime Change for the Equity Risk Premium?").

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**Bottom line**

In the most highly revised FOMC statement in months, the Fed has upgraded its view of the economy. Risks are no longer "considerable" yet they "remain." There were no changes to policy, and Powell was clear in the presser that the FOMC isn't even talking about it. Powell was asked repeatedly about the risks of coming inflation. His answers ranged from well-prepared arguments to stammered econobabble. But he retains his conviction that a post-pandemic rise in the price level will be transitory. Toward the end of the presser he noted that market-implied inflation expectations are still below, but getting near, mandate consistent levels. We interpret this more as his appreciation for progress in hand, rather than a warning that they are approaching dangerous levels. A question about a homeless camp near the Fed headquarters points to the Fed's abandonment of the Philips Curve, which for two generations has sacrificed the livelihoods of minorities and the less-educated to keep the economy from "overheating."