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TRENDMACRO LIVE!

On the July FOMC

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Donald Luskin

Was the use of the word "substantial" a little too insubstantial? Points to a split Committee.

All eyes were on the word "substantial" – would it be removed from today's FOMC statement, after having said in every statement since December that asset purchases would continue without tapering "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." *That key word – "substantial" – that serves to dimension the Fed's sense that the economy still needs maximum support, is indeed there in the statement. Or is it?*

- The word "substantial" is technically there, but by way of quoting what had been said since December. After the quotation, today's statement adds a sentence: "Since then, the economy has made progress toward these goals, and the Committee will continue to assess progress in coming meetings."
- *So we've made progress toward substantial progress?*
- *In the prepared remarks opening the post-meeting press conference, Powell said straight out that full asset purchases would continue pending "substantial further progress" – but without distancing that language by relegating it to mere quotation of past statements. He repeated the statement, and clearly.*
- *We can't help wondering whether the disparity between the slightly hawkish language of the written statement and the more dovish spoken statement by Powell implies a split on the Committee.*
- *Of course the first several questions from reporters focused on this issue, and Powell took every opportunity to stress that there is still "distance to travel" to substantial progress – while at the same time, admitted that the Committee was having conversations about how and when to taper.*
- Powell seemed very much to be improvising his answers, not the smooth pre-programmed performance we have recently gotten accustomed to from him. This was his worst, least leader-like presser in many months. This would tend to confirm our sense that he is free-lancing, without the confidence that comes from committee unanimity.
- *For the FOMC to take even this small and ambiguous step toward preparing the market for tapering is utterly unnecessary*. In our view, three governing dynamics make steady-as-you-go a fairly obviously optimal policy course.

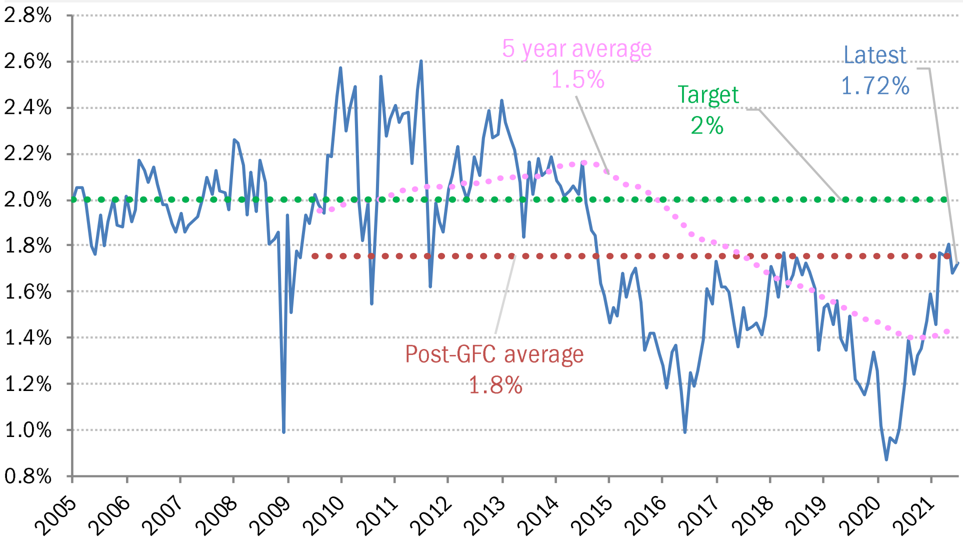
Update to strategic view

FEDERAL RESERVE, US MACRO: The written statement retained the word "substantial" to characterize the kind of progress required before tapering can begin, but relegated it to a mere quotation of prior statements. It reads like a tip-toe toward tapering, but then Powell's prepared press conference remarks used the word unambiguously. Answering reporter questions, Powell emphasized that a great deal of progress remains to be accomplished, but his clumsy improvisations create the impression that there is a split on the committee, with Powell representing the dovish side. With jobs still too few and inflation still too low, and the advantages of "running the economy hot" clearly on display as GDP is likely to print tomorrow morning at new all-time highs, there is no reason for the Fed to change policy at all. Any move toward the hawkish would be a policy error. For now at least, markets seem happy.

[Strategy dashboard]

- *Payrolls remain 6.7 million, or 4.4%, below the pre-pandemic peak*. The economy is a million miles from the Fed's mandate for "maximum employment."
- *Market-implied inflation expectations, despite a couple hot CPI prints, are below the too-low average since the Global Financial Crisis* (please see the chart below). A couple months of overshoot has done nothing whatsoever to achieve the Fed's goal under "average inflation targeting."

Five-year five-years forward TIPS breakeven spread (50bp down-adjusted to PCE basis)



Source: Bloomberg, TrendMacro calculations

- *The benefits of "running the economy hot" are abundantly evident, with tomorrow's Q2-2021 GDP report virtually certain to show the highest level of US output of goods and services in history, despite 3.6% fewer man-hours having been worked, compared to the prepandemic peak at Q4-2019.* This, despite 4.4% fewer payrolls – and 3.6% fewer man-hours worked – implies a productivity boom of historic dimensions.
- *So why, with jobs still too few, inflation no threat at all, and productivity surging, would the Fed say anything even slightly hawkish? Having done so, it seems to us, is a small policy error.*
- That said, from the moment the statement was released, and still, as of this writing 90 minutes later, markets seem more pleased than not.

Bottom line

The written statement retained the word "substantial" to characterize the kind of progress required before tapering can begin, but relegated it to a mere quotation of prior statements. It reads like a tip-toe toward tapering, but then Powell's prepared press conference remarks used the word unambiguously. Answering reporter questions, Powell emphasized that a great deal of progress remains to be accomplished, but his clumsy improvisations create the impression that there is a split on the committee, with Powell representing the dovish side. With jobs still too few and inflation still too low, and the

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advantages of “running the economy hot” clearly on display as GDP is likely to print tomorrow morning at new all-time highs, there is no reason for the Fed to change policy at all. Any move toward the hawkish would be a policy error. For now at least, markets seem happy.