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TRENDMACRO LIVE!

On the November FOMC

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Donald Luskin

Did Powell just make the elimination of Covid a new criterion for lift-off?

Today's FOMC statement was perfect.

- Tapering of asset purchases was made official, with implementation to commence "later this month," at a pace likely to conclude at mid-year 2022. This is perfectly compliant with the very detailed hints that were laid out three weeks ago in the minutes of the September meeting (see "Data Insights: FOMC Minutes" October 13, 2021). *No surprises.*
- There was no change at all to the long-standing statement language concerning the strict criteria for lift-off from the near-zero funds rate. Once again: "…until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time." *No surprises.*
- There was some risk that the FOMC would cave on its insistence that above-target inflation is "transitory," perhaps owing to supply chain disruptions lasting longer than expected. After all, the governor of the Bank of England has made it clear that, as far as he's concerned, British policy rates should be hiked in response to persistent high energy prices. Fortunately, the FOMC has not been infected with that particular thought contagion. Today's statement says the factors causing higher prices now "are expected to be transitory." It then called out specifically, "Supply and demand imbalances related to the pandemic and the reopening of the economy." *No surprises.*
- *Indeed, the statement forecasts that the transitory nature of those factors is not only inflation-mitigating but also growth-accelerating:*

  > "…an easing of supply constraints [is] expected to support continued gains in economic activity and employment as well as a reduction in inflation."

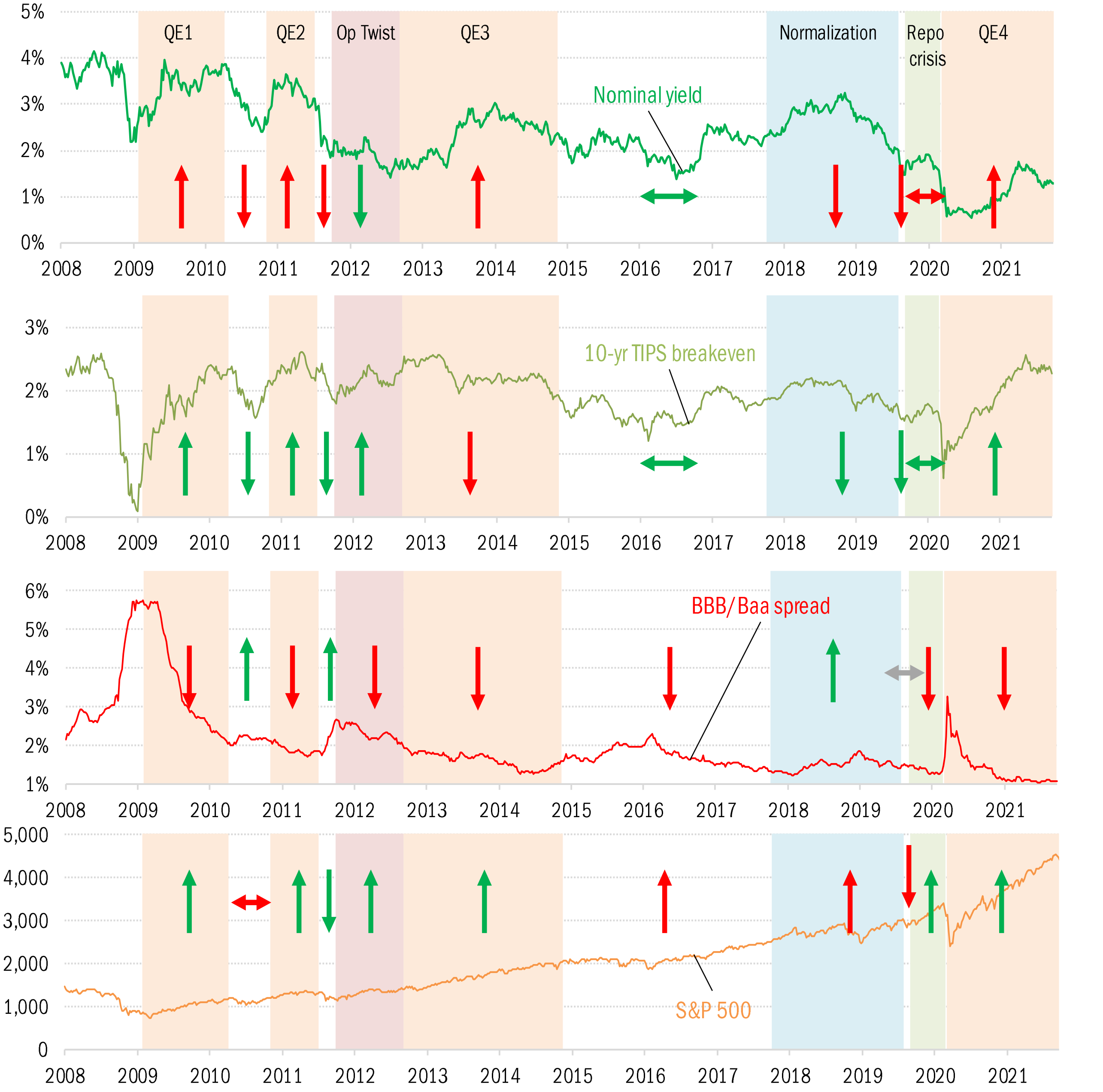
- *This is a surprise, because we never expect the Fed to say such smart things.*

Now that the taper is upon us, should we care about it? No.

Update to strategic view

FEDERAL RESERVE, US MACRO, US BOND, US STOCKS: Tapering will begin later this month, at a pace likely to wind it up by mid-year 2022. The statement made no change to the usual language making lift-off contingent on "maximum employment." It doubled down on the belief that inflation is "transitory," positing that the resolution of supply-chain disruptions will be both inflation-mitigating and growth-accelerating. We expect no meaningful consequences – if anything, a slight decline in yields and inflation expectations, a slight widening of credit spreads, and no particular effect on equities. When pressed to define the lift-off criterion of maximum employment, Powell was clear that it is more than just the unemployment rate – the inclusiveness of employment, and labor force participation are also factors. Powell said it is possible these criteria would be met by mid-year. All would have to be contextualized in a world in which Covid is no longer an economic factor – effectively introducing pandemic abatement as a new criterion.

Fed LSAPs market effects ↑ As predicted ↑ Not as predicted ↑ Neutral



Source: Bloomberg, TrendMacro calculations

- We've said all along that asset purchases stopped serving any purpose many months ago (see, among many, "Video What you aren't hearing about the Fed's taper talk" August 19, 2021). As far as we're concerned, if it weren't for the shock to expectations and mythologies that, somehow, asset purchases were necessary to the ongoing economic recovery from the pandemic recession, the Fed might as well have hard-stopped purchases many months ago. It would have made no difference to anything in the real world (nor would it matter if purchases went on forever).
- Historically (please see the chart above), asset purchases have

done nothing to keep long-term yields low – indeed, the opposite. They have been better at augmenting inflation expectations. They have helped ease credit crunches *in extremis*. Their effect on stock prices is inconsistent.

- *If history is a perfect guide, yields and inflation expectations should fall somewhat now and credit spreads should widen slightly, with no particular impact on equities.*

Now what about lift-off? Of course that was the subject of the very first question in the post-meeting press conference. As we expected, chair Jerome Powell tried to deflect the question by saying that this meeting was the time to talk about tapering, not lift-off.

- The *Wall Street Journal's* Nick Timiraos wouldn't let it end there: he went right to the heart of the matter. If lift-off is, as the statement says, contingent on "maximum employment," what exactly does the Fed mean by "maximum employment," and might it be achieved as early as mid-2022?
- Powell answered the question just as we said he would last week (see "Video: What you're not hearing about the Fed's liftoff from zero policy rates" October 26, 2021): "We measure maximum employment by a wide range of figures." That is, it's not just the unemployment rate (it could also be labor force participation, or differential unemployment as between more and less privileged demographics).
- As to whether it could happen by mid-year, as we had said, Powell admitted "that's certainly within the realm of possibility."
- *That's about what the money market curve already expects – so no surprise. That prospect, and Powell's confirmation of it today as a real possibility, doesn't seem to be perturbing growth-sensitive markets like equities. Indeed, why should it? If at any given future point the unemployment rate actually falls back to the very low levels where it was before the pandemic, that wouldn't necessarily be the worst time in the world for policy rates to be something above zero.*
- That said, another questioner asked again about the definition of "maximum employment." Significantly, Powell told him that it would have to be contextualized in a world – unlike the present one – when Covid is no longer an economic factor. *Is it going to far to think that this is a third criterion for lift-off?*

Bottom line

Tapering will begin later this month, at a pace likely to wind it up by mid-year 2022. The statement made no change to the usual language making lift-off contingent on "maximum employment." It doubled down on the belief that inflation is "transitory," positing that the resolution of supply-chain disruptions will be both inflation-mitigating and growth-accelerating. We expect no meaningful consequences – if anything, a slight decline in yields and inflation expectations, a slight widening of credit spreads, and no particular effect on equities. When pressed to define the lift-off criterion of maximum employment,

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