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TRENDMACRO LIVE!

On the September FOMC: Dotsaster

Donald Luskin
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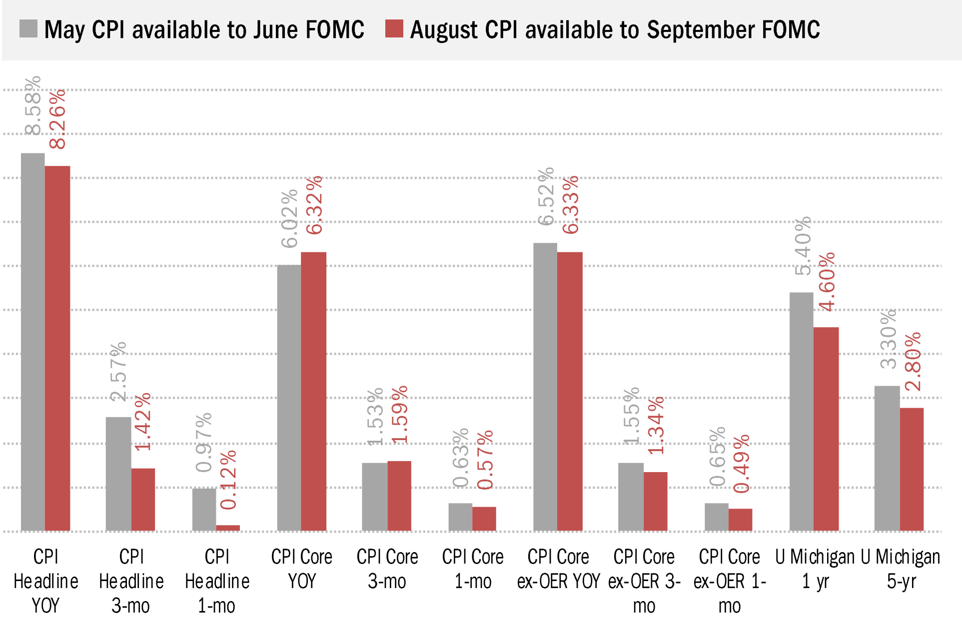
The dots blew through expectations into a higher-longer tightening cycle.

There are no doubt those who will see today's FOMC, with its sweeping new forward guidance – *taking the present hiking cycle to new highs, and extending it to new lengths* – as "getting serious" or "going Volcker." *No, this is simply madness*. It is the extension of the groupthink that seized public health officials during the Covid pandemic into the monetary policy domain: *to stop the viral spread of inflation, we have to lock down the economy*. Never mind the cost. And for that matter, never mind whether there is any reason to think it will even work (it didn't for Covid, did it?).

- Yes, today's 75 bp rate hike was no more than markets were expecting – dovish, in some sense, since there was an 18% implied probability of a 100 bp hike. And there were virtually no changes in the FOMC's statement.
- But markets were expecting the Summary of Economic Projections to put up a median "dot" representing the 2022 year-end funds rate at about 4-1/4% (implying a 75 bp hike in November and 50 bp in December). Instead, the 2022 "dot" came in at 4.4%, implying an even steeper policy path this year.



Source: BLS, University of Michigan, TrendMacro calculations

Update to strategic view

FEDERAL RESERVE, US MACRO: An expected 75 bp hike and no statement changes. But the Summary of Economic Projections strongly steepened and lengthened the policy path, now implying a 75 bp hike in November, a 50% probability of another one in December, and a higher funds rate at year-end 2023 than at year-end 2022. Estimates of the unemployment rate were commensurately raised, with Powell calling the prospect of 1.25 million job losses "relatively modest." This happened against the backdrop of broadly falling inflation levels since the prior SEP in June. After the meeting and during the press conference, the futures-implied policy path was only modestly upgraded, suggesting the market's strong skepticism that the Fed will actually carry out its mad scheme.

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- What's worst, the "dot" for year-end 2023 was set at 4.6% (see "Data Insights: Federal Reserve" September 21, 2022). *This is higher than the market's going-in expectation of 4.5% as the peak of the hiking cycle, to be reached in March 2023. If December 2023 is to be 4.6%, per the "dot," then unless that happens to be the cycle peak, any intra-year peak will have to be even higher.*
- *For year-end 2024, the "dot" says 3.9%, which means that two years and two months from now, the funds rate will be 40 bp higher than it is today.*
- There's even one FOMC member whose "dot" says he (or she) thinks the "appropriate" funds rate should be 4-5/8 in 2025 (see "Data Insights: Federal Reserve" September 21, 2022).
- *And all this despite the fact that reported statistical inflation, and survey-based inflation expectations, are broadly lower than they were in June the last time the SEP was published with a far more moderate policy path* (please see the chart on the previous page).

In this morning's FOMC preview video, we asked how high the B.S. can be stacked (see "Video: What you're not hearing about inflation and this afternoon's FOMC" September 21, 2022). Now we know.

- With this suddenly steeper policy path, the SEP anticipates higher unemployment rates – and higher than the June SEP anticipated. Versus today's 3.6%, the SEP's 3.8% forecasted for this year means 250,000 jobs lost, and the 4.4% forecasted for 2023 and 2024 means 1.25 million jobs lost. *In the post-meeting press conference, Chair Jerome Powell called this humanitarian catastrophe "relatively modest."* And of course it will be borne primarily by the lowest-income lowest-skilled workers – so much for Powell's high-minded talk about "inclusive maximum employment."
- Powell went on to note that "supply shocks" had contributed significantly to the present inflation, and suggested that as supply-chains around the world get working again, and the war in Ukraine potentially resolves, those shocks would work with monetary policy to bring inflation down. *But he has never explained how weakening the supply of labor and making capital investment more expensive doesn't work at cross-purposes, making the repair of supply chains more difficult.*

As of this writing, rather astonishingly, *futures-implied expectations for the policy path have only been modestly upgraded*, with the cycle-peak funds rate at about 4.56% in March 2023, and the year-end funds rate at 4.15%.

- Either markets are blind and can't see the dots – or they think that the Fed has stacked the B.S. unsustainably high.
- Maybe markets think, as we do, that inflation has peaked and is going to continue to come down, deflecting the Fed before it can carry out the mad sadistic schemes it has laid out today.
- Stocks tried to rally back while Powell was talking, but that's all reversed and more as of this writing. Markets are definitely *not*

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[About us]

celebrating the Fed's new "courage" or "resolve" – or whatever – to destroy the village in order to save it.

Bottom line

An expected 75 bp hike and no statement changes. But the Summary of Economic Projections strongly steepened and lengthened the policy path, now implying a 75 bp hike in November, a 50% probability of another one in December, and a higher funds rate at year-end 2023 than at year-end 2022. Estimates of the unemployment rate were commensurately raised, with Powell calling the prospect of 1.25 million job losses "relatively modest." This happened against the backdrop of broadly falling inflation levels since the prior SEP in June. After the meeting and during the press conference, the futures-implied policy path was only modestly upgraded, suggesting the market's strong skepticism that the Fed will actually carry out its mad scheme.