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TRENDMACRO LIVE!

On the December FOMC

Donald Luskin
Wednesday, December 14, 2022

Markets aren't buying the new higher dots. Despite appearances, the Fed got the memo.

Today's FOMC statement had literally no text changes from November's, underscoring the extent to which *the biggest surprise about today's policy posture is that there was no surprise (considering the substantial surprise of yesterday's CPI numbers* – see "On November CPI – Inflation Definitively Peaks" December 13, 2022).

- As repeatedly promised by Chair Jerome Powell and various spokespeople, the Summary of Economic Projections moved up

Update to strategic view

FEDERAL RESERVE, US MACRO: As promised, a 50 bp hike slows from the previous four 75 bp hikes, and the dots for …

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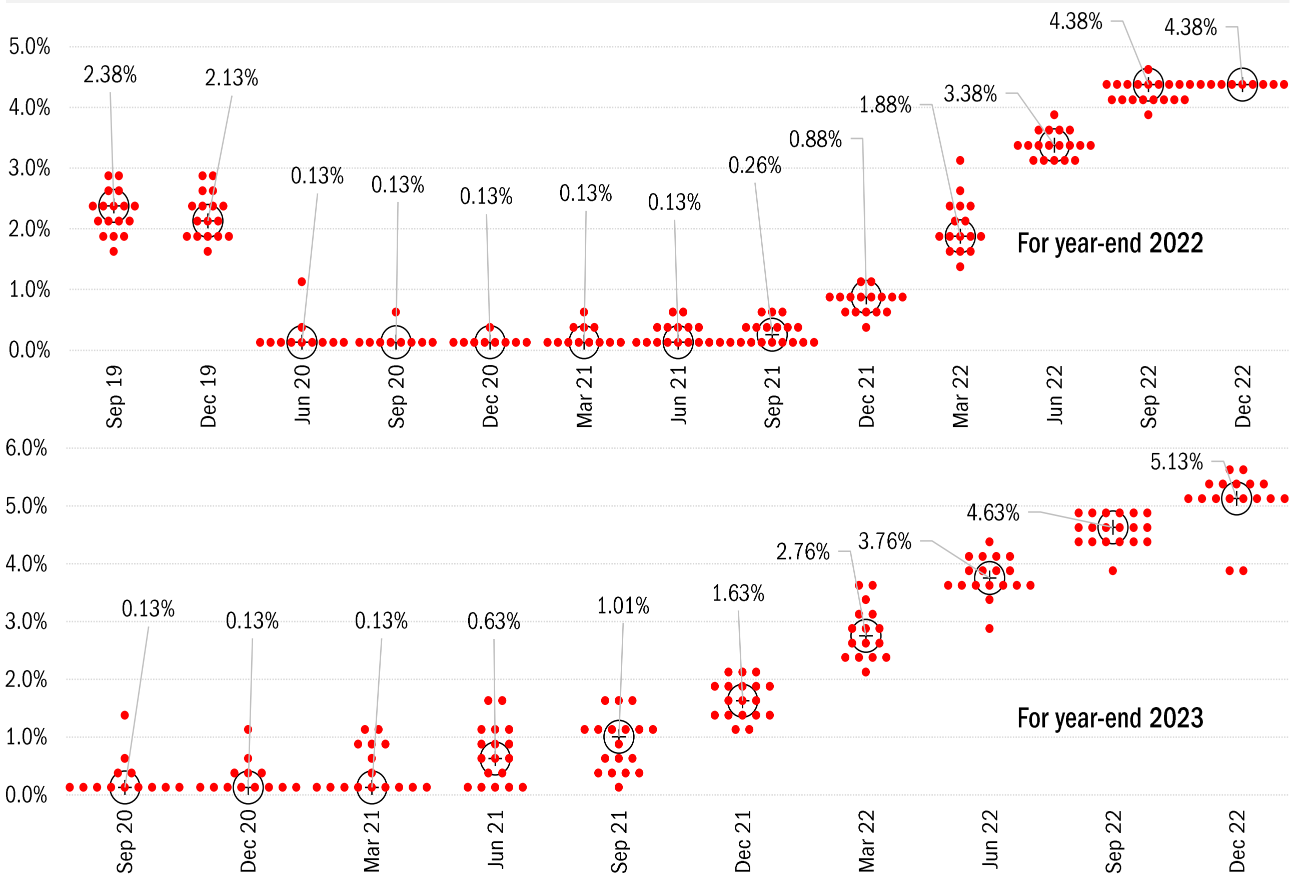
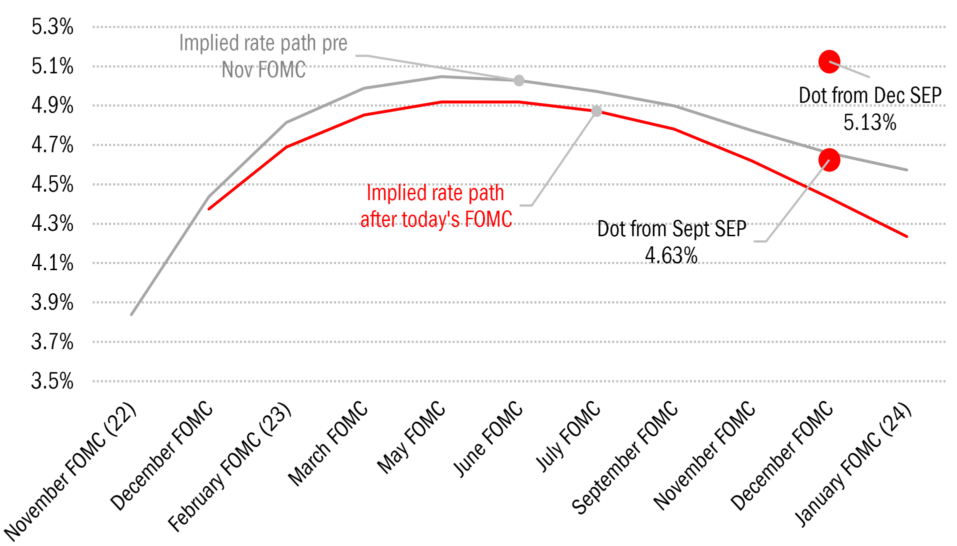
FOMC participants' estimate of "appropriate" target fed funds rate ● Vote by participant ○ Median



Source: FRB SEP, TrendMacro calculations the “dot” representing the FOMC’s median estimate of the funds rate at year-end 2023, to 5.1% from 4.6% at the September SEP (please see the charts on the previous page).

- *It’s remarkable that, over the year, the dots have moved relentlessly higher even as inflation visibly peaked by some measures in Q1, most others in Q2, and a couple stragglers in Q3. All in all, inflation has peaked.*
- In the post-meeting press conference, a reporter (perhaps unconsciously) asked Powell if this disinflation was “transitory.” It didn’t seem Powell detected the jab any more than he is detecting the disinflation.
- *And that makes it even more remarkable that today’s SEP raised the estimate of the unemployment rate at year-end 2023 to 4.6% from 4.4% at September* (see “Data Insights: Federal Reserve” December 14, 2022). *It was bad enough a quarter ago that the Fed was forecasting its own unnecessary actions would throw 1.23 million people out of work, and now that’s been upped by 329,000 poor souls to a total of 1.56 million.* In the press conference, Powell actually said, “That doesn’t sound like a labor market where a lot of people have to lose their jobs.”

Futures-implied funds rate, by FOMC meeting



Source: Bloomberg, TrendMacro calculations

- *That said, the fed funds futures markets have never believed that the actual funds rate would even meet the September dots, and as of this writing, they still don’t, and aren’t anywhere near the new December dot* (please see the chart below).
- *If the futures markets are right, then the FOMC’s new dots will prove to be as wrong as their old dots* (the year-end 2022 dot put up at the FOMC meeting one year ago was ludicrously wrong – a mere 7/8% estimated, versus 4-3/8 actual).
- *Perhaps the futures markets are betting that Powell has in fact gotten the memo that, with all the progress on inflation we already have, the cost-benefit ratio for risking a recession is getting worse*

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… estimated future funds targets were raised – to 5-1/8% at year-end 2023, from 4-5/8% at the September FOMC. The Fed appears to be oblivious to visible evidence that all measures of inflation have peaked. The unemployment rate forecast has also been upgraded to 4.6% from 4.4%, implying 329,000 more workers will be thrown out of a job, added to the 1.26 million already forecasted in September. Markets are completely looking through all this, with the Fed funds futures markets continuing to assume that the Fed will not hit its year-end dot – not the new higher one, and not even the old lower one. These markets may be relying on the pivot by the administration and the new Congress away from inflation-fighting and toward recession-fighting.

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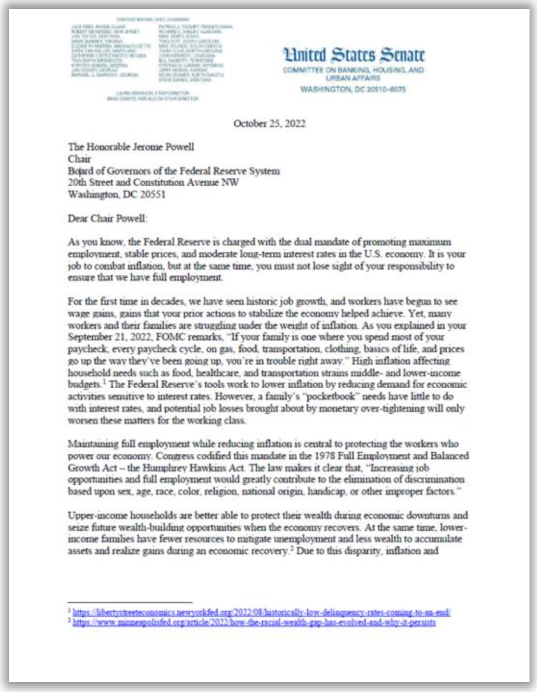
and worse. The dots indicate that the FOMC is oblivious to this – but those dots are only forecasts, and the reality is that the Fed as of today's meeting has slowed down. *So don't say the Fed has taken no cognizance at all of the changing landscape on inflation.*

- Don't forget that Powell, just before the November FOMC, received three letters from 14 Democratic senators and congresspeople, urging him to slow down. The first such letter came from no less an author than Senator Sherrod Brown (D-OH), who just happens to be the chairman of the Senate Banking Committee that just approved Powell's re-appointment (the second came from Senator John Hickenlooper (D-CO), and the third from Senator Elizabeth Warren (D-MA), and it was co-signed by a constellation of ten progressive stars in both houses of Congress. *They told him to slow down, and he slowed down.*
- In the post-midterms world, *Job One for Democrats looking to survive 2024* (when, in the Senate, 9 seats including Brown's will be at risk for Democrats, versus none at all for Republicans) *is to avoid the recession they have potentially unleashed by re-appointing a Trump Republican as Fed chair this year*.

- Markets seem to think that the Fed has "gotten the memo." We agree. The Fed will never hit the new dot, and probably not the old one either.

Letter from Senator Sherrod Brown to Jerome Powell, October 25, 2022


United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

October 25, 2022

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chair Powell:

As you know, the Federal Reserve is charged with the dual mandate of promoting maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy. It is your job to combat inflation, but at the same time, you must not lose sight of your responsibility to ensure that we have full employment.

For the first time in decades, we have seen historic job growth, and workers have begun to see wage gains, gains that your prior actions to stabilize the economy helped achieve. Yet, many workers and their families are struggling under the weight of inflation. As you explained in your September 21, 2022, FOMC remarks, "If your family is one where you spend most of your paycheck, every paycheck cycle, on gas, food, transportation, clothing, basics of life, and prices go up the way they've been going up, you're in trouble right away." High inflation affecting household needs such as food, healthcare, and transportation strains middle- and lower-income budgets.[1] The Federal Reserve's tools work to lower inflation by reducing demand for economic activities sensitive to interest rates. However, a family's "pocketbook" needs have little to do with interest rates, and potential job losses brought about by monetary over-tightening will only worsen these matters for the working class.

Maintaining full employment while reducing inflation is central to protecting the workers who power our economy. Congress codified this mandate in the 1978 Full Employment and Balanced Growth Act – the Humphrey Hawkins Act. The law makes it clear that, "Increasing job opportunities and full employment would greatly contribute to the elimination of discrimination based upon sex, age, race, color, religion, national origin, handicap, or other improper factors."

Upper-income households are better able to protect their wealth during economic downturns and seize future wealth-building opportunities when the economy recovers. At the same time, lower-income families have fewer resources to mitigate unemployment and less wealth to accumulate assets and realize gains during an economic recovery.[2] Due to this disparity, inflation and

[1] https://libertystreeteconomics.newyorkfed.org/2022/08/historically-low-delinquency-rates-coming-to-an-end/
[2] https://www.minneapolisfed.org/article/2022/how-the-racial-wealth-gap-has-evolved-and-why-it-persists

Source: Senate Banking Committee, TrendMacro calculations

Bottom line

As promised, a 50 bp hike slows from the previous four 75 bp hikes, and the dots for estimated future funds targets were raised – to 5-1/8% at year-end 2023, from 4-5/8% at the September FOMC. The Fed appears to be oblivious to visible evidence that all measures of inflation have peaked. The unemployment rate forecast has also been upgraded to 4.6% from 4.4%, implying 329,000 more workers will be thrown out of a job, added to the 1.26 million already forecasted in September. Markets are completely looking through all this, with the Fed funds futures markets continuing to assume that the Fed will not hit its year-end dot – not the new higher one, and not even the old lower one. These markets may be relying on the pivot by the administration and the new Congress away from inflation-fighting and toward recession-fighting.