Trend Macro™

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TRENDMACRO LIVE!

On the February FOMC

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One word means one and done. It's now not about the "pace" but the "extent" of hikes.

Update to strategic view

FEDERAL RESERVE, US MACRO: A single word changes in the statement – it's now about the "extent" of future rate hikes, no …

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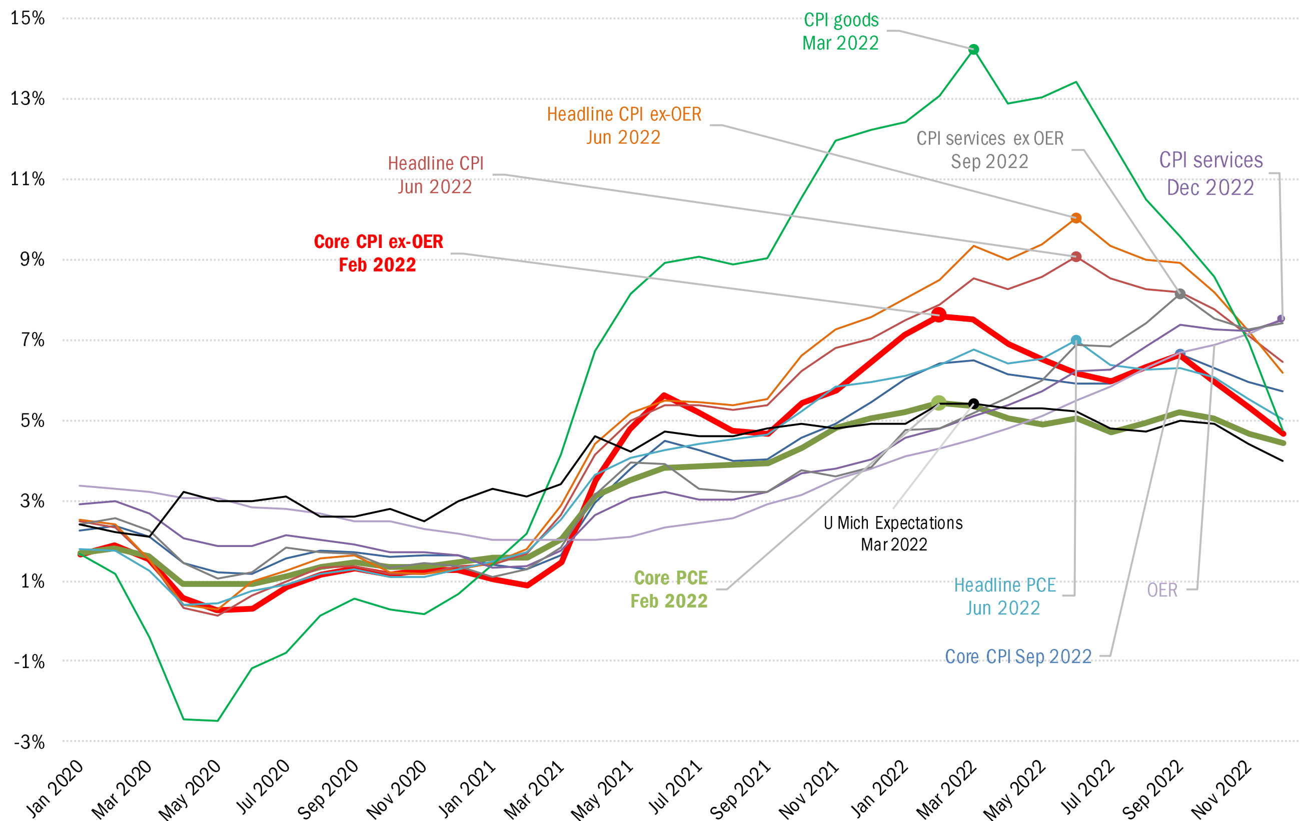
Today's FOMC statement includes *a momentous change in one all-important word: "pace" has become "extent."*

> *"In determining the ~~pace~~ extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."*

Now it's no longer a question of the size of rate hikes – with their "pace"

Year-on-year inflation, various measures ● Peak



Source: Bloomberg, TrendMacro calculations

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already having fallen from 75 bp in November (when the original version of that sentence was first added, indicating the Fed would slow down – see "On the November FOMC" November 2, 2022) to 50 bp in December to 25 bp today. *Now it's a question of whether this hiking cycle will continue at all – its "extent," or lack thereof.*

We say: one and done (see "Surprises of 2023 Volume 1: From Inflation to Deflation" January 3, 2023)

- *And at the same time, the statement for the first time acknowledges that "inflation has eased somewhat," the first such acknowledgement ever, even after the Fed's own favorite inflation gauge peaked all the way back in February 2022* (please see the chart on the first page, and for a full red-line mark-up of the statement, see "Data Insights: Federal Reserve" February 1, 2023).
- *Furthermore, the statement ditched all the bogus rationales for inflation* (such as "supply and demand imbalances" and "price pressure," the latter amounting to little more than arguing that inflation causes inflation). A thing that is no longer a thing no longer has to be rationalized, you see.
- *And the Russian invasion of Ukraine is no longer cited as inflationary, but as a source of "elevated global uncertainty." The balance of risks has reversed – inflation is now officially less a threat than slowing growth.*
- Indeed. Inflation has peaked and is headed down (again, see the chart on the first page). And while we don't think a hard landing is likely at all, just today there was plenty of evidence that there are indications of some degree of economic weakness – a poor ISM manufacturing index, and far-below-consensus ADP payrolls.

Powell started out the post-meeting press conference seeming to walk all that back, saying "we have more work to do" on inflation. And he repeated the statement language that "The Committee anticipates that ongoing increases in the target range [of the funds rate] will be appropriate."

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… longer the "pace." With today's mere 25 bp hike, the size of hikes is no longer on the table – it's whether there will be any more hikes at all. We think there won't. The statement downgraded the inflation threat by noting it has "eased somewhat," and all the bogus explanations for it have been removed. The Ukraine crisis has been changed from an inflation threat to a source of "uncertainty," that is, a growth threat. The balance of risks has changed from inflation to growth. The Fed had the chance to correct dovish expectations embedded in the money market curve, and instead it ratified them. We reiterate our call for "one and done" in this cycle (and today was the "one"). Nothing was said about the year-on-year contraction in the money supply, a first in the history of modern post-1959 data, despite the Fed's mandate under the Federal Reserve Act beginning by calling for the management of monetary and credit aggregates.

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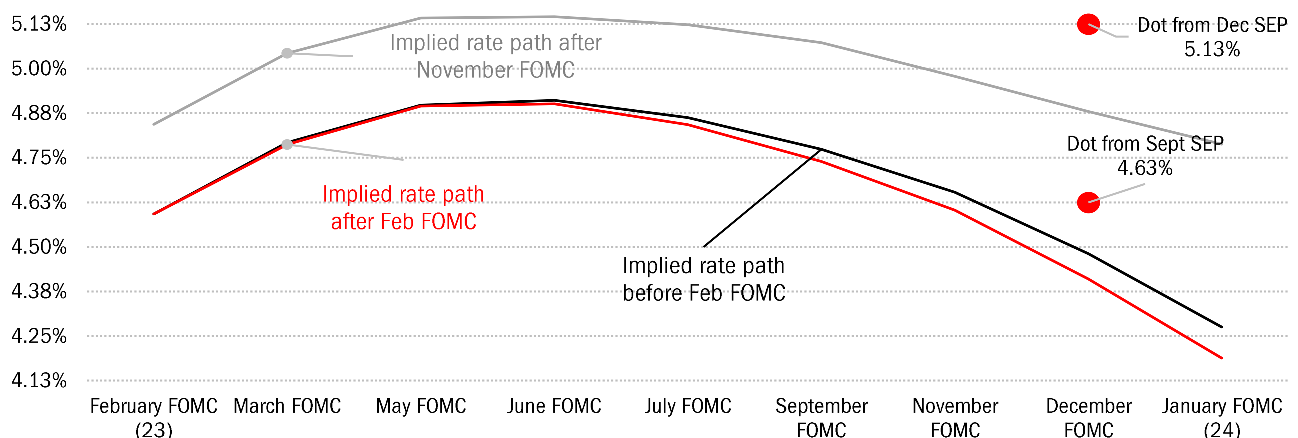
Futures-implied funds rate, by FOMC meeting



Source: Bloomberg, TrendMacro calculations

- But we see this as a replay of the November FOMC, where the written statement introduced the sentence about the pace – now the extent – of rate hikes, effectively announcing the Fed was looking to wind down this hiking cycle. In his spoken remarks, he warned of higher-than-expected for longer-than-expected rates, seemingly overwriting the dovish turn in the statement.
- But we said to go with what he writes, not what he says (again, see “On the November FOMC”). And that’s just what markets have done. Coming into this meeting, the money-market curve has come to expect lower rates, not higher, and for a shorter time, not longer (please see the chart on the previous page).
- Indeed, this was a source of risk coming into today’s FOMC. The minutes of the December FOMC famously called this “an unwarranted easing in financial conditions…driven by misperception by the public” (see “Data Insights: FOMC Minutes” January 4, 2023). *So today was the chance to correct those misperceptions, which would have been quite a shock.*
- *But the FOMC, instead, ratified the market’s expectations*. As of this writing, the money market curve has actually eased slightly, taking 9 bp out go the funds rate one year out (again, see the chart on the previous page).
- *When asked about it in the press conference, Powell blew it off by saying “I’m not going to try to persuade anyone they should have a different forecast.”*

We are surprised that no one in the press conference asked Powell to comment on the fact that the M2 money supply has now contracted on a year-over-year basis for the first time in the post-1959 modern history of the Fed’s data (please see the chart below).

- We think this, inevitably, means year-over-year inflation will be

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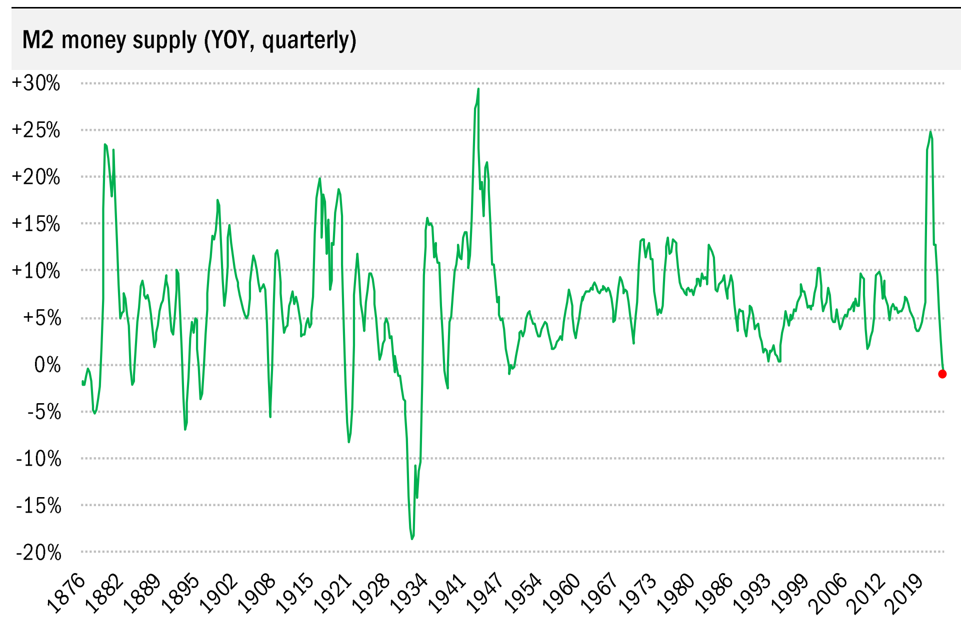
M2 money supply (YOY, quarterly)



Source: 1876-1958 NBER, 1959-present Federal Reserve, TrendMacro calculations

negative – that is, it will be outright deflation – in a little more than a year (again, see “Surprises of 2023 Volume 1: From Inflation to Deflation”).

- With today’s statement having ditched all the rationales about things that *don’t* really cause inflation, it would have been nice to hear Powell opine as to his view on the money supply, that *does* (see “Why Inflation Is on the Way Down” July 25, 2022).
- Well, we already know. In a colloquium last year, he dismissed changes in the money supply as having nothing to do with inflation or anything else (see “Demand and Supply and Things Like That” September 9, 2022).
- He should review the Fed’s mandate under the Federal Reserve Act.

“The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.”

- Powell always talks about the last part – “maximum employment” and “stable prices.”
- But how about the first part? The statute is clear that that all the Fed’s goals will be achieved through managing “monetary and credit aggregates.”
- The day will come sometime this year when the market turns to the contraction in the money supply, remembering the severe economic disruptions caused by it in the deep history back in the 1930s and 1940s.
- The Fed can’t achieve the back end of its mandate if it doesn’t acknowledge the front end.

Bottom line

A single word changes in the statement – it’s now about the “extent” of future rate hikes, no longer the “pace.” With today’s mere 25 bp hike, the size of hikes is no longer on the table – it’s whether there will be any more hikes at all. We think there won’t. The statement downgraded the inflation threat by noting it has “eased somewhat,” and all the bogus explanations for it have been removed. The Ukraine crisis has been changed from an inflation threat to a source of “uncertainty,” that is, a growth threat. The balance of risks has changed from inflation to growth. The Fed had the chance to correct dovish expectations embedded in the money market curve, and instead it ratified them. We reiterate our call for “one and done” in this cycle (and today was the “one”). Nothing was said about the year-on-year contraction in the money supply, a first in the history of modern post-1959 data, despite the Fed’s mandate under the Federal Reserve Act beginning by calling for the management of monetary and credit aggregates.