Trend Macro™

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TRENDMACRO LIVE!

On the March FOMC

Wednesday, March 22, 2023
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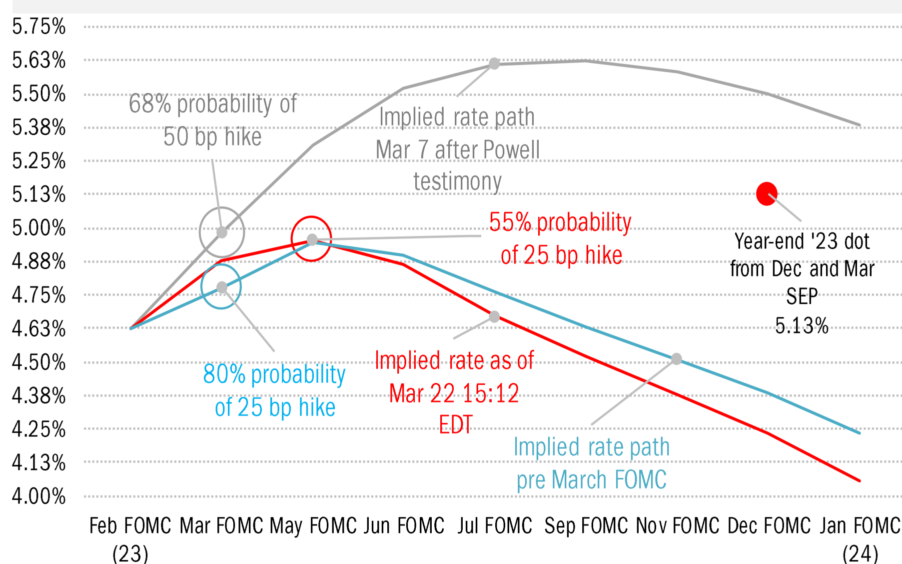
One and done, by the "dots." But Powell thinks the banking crisis is a feature, not a bug.

We're sure the FOMC thinks it was terribly clever with its "dovish hike," a small 25 bp rate hike to 4-7/8% linked with no increase in the Summary of Economic Projections' call for a 5-1/8% optimal rate at year-end (please see the chart on the following page). The problem is that the year-end "dot" doesn't say much about where the funds rate will be between now and then (please see the charts on the following page). Hypothetically it could peak higher than the year-end 5-1/8%. Even if it doesn't, the implication is that today's funds rate plus a 25 bp hike will still be in force nine months from now – at least in the Fed's collective mind.

But as of this writing, *the futures-implied path for the funds rate is more dovish than it was just before the FOMC statement was released* (please see the chart directly below). There's a 55% probability of a 25 bp hike at the May FOMC. But that's it. Then come the cuts. *As to that 5-1/8% "dot" – well, fuggedaboutit. Markets are saying a full percentage point less*.

But still another hike likely coming. Despite a banking crisis. Yes, despite a banking crisis.



Source: Bloomberg, TrendMacro calculations

Update to strategic view

FEDERAL RESERVE, US MACRO: A "dovish hike" where 25 bp on the funds rate is offset by no change in the "dot" for the year-end rate at 5-1/8%. Powell sanctimoniously paid lip service to the risks of a deepening banking crisis, but under questioning reveals he sees it as the equivalent of a rate hike, helpfully tightening conditions in his holy war against an inflation that has already peaked. On the face of it the steady year-end "dot" implies one-and-done, but it's silent as to the peak rate in the meantime, and clearly implies the rate should be expected to be higher nine months from now than it is today. Markets weren't surprised by the hike. The futures-implied probability of it was 80%, and now there's a 55% probability of another 25 bp in May. The implied path moved lower overall after the meeting statement, and the year-end expectation is for 4-1/8%, a full percentage point below the "dot."

[Strategy dashboard]

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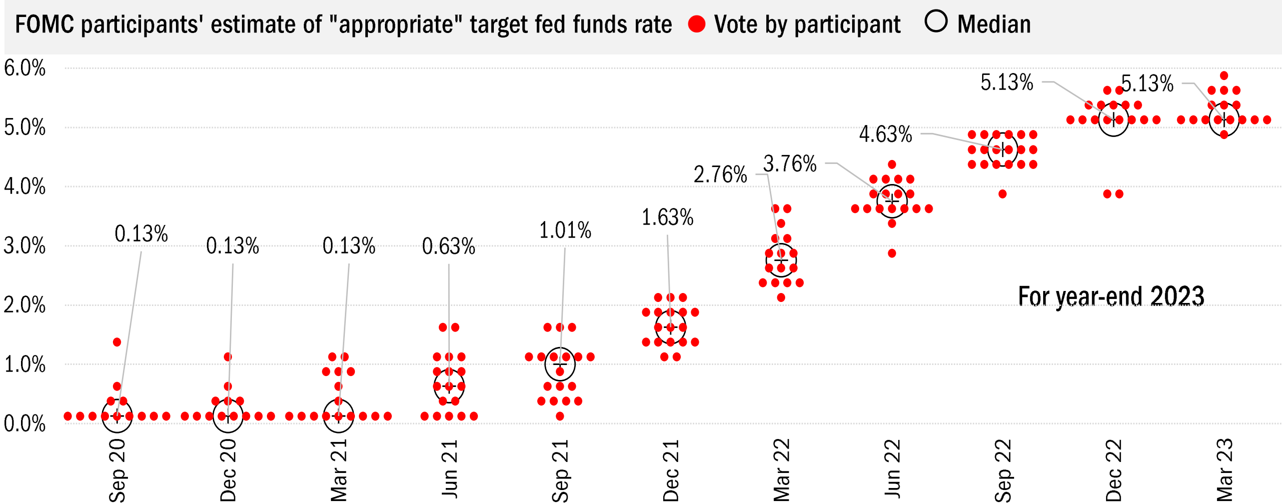
FOMC participants' estimate of "appropriate" target fed funds rate ● Vote by participant ○ Median

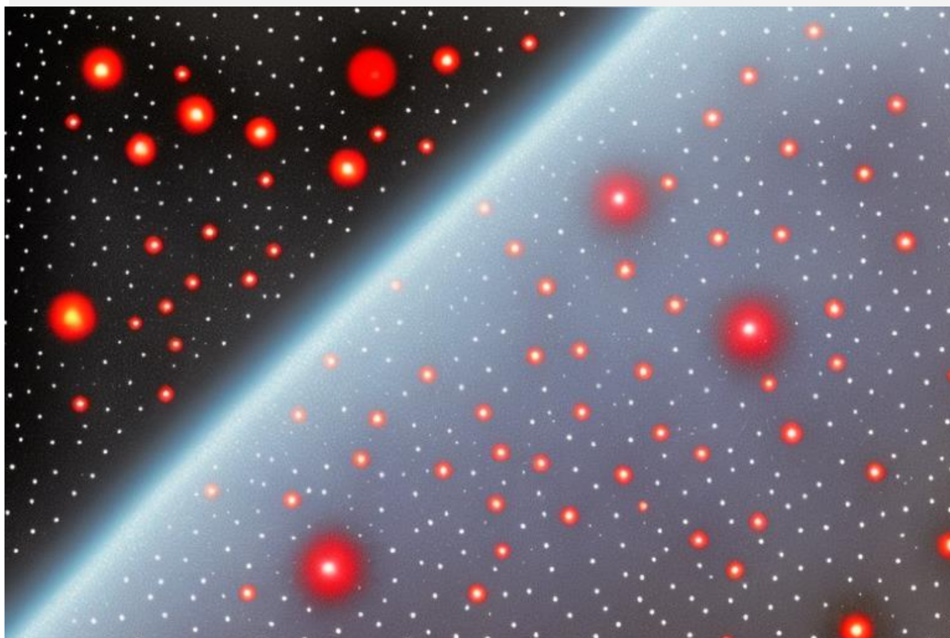


Source: FRB SEP, TrendMacro calculations

To be sure, Chair Jerome Powell is well aware of it. For the first time in many months, *the banking crisis crowded out inflation as the sanctimonious opening phrases of his prepared remarks in the post-meeting presser*. That, at least, is progress considering that all measures of inflation have already passed their peak (even Powell's super-secret personal measure of inflation, "core PCE services excluding shelter" – see "On Powell's Shocking Testimony" March 7, 2023).

- Just two weeks ago, in Congressional testimony, Powell was talking about accelerating the pace of rate hikes (see "On Powell's

Generative AI token: "Dot plot in the style of the Webb Space Telescope"



Source: DreamStudio running Stable Diffusion 1.5

Shocking Testimony" March 7, 2023).

- It took a banking crisis to keep the FOMC from doing it. But that doesn't mean that Powell is stepping into the shoes of former chair Alan Greenspan and doing "whatever it takes" to keep the system confident and stable (see "FOMC Preview: The Meh-stro" March 20, 2023). *Greenspan wouldn't have hiked. He wouldn't have paused. He would have cut, as he did in 1987 in reaction to the stock market crash and in 1998 in reaction to the Long Term Capital Management collapse.*
- But Powell just sees the banking crisis as a feature, not a bug. *It's a helping hand in his scorched earth tightening cycle*. In today's FOMC statement the FOMC says it is "likely to result in tighter credit conditions for households and businesses and to weigh on economic activity." In the post-meeting presser, Powell went on to say "In principle you can think of it as the equivalent of a rate hike, maybe more than that."
- Yeah. The equivalent of a potentially contagious rate hike that threatens the very core of the financial system – a threat that the Federal Reserve was created 110 years ago to protect against.
- All of which implies, clearly enough, that *if we are lucky and get through this banking crisis with only a speed-bump the economy, its contribution to tightened financial conditions will cease and it's right back to rate hikes to combat inflation*. Powell said as much in the presser in response to a question, and that pretty much ended the little equity rally that had developed since the statement was released.

In the background, the same Summary of Economic projections that kept the year-end 2023 dot at 5-1/8% is a grosser-than-usual dogs breakfast of incompatible ideas.

- 2023 real GDP growth was downgraded from December to 0.4% from 0.5% – at a moment when Q1-2023 looks like it's going to come in at 3.2%. So is that a recession forecast?
- But don't worry the unemployment rate has been moved down from 4.6% expected in December to 4.5%. You see, fewer people get thrown out of work when the economy grows slower (according to the FOMC's models at least – unfortunately, though, not in reality).
- And wait. Core inflation has now been upgraded from 3.5% to 3.6%. So for all that, *the quirky recession embedded in the projected doesn't even deal with what the FOMC sees as the number one threat – not ever directionally*.
- So let's raise the "dot" for the funds rate at year-end 2024 from 4-1/8% to 4-1/3%.
- *So let's get this right – a banking crisis and the threat of more rate hikes will cause a recession.*

Obviously all this is far less than we predicted Monday (see "FOMC Preview: The Meh-stro" March 20, 2023). *We just seem to never learn that no one ever went broke underestimating Jerome Powell.*

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[About us]

- Our vision – maybe just our hope – for a powerful risk-back-on rally when Powell does the right thing is off the table.
- For the moment, this appears to be a pretty much at-market-expectations event (the futures implied probability of today's hike was 80%).
- So we muddle onward…

Bottom line

A "dovish hike" where 25 bp on the funds rate is offset by no change in the "dot" for the year-end rate at 5-1/8%. Powell sanctimoniously paid lip service to the risks of a deepening banking crisis, but under questioning reveals he sees it as the equivalent of a rate hike, helpfully tightening conditions in his holy war against an inflation that has already peaked. On the face of it the steady year-end "dot" implies one-and-done, but it's silent as to the peak rate in the meantime, and clearly implies the rate should be expected to be higher nine months from now than it is today. Markets weren't surprised by the hike. The futures-implied probability of it was 80%, and now there's a 55% probability of another 25 bp in May. The implied path moved lower overall after the meeting statement, and the year-end expectation is for 4-1/8%, a full percentage point below the "dot."