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TRENDMACRO LIVE!

On the June FOMC

Wednesday, June 14, 2023

Donald Luskin

Dots all folks. The market mustn't think there will be rate cuts (though inflation is collapsing).

So this is what a "hawkish skip" looks like. It looks like utter confusion.

There was no rate hike today, for the first time since March 2023. Today's [FOMC statement] explained it by following through on recent comments [by Chair Jerome Powell] and [by Vice Chair-designate Philip Jefferson]. If anything, to our eye, these language changes feel slightly more dovish than those comments.

> "…the Committee decided to ~~raise~~maintain the target range for the federal funds rate ~~to~~at 5 to 5-1/4 percent. ~~The~~ Holding the target range steady at this meeting allows the Committee ~~will closely monitor incoming~~ to assess additional information and ~~assess the~~its implications for monetary policy. In determining the extent ~~to which~~of additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy

Generative AI token: "Inflation is coming down fast. Soon it will be deflation."

Source: DreamStudio running SDFX Beta

Update to strategic view

FEDERAL RESERVE, US MACRO: No rate hike, and a dovish statement about buying time to collect more data. Contradicting that is a sharp upgrade in the "dot" for year-end 2023, projecting a funds rate at 5-5/8%. That means two 25 bp hikes and two skips over four meetings. The mission is to disabuse the market of its belief over the entire intermeeting period that the first cut will come no later than January. But while the SEP raises the funds rate dot, at the same time it has lowered its estimate of unemployment and inflation. That's a three-way combination of realities which, in the Fed's thought-model, cannot coexist. Inflation is collapsing, and this morning's PPI is clearly signaling downright deflation. For all today's confusion, the Fed has bought the gift of time over which deflation will be so obvious they will have no choice but to pivot. No more rate hikes.

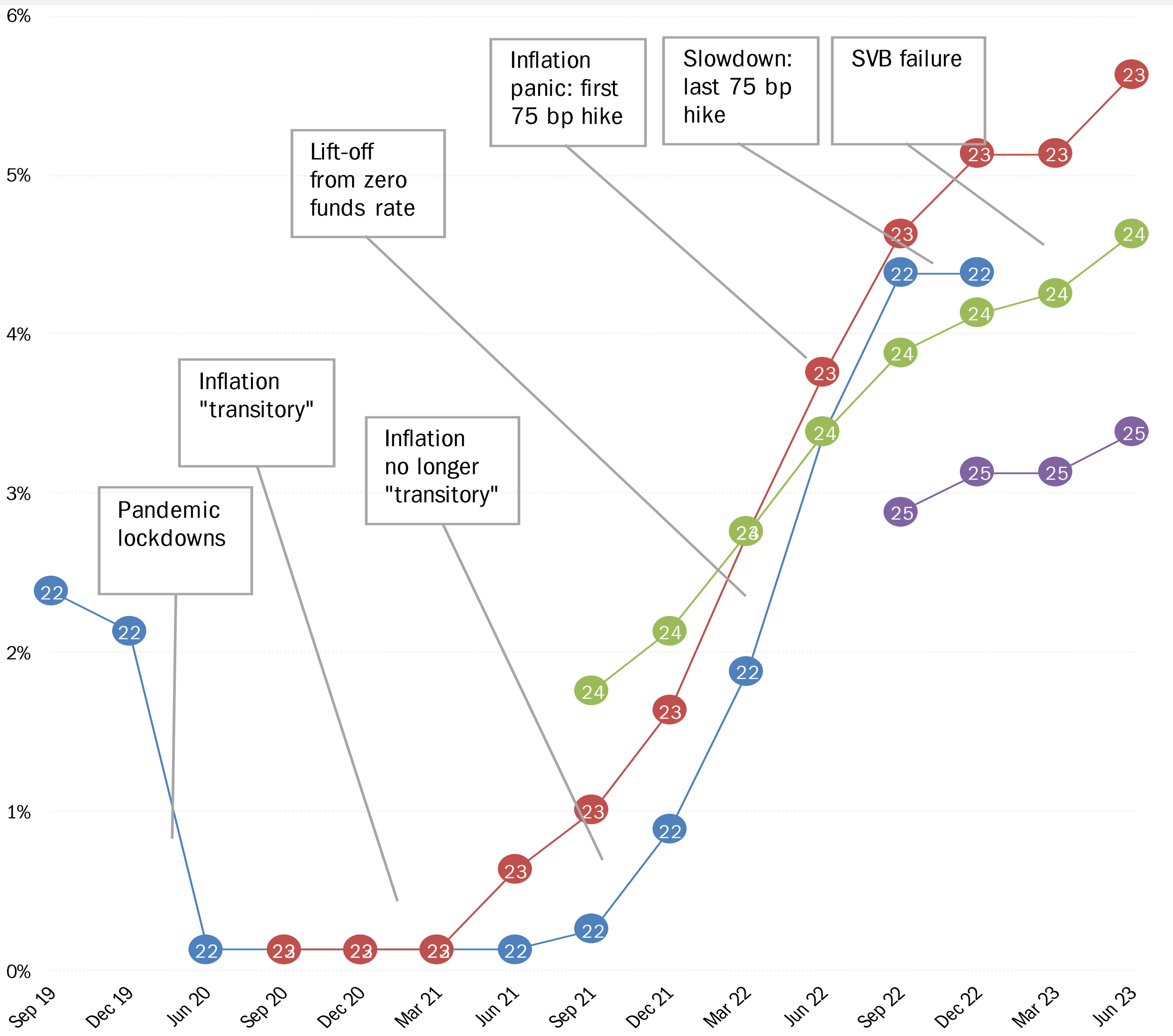
[Strategy dashboard]

affects economic activity and inflation, and economic and financial developments."

But then, there are those damn "dot plots" in the [Summary of Economic Projections] (please see the chart below). There really was no good way the dots could have been laid out to tell a coherent story about this meeting's zero rate hike (see ["Video: What you're not hearing about next week's June FOMC"] June 8, 2023). Of all the bad ways, the FOMC chose the worst.

- After leaving the year-end 2023 "appropriate" federal funds rate at 5-1/8% [at the March FOMC's SEP], the median dot jerked all the way up to 5-5/8%. *That's 50 bp of hiking across four meetings, which on the face of it suggests two 25 bp hikes and two "skips"*

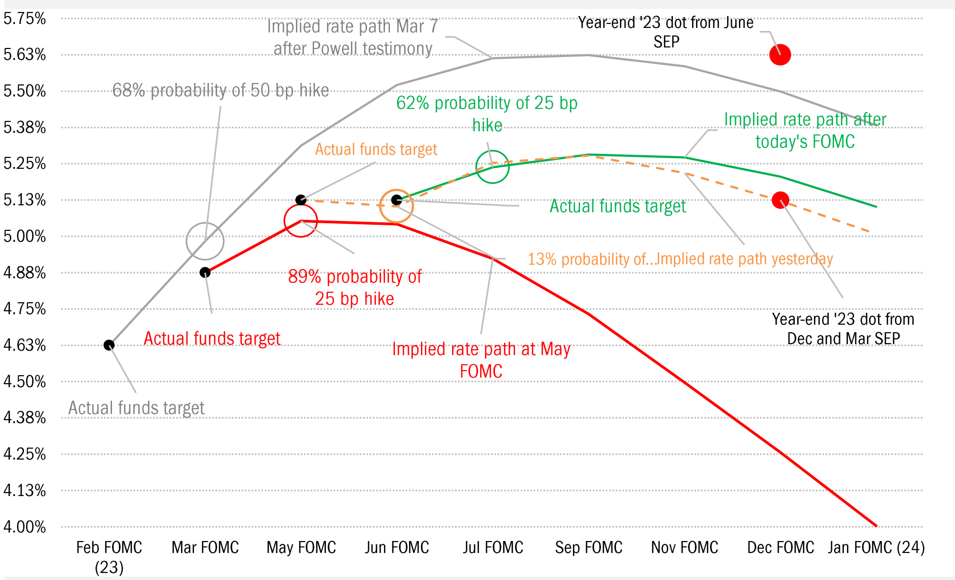
Dot-plots: "Appropriate monetary policy: Midpoint of target range for the federal funds rate" by FOMC meeting



Source: FRB SEP, TrendMacro calculations *like today."* That's consistent with a remark by Powell in his answer to the first question in the post-meeting presser, that a "skip" is consistent with the Fed's slowing down the pace of rate hikes after the last 75 bp hike in November: "this is a continuation of that process" (see ["On the November FOMC"]() November 3, 2021).

- The dot for 2024 was raised from 4-3/8 to 4-5/8. The 2025 dot was moved from 3-1/8 to 3-1/2. *Both still show multiple rate cuts from 2023's projected level or, for that matter, even from today's level.*
- *This exercise is a matter of signaling, as much or more than it is a matter of sincerely forecasted reality*. For some reason – maybe to curb speculation, maybe to prevent self-fulfilling prophecies, maybe to preserve its pride – the Fed doesn't want markets to expect cuts this year, as the money-market curve has been expecting for most of the inter-meeting period since the May FOMC.
- *In the presser, if Powell said it once he said it half a dozen times, there was complete unanimity on the committee that there would be no cuts this year*.
- *If there were any sincerity to it, then why would the SEP have moved its estimate of the unemployment rate at year-end from 4.5% to 4.1%, and its estimate of core inflation at year-end from 3.2% to 3.1%?*
- After all, Powell says all the time – as he did multiple times today – that a right labor market causes inflation. And he admits all the time that tighter policy is necessary to curb inflation, but will also cause some unemployment. So let's get this straight. *The labor market is going to be TIGHTER than we thought AND inflation will be LOWER than we thought AND the funds rate will be HIGHER than we thought.* All at the same time? See, this isn't serious.

Futures-implied funds rate, by FOMC meeting



Source: Bloomberg, TrendMacro calculations

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[About us]

- *Oh... And as of this writing, the money-market curve has barely changed its pre-meeting estimate of the year-end funds rate, and there's only a 62% probability of a hike a* (please see the chart on the previous page). At least for now, the market agrees that none of this is serious.
- Of course the worst part of it is the seeming obliviousness to the progress made so far in the reversal of inflation. The Consumer Price Index is now about 80% of the way back to the Fed's target for it, in just 11 months. Worst, Powell didn't even mention (and the polite coterie of reporters at the presser didn't ask – because they want to be invited back) this morning's Producer Price Index, at 1.1% year-over-year for final demand is *below* target. Most of the PPI sub-indices are now outright negate year-over year (see "Data Insights: CPI/PPI" updated June 14, 2023).
- PPI is the head of the pipeline, the gateway drug, to consumer inflation. Not because it "causes" it, but because, being in a less complex position in the supply chain, it signifies it more directly and more sensitively. As this short, sharp inflation cycle began, PPI final demand broke above target in February 2021 at 3.0% (CPI didn't break out until March, at 2.6%). PPI final demand peaked first, too, in March 2022 at 11.7% (CPI didn't peak until June, at 9.1%).
- The problem isn't inflation anymore. The problem is deflation. The meta-problem is that "deflation" isn't even a word that Powell mentions (see "Inflation Has Peaked -- Get Ready for Deflation" May 24, 2023).
- Soon enough he will. This morning's PPI is a demonstration, a shot across the bow. This can happen very quickly, even in the lagging data Powell insists on following.
- As inflation continues to fall, and as that fall accelerates, this "skip" will have bought the Fed the gift of time to change its mind. *There will be no more rate hikes, dots or no dots.*

Bottom line

No rate hike, and a dovish statement about buying time to collect more data. Contradicting that is a sharp upgrade in the "dot" for year-end 2023, projecting a funds rate at 5-5/8%. That means two 25 bp hikes and two skips over four meetings. The mission is to disabuse the market of its belief over the entire intermeeting period that the first cut will come no later than January. But while the SEP raises the funds rate dot, at the same time it has lowered its estimate of unemployment and inflation. That's a three-way combination of realities which, in the Fed's thought-model, cannot coexist. Inflation is collapsing, and this morning's PPI is clearly signaling downright deflation. For all today's confusion, the Fed has bought the gift of time over which deflation will be so obvious they will have no choice but to pivot. No more rate hikes.