Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

TRENDMACRO LIVE!

On the July FOMC: The Most Unkindest Hike of All

Wednesday, July 26, 2023
Donald Luskin

Powell won't wait to see inflation at 2% to stop the hikes – but half of CPI is already deflating.

At the prior FOMC in June the committee said for the first time that policy was already "restrictive," and decided to leave rates unchanged in order to "maintain" it (prior to that, restrictive policy was to yet to be "attained"). Now, with today's 25 bp rate hike to a funds rate target of 5-1/4% to 5-1/2%, the decision was to make policy even *more* restrictive. Chair Jerome Powell admitted as much multiple times in the post-meeting press conference.

Right or wrong, this is not a surprise – it was fully anticipated by markets. As of this writing, with the presser all done, the futures market and the 2-year yield have slightly downgraded the implied future path of the funds rate (please see the chart on the following page). *Markets never assigned a strong probability to any further hikes from here, and they still don't. We agree.*

- This hike comes despite the June FOMC's "skip" in order to "assess additional information and its implications" (see "On the June FOMC" June 14, 2023).
- Of the 68 economic data releases since then, 51 show the economy

Generative AI token: "The information we said we needed told us not to hike interest rates but we did it anyway."

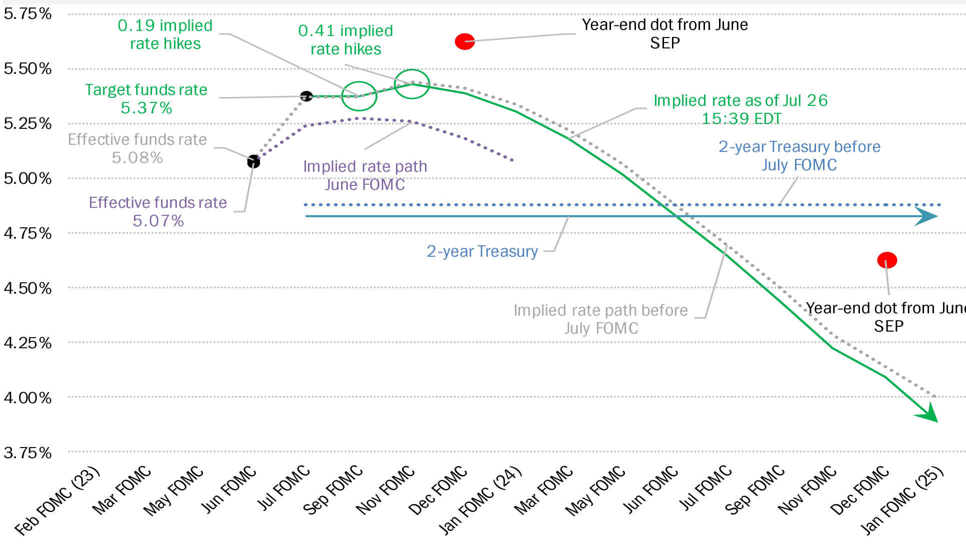
Source: DreamStudio running SDFX Beta

Update to strategic view

FEDERAL RESERVE, US MACRO: As the market fully expected, a 25 bp rate hike to a 22-year high on top of a rate the FOMC openly admits is "restrictive." June's "skip" was to attain more information – the bulk of which turned out to be dovish. Yet today's statement changes only a single word, recharacterizing growth as "moderate" rather than "modest." The "skip" is revealed as not about data at all, but only part of the slowing pace of hikes announced at last November's meeting. As of this writing. Powell said it would be "not appropriate" to wait to see inflation all the way back at target before halting the hikes. Yet he seems blind to the fact that, excluding shelter, half the CPI consumption basket is already in outright deflation. Following the meeting, markets slightly downgraded the implied probability of any further hikes. We agree.

[Strategy dashboard]

Futures-implied funds rate, by FOMC meeting



Source: Bloomberg, TrendMacro calculations

and inflation decelerating or outright slowing (see [“Video: What you’re not hearing about Wednesday’s FOMC”] July 24, 2023), and only 17 show the economy accelerating (none show inflation accelerating).

- Yet today’s FOMC statement pretty much changes only a single word compared to June’s. Economic expansion is now described as “moderate” rather than “modest” (see “Data Insights: Federal Reserve” July 26, 2024).
- Yep. *All that dovish inter-meeting information drives a single word-change (in which the first syllable is even the same). Oh, yes, and it drives a rate hike – from a funds rate that was already restrictive to one that is more so*, to a level not seen since March 2001
- In response to the first question in the post-meeting presser Powell said “intermeeting data came in broadly in line with expectations.” That’s his dodge to alibi the inescapable conclusion that *the claimed purpose of the “skip,” to gather new information, was never real. The true purpose of the “skip” was simply to continue to slow the pace of hikes, consistent with guidance first given at the November 2022 FOMC with the last of four 75 bp hikes* (see “On the November FOMC” November 3, 2021).
- Later in the presser, in response to multiple questions about the pace and magnitude of future hikes. Powell said the important thing is that the committee “slow down while we make these finely judged decisions.”
- It is indeed wise to slow the pace. The Fed’s reckless excessive speed is what killed Silicon Valley Bank (see “It’s Over For SVB – And the Fed” March 13, 2023). *But better yet to stop altogether, recognizing that the back of inflation has been broken*.
- Goods, which make up 38.4% of CPI, is already in outright deflation at negative 0.90% year-over-year (see “On June CPI: Sticky Inflation Just Came Unstuck” July 12, 2023). Core goods, excluding food and

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

energy, making up 21.4% of the index, is well below target at 1.41%.

- Services inflation is still at 5.75% year-over-year, and that makes up 61.6% of the index. But that's something of an illusion. First, services inflation is only up 2.28% over three months at an annual rate. And more than half of that is shelter (and over a third is owners' equivalent rent).
- Take out just OER and overall CPI is up only 1.42% year-over-year, and core CPI is up only 3.18%.
- So then how to interpret Powell's answer to this question in the presser:

  "QUESTION: How close do you need to get with the inflation numbers coming down? How many months of data do you need to see…before you are willing to declare victory on it?

  "POWELL: The idea that we would keep hiking until it gets to 2% would be a prescription for going way past the target. That's clearly not the appropriate way to think about it."

- *So then wouldn't the appropriate way to think about be to recognize that half the non-shelter CPI index is already in deflation? And stop the hikes – now, if not sooner?*

Overall, we interpret this FOMC as pretty much a non-event. We remain confident that as more data comes in this year, which will point increasingly clearly to attainment of inflation targets and more – turning toward to deflation. The Fed will surely have to hike no more than the single additional one already anticipated by the "dots" put up at the June FOMC's Summary of Economic Projections. We see that as a worst-case scenario – and at the risk of being wrong about this yet again, our baseline forecast is that this is the last rate hike.

Bottom line

As the market fully expected, a 25 bp rate hike to a 22-year high on top of a rate the FOMC openly admits is "restrictive." June's "skip" was to attain more information – the bulk of which turned out to be dovish. Yet today's statement changes only a single word, recharacterizing growth as "moderate" rather than "modest." The "skip" is revealed as not about data at all, but only part of the slowing pace of hikes announced at last November's meeting. As of this writing. Powell said it would be "not appropriate" to wait to see inflation all the way back at target before halting the hikes. Yet he seems blind to the fact that, excluding shelter, half the CPI consumption basket is already in outright deflation. Following the meeting, markets slightly downgraded the implied probability of any further hikes. We agree.