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TRENDMACRO LIVE!

On the November FOMC

Wednesday, November 1, 2023

Donald Luskin

This is so dovish Powell can't even bring himself to admit it.

No rate hike today, as everyone expected. You can take a rate hike in December utterly off the table, which means the funds rate will finish the year at 5-3/8%, not the 5-5/8% insisted on in the "dot plot" as recently as the September FOMC's Summary of Economic Projections (see "On the September FOMC" September 20, 2023).

- Yes, it's official. In today's FOMC statement, the committee mildly acknowledged the Q3-2023 real GDP boom (see "Data Insights: GDP" October 26, 2023) by upgrading its characterizing of economic activity from "solid" at in the prior meeting's statement to "strong" now.
- It similarly did not over-react to September's surprisingly strong jobs report (see "On the September Jobs Report" October 6, 2023), saying "job gains have moderated since earlier in the year," basically the same as the prior meeting's "slowed in recent months."
- And best of all, the statement explicitly acknowledged "tighter financial and credit conditions" – at the prior meeting it was just "credit conditions" – in light of the back-up in the 10-year Treasury yield to as much as 5%. All the way back in March the FOMC argued

Generative AI token: "No more rate hikes, but no cuts till much later (till it's too late)."

Source: DreamStudio running SDFX Beta

Update to strategic view

FEDERAL RESERVE, US MACRO: Critical changes to the statement language – downplaying strong Q3-2023 real GDP growth and the strong September payrolls report – and explicitly citing the effects of tightening financial conditions – absolutely takes a December rate hike off the table. This is an embarrassing concession considering that one more hike was baked into the "dot plot" just one meeting ago. In the presser Powell was at pains to underplay all this, saying repeatedly that rate cuts were not even discussed at the meeting. But of course they were – they are already reflected in the "dot plot" and markets expect, and have always expected, even more. We think markets have underestimated the dovishness and bullishness of this meeting.

[Strategy dashboard]

that Silicon Valley Bank failure would tighten credit conditions, doing some of the Fed's work for it – meaning fewer policy hikes would be necessary (see "On the March FOMC" March 22, 2023). And now they say they believe long-term yields at high levels not seen since 2007 are similarly doing the Fed's work for it.

We think this is solidly dovish and bullish at the margin, and we'll see it in markets over the next several days. It can't be easy for Powell to have to foreshadow an embarrassing failure of the Fed to reach the 5-5/8% funds rate the "dot plot" promised just one FOMC meeting ago.

Of course, as usual, Powell has poured cold water on all this in the post-meeting presser. All of the first five questions were about the critical question of the extent to which tightening financial conditions substitute for rate hikes. Despite enshrining that idea in the statement, and despite recent speeches by Powell and Vice Chair Phillip Jefferson signaling that it's a real thing – Powell was at pains to convey that he's not sure whether it really matters (except he said he is sure that the Fed's high funds rate target was not itself responsible for higher long-term yields).

But far from perfect, without a single change in the language about inflation.

- *But inflation has fallen back to, and indeed below, the Fed's target*. Our best benchmark for the underlying inflation signal – core CPI less owners' equivalent rent – is at 2.4% year-over-year, compared to the Fed's target for any CPI-based measure at 2.5% (see the chart on the next page, and "Data Insights: CPI" October 12, 2023). To be sure, the Fed's canonical metric, core PCE inflation, is higher at 3.7% year-over-year, but is at 2.6% on a 3-month annual basis – just a little above the Fed's target of 2.0% (see "Data Insights: PCE Inflation" October 27, 2023). *Given the policy lags the Fed has been obsessing about since last year's November FOMC* (see "On the November FOMC" November 2, 2022), *surely inflation has been conquered*.
- In the post-meeting presser, Powell waved this away by saying "a couple months of better data" is not dispositive. Indeed it's not, but that's not all the evidence we have. Inflation peaked a year and a half ago.
- *The FOMC is not acknowledging this, nor the consequences of failing to adjust the policy rate lower in light of it*. The lower the inflation rate, the higher the *real* policy rate. With every tick down in the inflation rate, the tighter the Fed effectively gets by simply standing pat.

This should be so easy. *The Fed should simply declare victory* as we have wrongly expected they would since June (see "Video: What you're not hearing about the coming deflation" June 23, 2023) *and announce the imminent normalization of policy rates* at least back down to a "neutral rate."

- This has been achieved without a hard landing, in fact even without a soft landing – indeed a boom, judging by Q3-2023 real GDP at a

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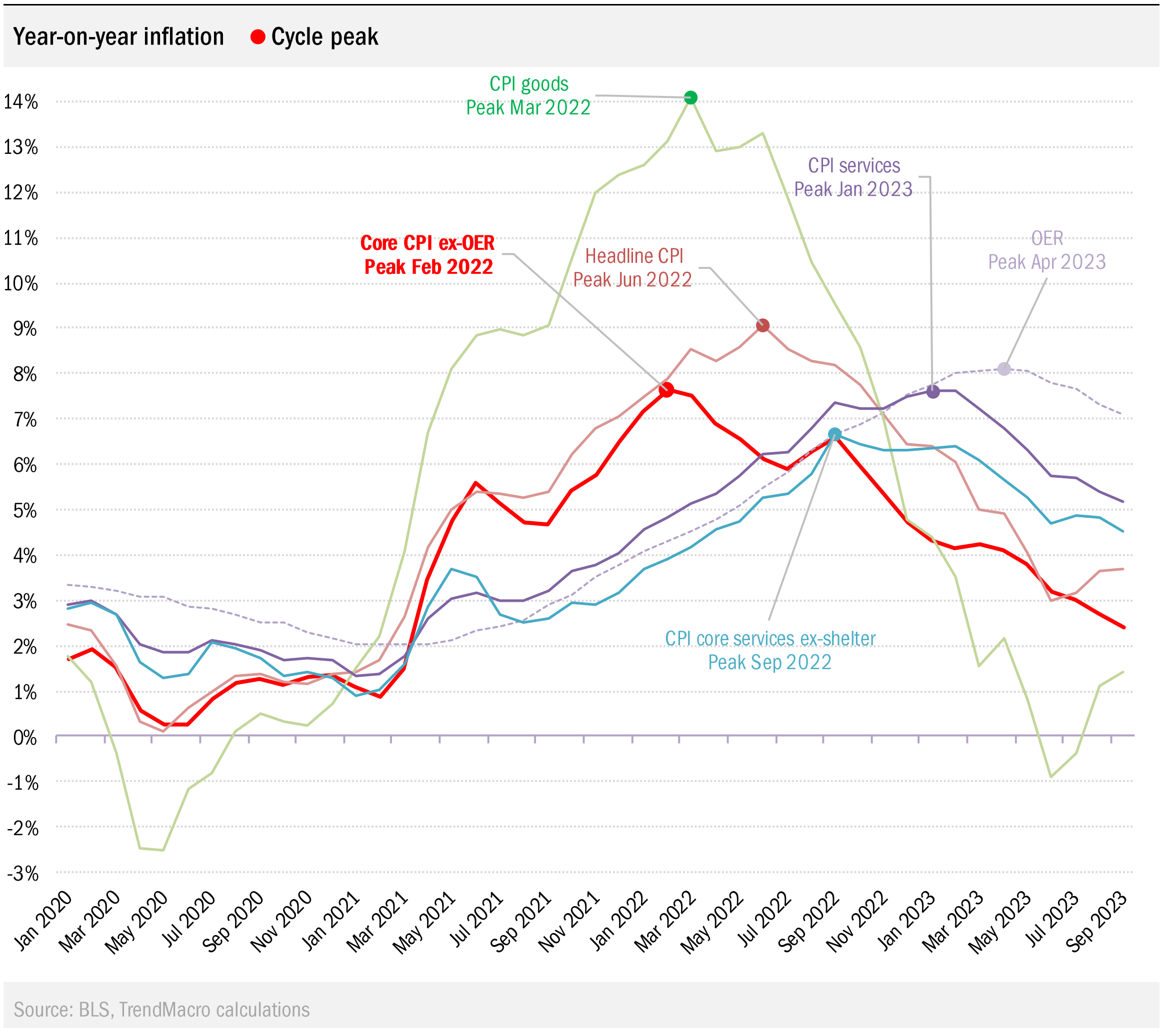


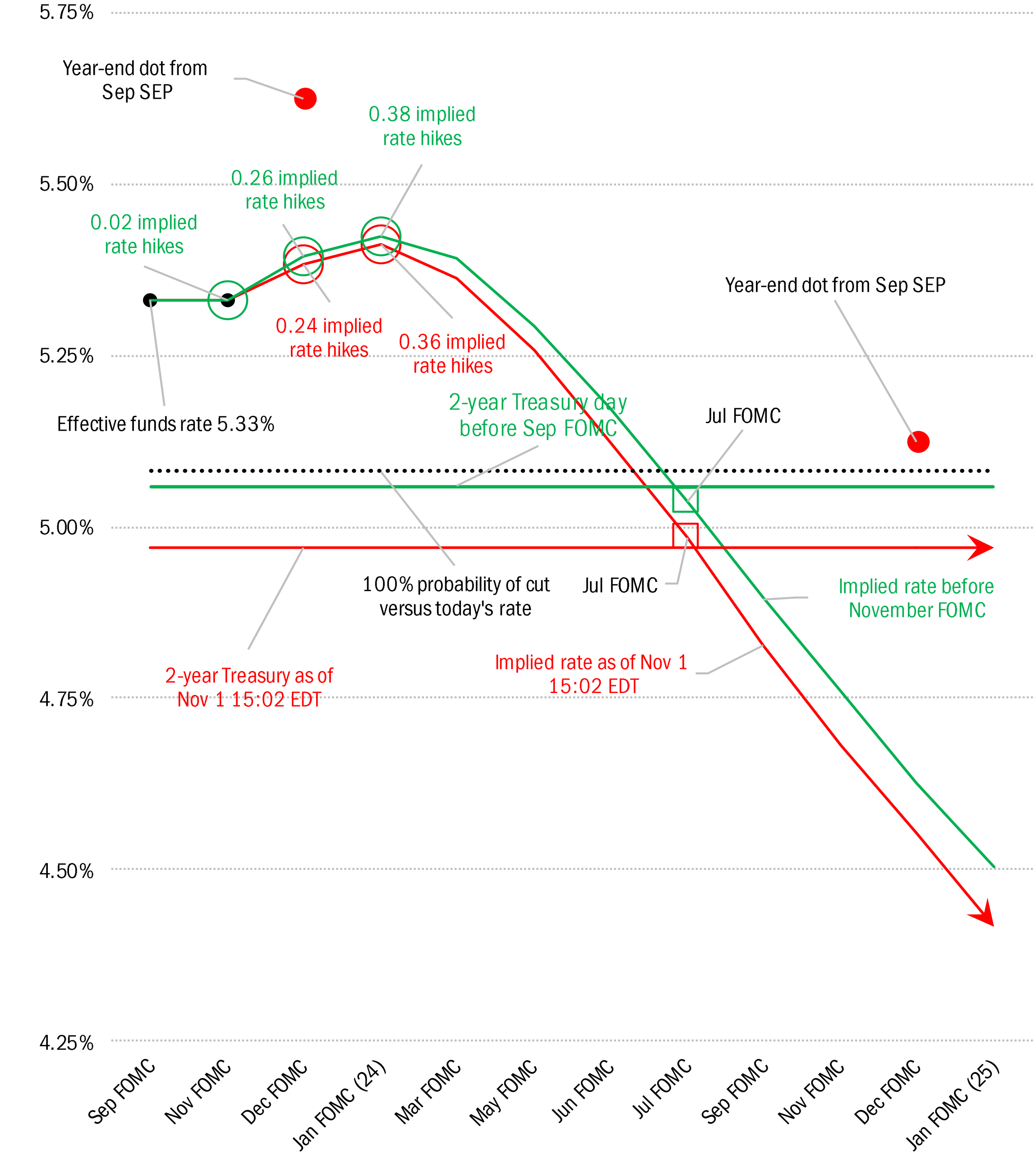
4.9% annual rate (again, see [“Data Insights: GDP”](#)). [Powell and all the other spokespeople insist](#) that such growth rates are inflationary, and it’s not hard to conclude that they won’t *cut* rates until they see growth visibly faltering. *But surely they can see that inflation has been coming down hard even as the economy has accelerated – in fact, it peaked during Q1 and Q2-2022 when real GDP was contracting.*

But no…

- In the presser, Powell said twice in response to a single question, “We’re not talking about rate cuts.” To another he said, “The decision is about whether to hike more.”
- But that’s just his usual “scare you straight” rhetoric. We know they are talking about rate cuts because the “dot plot” sets the December 2024 policy rate at 5-1/8%, which is one cut from the present rate of 5-3/8% and two from the “dot plot’s” 5-5/8% for December 2023.
- The market has never thought the funds rate would be anywhere near 5-1/8% at year-end 2024.
- Before today’s meeting the futures curve was anticipating the first cut at the July 2024 meeting, and a year-end rate of 4.5%. *After today’s*

meeting, as of this writing, the curve has brought forward the first cut by half a meeting, and lowered the year-end expectation to 4.42% (it also downgraded the chances of a hike at the next meeting from an already low 26% to a lower 24% (please see the chart below).

Futures-implied funds rate, by FOMC meeting, before an after today's FOMC meeting



Source: Bloomberg, TrendMacro calculations

Bottom line

Critical changes to the statement language – downplaying strong Q3-2023 real GDP growth and the strong September payrolls report – and explicitly citing the effects of tightening financial conditions – absolutely takes a

December rate hike off the table. This is an embarrassing concession considering that one more hike was baked into the "dot plot" just one meeting ago. In the presser Powell was at pains to underplay all this, saying repeatedly that rate cuts were not even discussed at the meeting. But of course they were – they are already reflected in the "dot plot" and markets expect, and have always expected, even more. We think markets have underestimated the dovishness and bullishness of this meeting.