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

TRENDMACRO LIVE!

On the December FOMC

Wednesday, December 13, 2023
Donald Luskin

The dots are down, the Fed is done, the cuts are coming in March.

We said yesterday it's all about the "dot-plot" for the funds rate at year-end 2024 (see "On November CPI: Good, Not Great" December 12, 2023). At today's FOMC, the Summary of Economic Projections *lowered it to 4-5/8% from 5-1/8%* where it had been placed at the September FOMC, right back to where it had been placed at the June FOMC. *Today marks the first time in this hiking cycle that the dot has been lowered.* Even at 5-3/8% it already put the lie to Chair Jerome Powell's November claim that "the Committee is not thinking about rate cuts right now at all." *Today, with the dot at 4-5/8% the Committee is definitely thinking about rate cuts – at median, three of them. In fact 17 of the 19 participants are thinking about cuts to some degree, and 5 of them see more cuts than the median, according to the distribution of individual dots* (please see the chart below, and "Data Insights: Federal Reserve" December 13, 2023).

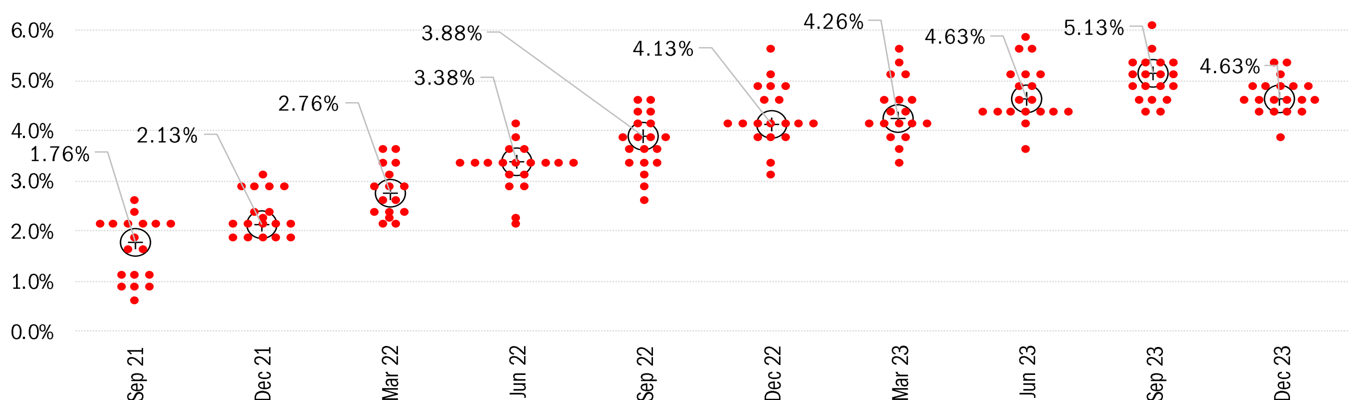
- Indeed, the recent rallies in stocks and bonds have likely been driven by Mr. Market's belief that the Committee *has already been* thinking along these lines.
- The market-implied funds rate only grudgingly came to believe the June SEP's 4-5/8% dot by the time of the September FOMC, three months after it was initially posited (please see the chart on the following page). Now, another three months later, markets have *never* taken on board the September SEP's move to 5-1/8%, and in

Update to strategic view

FEDERAL RESERVE, US MACRO: With the year-end 2024 "dot plot" moving to 4-5/8% from 5-1/8%, we have the first-ever lowering of rate guidance in this hiking cycle. And with the little but critical word "any" added to qualify future rate hikes, it's now official the cycle ended already, five months ago, at the July FOMC. Expectations for something like this have driven rallies in stocks and bonds since the November FOMC, when we pointed out the broad hints to this denouement. Today didn't disappoint, and Powell's full-throated underscoring of the message of the…

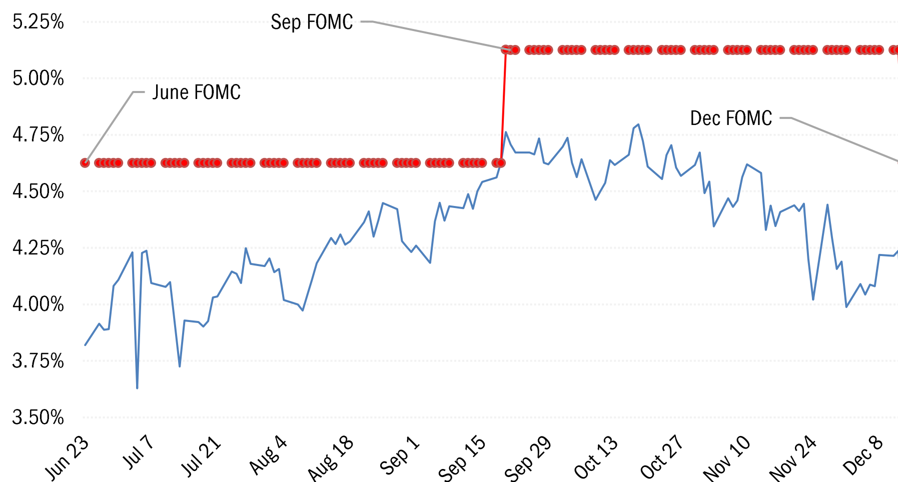
[Continued on next page]

Summary of Economic Projections "dot plots" of "appropriate policy path" for year-end 2024



Source: FRB, TrendMacro calculations

Copyright 2023 Trend Macrolytics LLC. All rights reserved. This document is not to be forwarded to individuals or organizations not authorized by Trend Macrolytics LLC to receive it. For information purposes only; not to be deemed to be recommendations for buying or selling specific securities or to constitute personalized investment advice. Derived from sources deemed to be reliable, but no warranty is made as to accuracy.



Source: Bloomberg, FRB, TrendMacro calculations

[Continued from first page]

… is something of a surprise. Market-implied funds rate expectations, already way ahead of the Fed's "dot plot," have gotten even further ahead as of this writing. Markets are moving toward our prediction that the first cut will come at the March FOMC. Inflation will continue to fall and morph into deflation. Despite concerns with lags in the Fed's scorched-earth tightening regime, there will be no recession.

[Strategy Dashboard home]

fact come into today's FOMC and the December SEP expecting a 4-3/16 rate at year-end 2024.

- *So arguably this is a disappointment. Will there have to be some kind of correction to process it?*
- *No. No one thought the dot would be lowered a full percentage point to meet the market. And the curve is not forecasting what the Fed will say today. It is forecasting what the Fed will do a whole year out*, impounding all manner of implicit inputs including estimates of growth, recession risk, the stickiness of inflation, and the possibility of deflation. The market and the Fed don't have to agree on those inputs at this time – what matters is whether they agree next

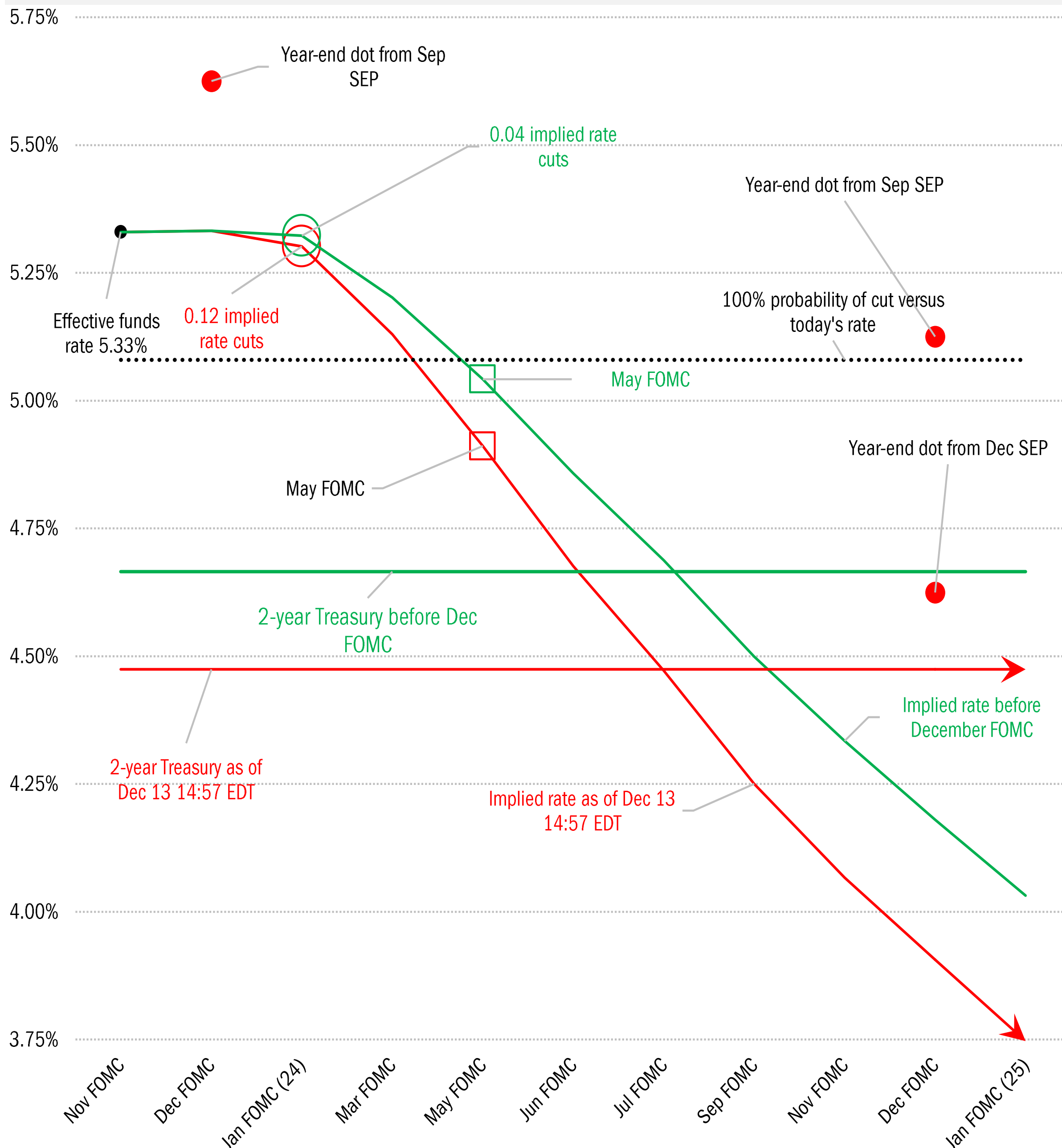
Generative AI token: "Jobs cause inflation. Nope. Growth causes inflation. Nope. Wait! I've got it! Dovish market expectations cause inflation!"

Source: DreamStudio running SDXL 1.0

December.

- So we are inclined to think that this is not a disappointment at all. *But is it a surprise that would fuel ongoing stock and bond rallies – though it's always a surprise when the Fed doesn't do the wrong thing? Maybe yes. As of this writing, the year-end implied funds rate has fallen from 4-3/16% to 3-7/8%. And the probability of the first cut coming in March (as we've been predicting) has risen from about 50% earlier today to about 75% as of this writing* (please see the chart below).
- To be sure, In substance, this was all built in at the November FOMC

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



Source: Bloomberg, TrendMacro calculations

– when there was no SEP, so no new dots – when we made the bull case that *critical changes in the statement language* made it clear for the first time that the Fed wasn't just paused, but done (see "On the November FOMC" November 1, 2023).

- Today is ratification that this hiking cycle ended at the July FOMC (as we predicted – indeed had been predicting too early since March; see "On the July FOMC: The Most Unkindest Hike of All" July 26, 2023). That means it's already been over for five months. Be happy.
- *Again, now, this is the first time in this hiking cycle that the 2024 dot has been lowered. It's official that an easing cycle has begun. Whatever else, there's now almost no risk that the markets and the Fed are at odds directionally – cuts are coming. It's all just timing.*

Underscoring this, today's FOMC statement, only makes only three small changes from November's, but all critical.

- Economic growth is said to have "slowed from its strong pace." The Fed (wrongly) believes growth causes inflation, so this is dovish (if stupid).
- They note, in entirely new language, that inflation "has eased over the past year." Indeed. All you had to have done was look.
- Most critical, the word "any" was added to this phrase:

  "In determining the extent of any 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 affects economic activity and inflation, and economic and financial developments."

- Additional firming is no longer taken for granted. This cycle is over. Powell affirmed this loud and clear in his answer to the very first question about it in the post-meeting presser.

We continue to think the first rate cut will happen at the March FOMC. We think inflation will continue to roll over (indeed, morph into deflation) – and we don't for one instant worry that the Fed cutting rates will undermine that forecast. And while it is prudent to worry about policy lags, the *worst* of the Fed's scorched-earth tightening cycle came more than a year ago. So far so good. We continue to not expect a recession.

Bottom line

With the year-end 2024 "dot plot" moving to 4-5/8% from 5-1/8%, we have the first-ever lowering of rate guidance in this hiking cycle. And with the little but critical word "any" added to qualify future rate hikes, it's now official the cycle ended already, five months ago, at the July FOMC. Expectations for something like this have driven rallies in stocks and bonds since the November FOMC, when we pointed out the broad hints to this denouement. Today didn't disappoint, and Powell's full-throated underscoring of the message of the dots is something of a surprise. Market-implied funds rate expectations, already way ahead of the Fed's

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]

"dot plot," have gotten even further ahead as of this writing. Markets are moving toward our prediction that the first cut will come at the March FOMC. Inflation will continue to fall and morph into deflation. Despite concerns with lags in the Fed's scorched-earth tightening regime, there will be no recession.