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FED SHADOW

FOMC Preview: Groupthink is Dead, Now It's Just Lies

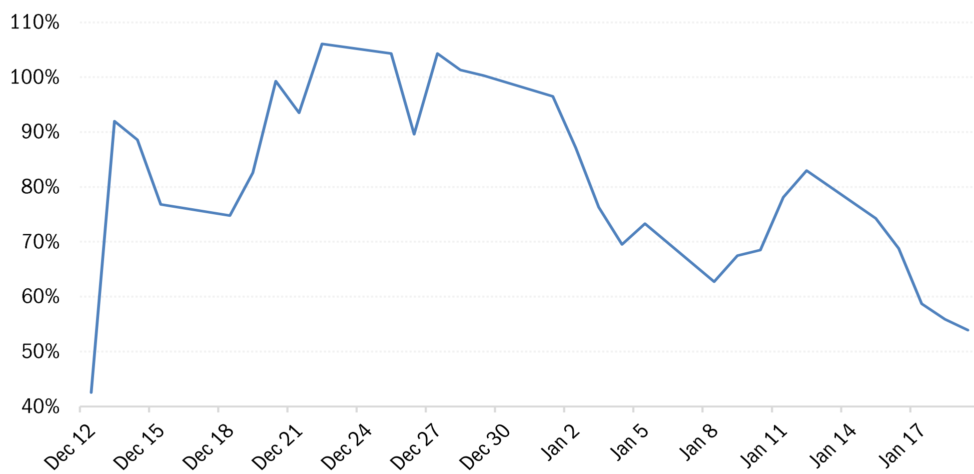
Friday, January 19, 2024

Donald Luskin

Powell and Jefferson are the only ones telling the truth (because they're not speaking).

A polite way to say it is that *the Fed has completely lost messaging discipline*. Exhibit A: The day before the December FOMC, the futures-implied probability of a rate cut at the March 2024 FOMC was about 40%; then, after Chair Jerome Powell's dovish post-FOMC press conference, it rose to about 90%; it's been over 100%; and as of this writing it's back all the way down to 55%, almost as though Powell's pivot hadn't even happened (please see the chart below, and "On the December FOMC" December 13, 2023).

Futures-implied probability of rate cut at March FOMC (from day before December FOMC)



Source: Bloomberg, TrendMacro calculations

The uncertainty isn't coming from Powell. *The chair has not uttered a single public word since the December FOMC*, which is quite unusual. Vice Chair Phillip Jefferson, who has been the most reliable conduit of Powell's policy posture, has been silent too, which is also quite unusual. There is nothing on the calendar for either of them before the January FOMC the week after next.

The uncertainty is coming from statements by other Fed officials, and they strongly contradict and undermine Powell's December pivot to the upside. To continue to be polite, we could say that these officials simply disagree with Powell, as is their right.

Update to strategic view

FEDERAL RESERVE, US MACRO: Powell and Jefferson, the most reliable Fed spokesmen, have been silent since the dovish pivot at the December FOMC. But expectations for a March rate cut have varied wildly as other high-ranking Fed officials have made more hawkish statements. This week Waller managed to interpret very strong economic activity as "moderating" in order to square it with falling inflation, impossible within his mental model. But not accepting the data he himself acknowledges, he frets it can't last. He worries that revisions to seasonal adjustments in CPI will make inflation look less contained, claiming that last year's revisions "erased" all the progress to date – which is flatly untrue. This is welcome evidence of the end of the groupthink that has prevailed throughout this hiking cycle, but also of deep cognitive dissonance. Powell, not a dogmatic trained economist, seems to be immune. We expect him to reiterate his pivot at the January FOMC, and for the first cut to come in March.

[Strategy dashboard]

- *It's a good thing to see the end of an era of groupthink at the Fed*. There hasn't been a dissenting vote at an FOMC meeting since June 2022 when this scorched-earth tightening process began (it was dovish, by the way: (see "On the June FOMC" June 15, 2022).

But to be less polite, and more realistic, we think it's more likely *that these officials are in deep cognitive dissonance, facing what for them is the impossible and embarrassing reality that inflation has completely rolled over at the same time as the economy has continued strong* (see "Video: What you're not hearing about inflation and the coming rate cuts" January 16, 2024).

- As our friend Scott Adams says, *the tell for cognitive dissonance is when people start talking in "word salad"* (see "Video: TrendMacro conversation with Scott Adams" September 6, 2023).
- And to be even less polite, *that often entails outright lies*.
- We've already pointed out New York Fed President John Williams' absurdly transparent howler, claiming that no one at the December FOMC discussed rate cuts (see "It's Two! Two Feds in One!" December 15, 2023) – despite Powell's statement to the contrary at the post-meeting presser, and subsequent confirmation in the minutes of the meeting (see "Data Insights: FOMC Minutes" January 3, 2024).

Now comes this Tuesday's speech by Federal Reserve Board Governor Christopher Waller, one of the most reliable hawks, and the most glib.

- His framework treats it as literally axiomatic that inflation is an unwelcome by-product of strong growth and strong employment. His speeches treat that proposition – which is easily disproved in the data, both recent and historical – as beyond question (see "As Inflation Collapses, the Fed Clings to The Big Lie" November 30, 2023).
- Despite real GDP growth the likes of which we haven't seen since before the Global Financial Crisis, an unemployment rate so low it would have been considered impossible for most of the last half century, and wage growth a third higher than the historical average, Waller manages in Tuesday's speech to conclude that "economic activity has moderated." That would excuse the collapse in inflation – so you would think all would be well, and the Fed could cut rates.
- Sadly, no. *Here comes the word salad: "But will it last?"* For a Fed that constantly claims to be data-dependent, he is saying that even when he has the data in hand it is not a call for a policy change because the data might change. That means that no actual data is ever good enough. So decisions are made, well, *how*?
- *And here come the lies*. He says,

  "One piece of data I will be watching closely is the scheduled revisions to CPI inflation due next month. Recall that a year ago, when it looked like inflation was coming down quickly, the annual update to the seasonal factors erased those gains."

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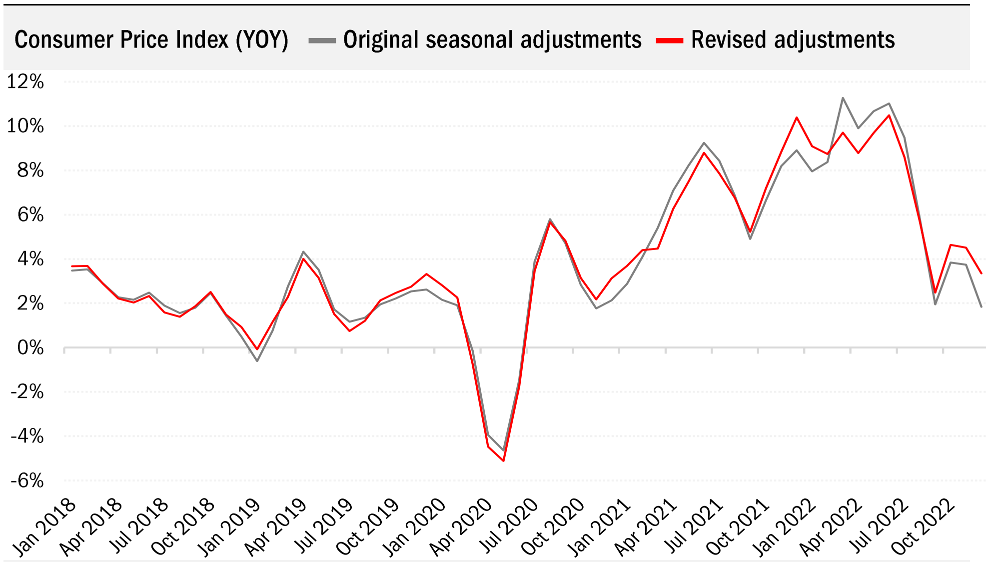

Source: BLS, TrendMacro calculations

- The truth is that last year's update changed the picture of progress on inflation hardly at all (please see the chart above). Originally, the data showed CPI, on a three-month annual basis, falling from a high of 11.3% to 1.8%. The revised data showed it falling from 10.5% to 3.3%.
- Either way, the data shows inflation back to pre-pandemic levels. And to be sure, the revised 3.3% is higher than the original 1.8%. But at the same time, the revised peak of 10.5% is lower than the original 11.3%. A little less progress, but a little less progress required in the first place.
- Sorry to be harsh, but the bottom line here is that it is literally a lie for Waller to say that the revisions "erased those gains." Why lie, especially when it is so easily fact-checked? Well – that's cognitive dissonance. It's hard to admit you're wrong. All the more so when you are a public official.
- The dissonance here comes from the falsification by reality of deeply held beliefs Waller (and, like him, Williams) have spent their whole adult lives with, and which are widely held by the professional fraternity to which they belong and from which they derive their identities. We rarely say anything good about Powell (we did lavishly praise his pandemic crisis response) – but maybe it's a good thing right now that he's not a trained economist. *Maybe that's why he was able to pivot in December, and then keep his mouth shut.*
- At the January FOMC the week after next, we expect him to underscore his pivot. We stand by our call that the two inflation data releases coming before the March FOMC to drive the first rate cut then.

Bottom line

Powell and Jefferson, the most reliable Fed spokesmen, have been silent since the dovish pivot at the December FOMC. But expectations for a

March rate cut have varied wildly as other high-ranking Fed officials have made more hawkish statements. This week Waller managed to interpret very strong economic activity as "moderating" in order to square it with falling inflation, impossible within his mental model. But not accepting the data he himself acknowledges, he frets it can't last. He worries that revisions to seasonal adjustments in CPI will make inflation look less contained, claiming that last year's revisions "erased" all the progress to date – which is flatly untrue. This is welcome evidence of the end of the groupthink that has prevailed throughout this hiking cycle, but also of deep cognitive dissonance. Powell, not a dogmatic trained economist, seems to be immune. We expect him to reiterate his pivot at the January FOMC, and for the first cut to come in March.