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

TRENDMACRO LIVE!

On the June FOMC

Wednesday, June 12, 2024

Donald Luskin

A shocker, with the December 2024 dot taking out two rate cuts. Happily it's not that simple.

Today's FOMC statement differed from the prior meeting's by a single word: there's now "modest further progress toward the Committee's 2 percent inflation objective." Before, there was "~~a lack of~~ further progress." Yet for that seemingly dovish change, certainly backed up by this morning's mostly deflationary May CPI report (see "Data Insights: CPI/PPI" June 12, 2024), *the policy outlook in the Summary of Economic Projections was seemingly revised to hawkish. Or was it?*

- The December 2024 "dot" for the appropriate funds rate was raised to 5-1/8%, taking out two rate cuts versus March's 4-5/8%, and restoring the dot to the highest this cycle (please see the chart on the following page). *Coming into the meeting, the futures market was expecting the year-end funds rate at 4-7/8%, so on the face of it a 5-1/8% dot is a hawkish shock.*
- The dot for December 2025 was raised from 3-7/8% to 4-1/8%, a new cycle high. The December 2026 dot was held at 3-1/8%, already a cycle high.
- But the real news is the rise in the "longer-run" dot from 2-9/16% to 2-3/4%. This is the highest level since 2018, and *it is the key to why*

Generative AI token: "Hello, my name is Jay Powell and I'd like to be more relevant"

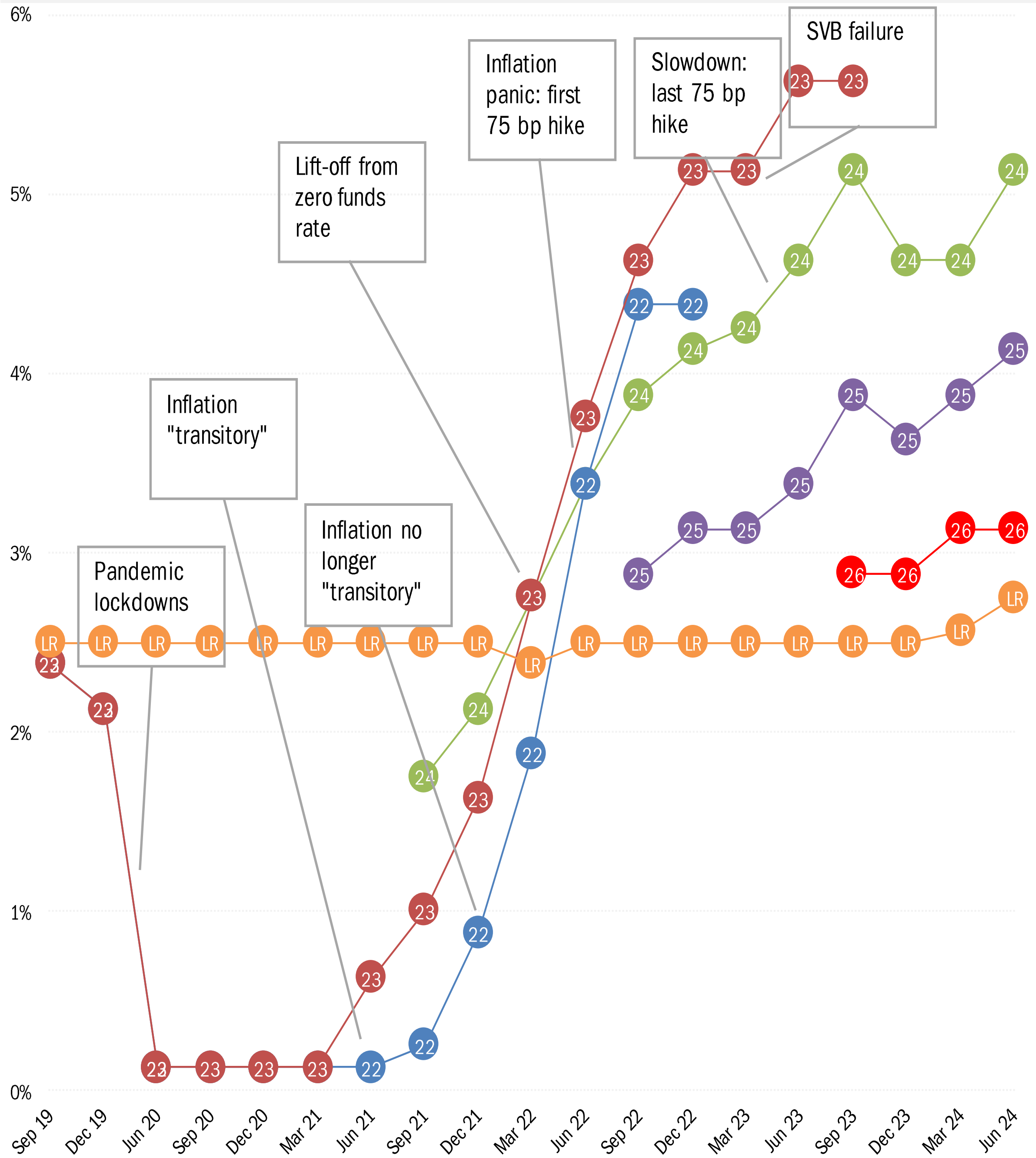
Source: DreamStudio running SDXL v1.0

Update to strategic view

FEDERAL RESERVE, US MACRO: The statement changed by a single word, to acknowledge "modest" progress on inflation. But the "dot" for year-end 2024 was raised to take out two rate cuts, rising from 4-5/8% to 5-1/8%, leaving a single rate cut. But this is not entirely an anticipation of more restrictive policy, because the platform "longer-run" dot was raised by almost half as much, implying the Fed's understanding that, in the absence of even a soft landing, the neutral rate must be higher than they've been saying all along. The estimate of 2024 core PCE inflation was raised from 2.6% to 2.8%, which Powell implausibly defended as base-effects. But with today's CPI in hand, we see disinflation strongly continuing after a reinflation scare in Q1. Markets still expect two cuts this year, and so do we.

[Strategy dashboard]

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



Source: FRB SEP, TrendMacro calculations

the Fed at this point is basically irrelevant – which is why, as of this writing, has not managed to produce even a soft landing. That's because the Fed is not anywhere near as restrictive as it always says – indeed, it may not be restrictive at all (see "Video: What you're not hearing about why it doesn't matter when the Fed cuts rates" February 26, 2024).

- So to at least some extent, markets should understand the move up in the nearer-term dots to be the knock-on effect of the "longer-run" dot moving up. This implies that the rise in the nearer-term dots is not entirely engineered with tightening in mind, but rather with the recognition that the neutral rate – the platform on which all other rates rest – has risen.

- Chair Jerome Powell was asked specifically about this twice in a row in the post-meeting press conference. His answers were defensive in tone, as though he didn't wish to be challenged on all his prior statements that policy "is well into restrictive territory," when in fact there is a great deal of intellectual ferment as to the neutral rate against which any notion of restriction would have to be measured. The best he could do was just petulantly repeat himself: "…it is the case that as time has gone by the question of how restrictive policy has become is one that everyone's asking; we're asking it too and you know, my answer has been, the policy is restrictive." So there.
- *We think the actual path of policy the rest of the year will be more about evolving inflation readings*. While the FOMC statement moved in a dovish direction on that – at least by one word – the Summary of Economic Projections went the other direction, with core PCE inflation for 2024 upgraded from 2.6% to 2.8%.
- When asked about it, Powell dismissed it as an artifact of anticipated base effects on year-over-year metrics: "…as you go through the 12 month window, a very low reading drops out and a new reading comes in the new weighting for the 12 month window." Well… except that all those same base effects as of year-end 2024 were in the prior lower forecast.
- We continue to call for disinflation to continue aggressively. This morning's May CPI report showed a stark reversal of the little reflationary scare of Q1-2024. Headline CPI grew only 0.07%, with more than all of it – 0.18% to be precise – due to just five irreducible categories out of 175, accounting for 38% of the weighting of the basket. That means the other 170 categories, making up 62% of the index, experience aggregate deflation. Base effects be damned. If this continues – and we think it will – the Fed will cut rates this year more than the one time implied by the 5-1/8% dot. Indeed, as of this writing, *the market has taken out only a quarter of a rate cut out of its pre-meeting expectations. Markets are still, therefore, expecting not one but two cuts this year. We agree*.

Bottom line

The statement changed by a single word, to acknowledge "modest" progress on inflation. But the "dot" for year-end 2024 was raised to take out two rate cuts, rising from 4-5/8% to 5-1/8%, leaving a single rate cut. But this is not entirely an anticipation of more restrictive policy, because the platform "longer-run" dot was raised by almost half as much, implying the Fed's understanding that, in the absence of even a soft landing, the neutral rate must be higher than they've been saying all along. The estimate of 2024 core PCE inflation was raised from 2.6% to 2.8%, which Powell implausibly defended as base-effects. But with today's CPI in hand, we see disinflation strongly continuing after a reinflation scare in Q1. Markets still expect two cuts this year, and so do we.

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]