Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Lorcan Roche Kelly, Chief Europe Strategist

Data Insights: Federal Reserve

Wednesday, June 19, 2013

Today's FOMC statement: how the language changed from prior meeting

Release Date: ~~May 1~~June 19, 2013

Information received since the Federal Open Market Committee met in ~~March~~May suggests that economic activity has been expanding at a moderate pace. Labor market conditions have shown ~~some~~further improvement in recent months, on balance, but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has strengthened further, but fiscal policy is restraining economic growth. ~~Inflation~~Partly reflecting transitory influences, inflation has been running ~~somewhat~~ below the Committee's longer-run objective, ~~apart from temporary variations that largely reflect fluctuations in energy prices. Longer~~but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee ~~continues to see~~ sees the downside risks to the ~~economic~~ outlook for the economy and the labor market as having diminished since the fall. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

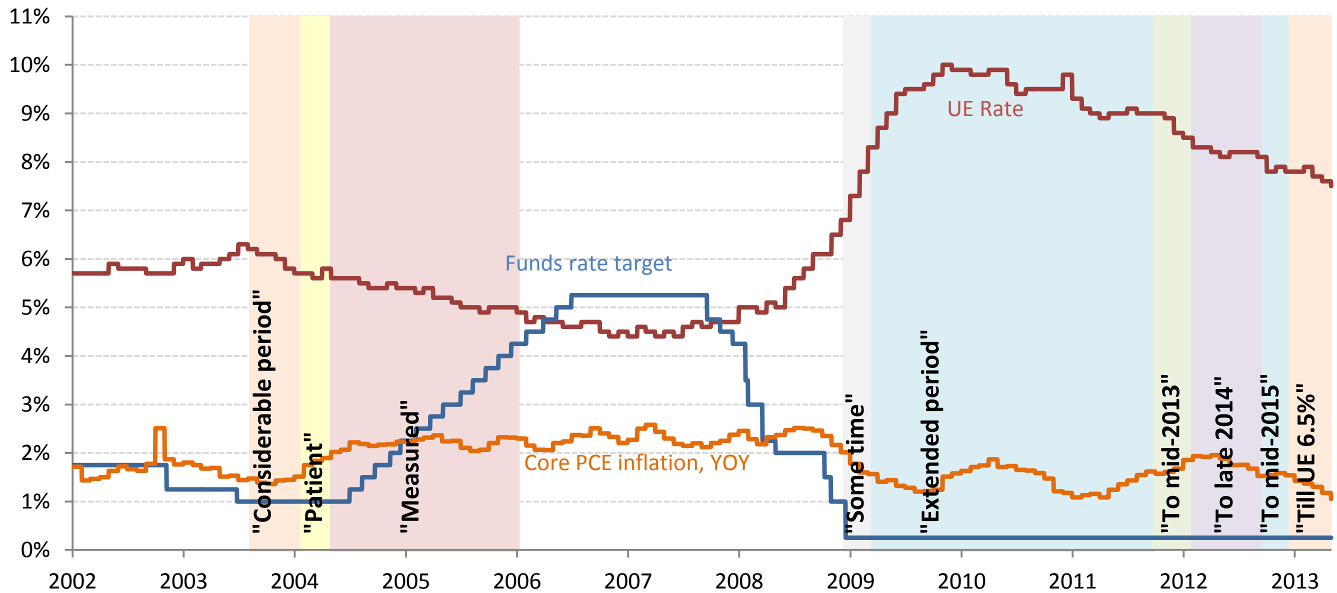
The Committee will closely monitor incoming information on economic and financial developments in coming months. The Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes. In determining the size, pace, and composition of its asset purchases, the Committee will continue to take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman~~;~~ ~~James Bullard~~; Elizabeth A. Duke; Charles L. Evans; Jerome H. Powell; Sarah Bloom Raskin; Eric S. Rosengren; Jeremy C. Stein; Daniel K. Tarullo; and Janet L. Yellen. Voting against the action was ~~Esther L.~~James Bullard, who believed that the Committee should signal more strongly its willingness to defend its inflation goal in light of recent low inflation readings, and Esther L. George, who was concerned that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in long-term inflation expectations.

Source: FOMC, TrendMacro analysis

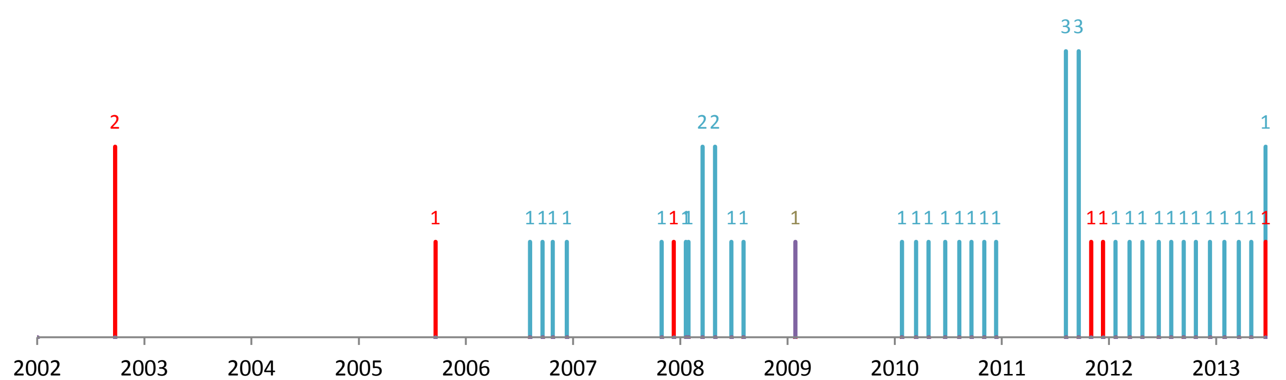
Fedspeak regime change



Source: FOMC, Federal Reserve H.15, BLS, BEA, TrendMacro calculations

Other voices: number of FOMC decision dissents

Dovish Hawkish Procedural

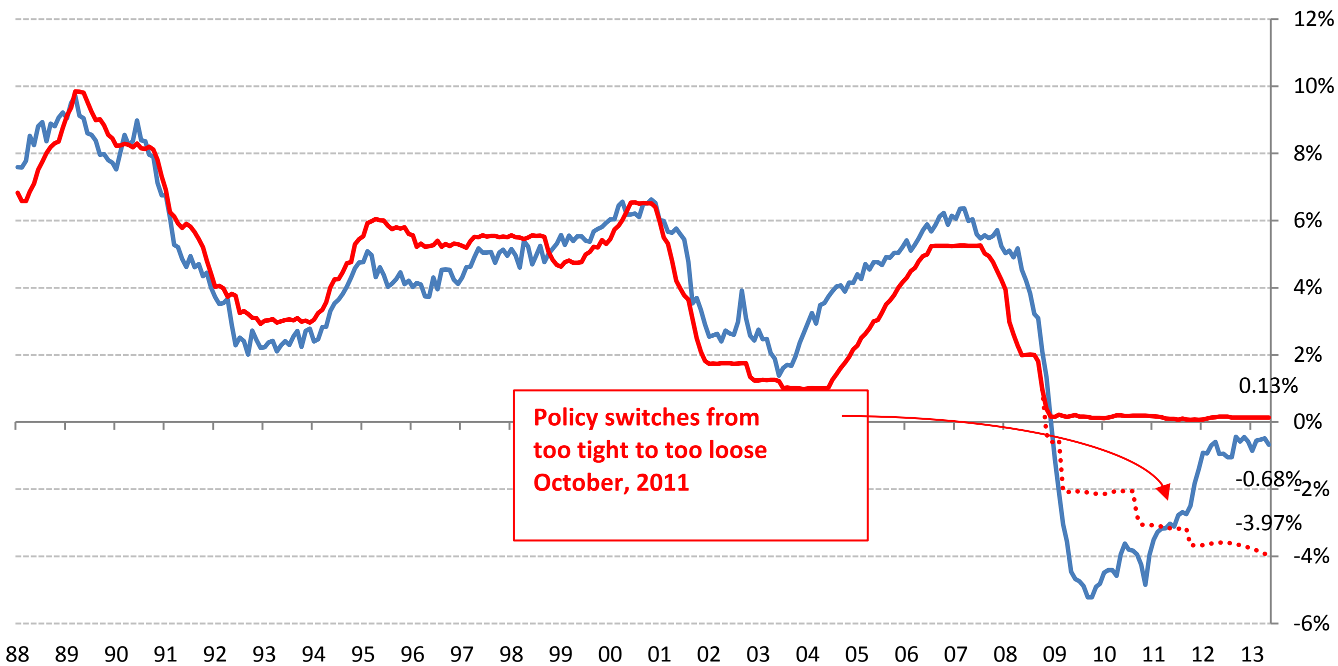


Source: FOMC, TrendMacro calculations

The Taylor Rule (per Rudebusch 2009): Is the Fed tight or loose?

Rule: 2.07 + 1.28 x 12-mo core PCE inflation - 1.95 x (UE - CBO natural rate)

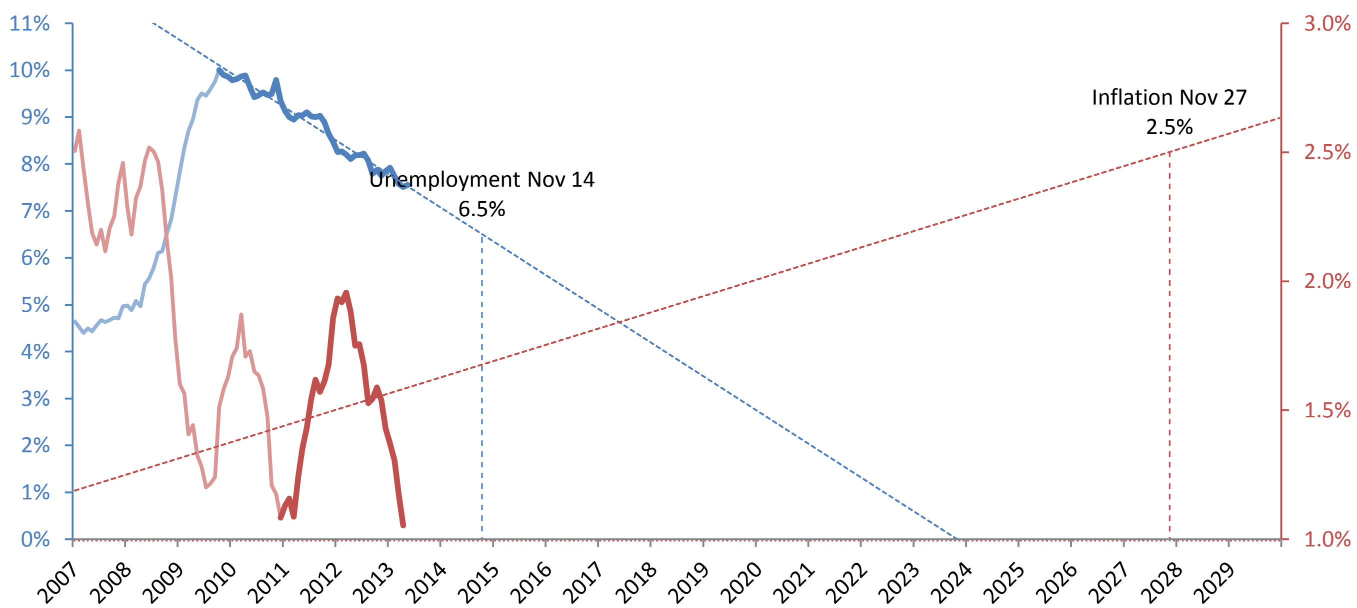
Actual funds rate ···· Balance sheet-augmented funds rate



Source: BLS Current Population Survey, TrendMacro calculations

The Evans Rule: When will the Fed start hiking rates?

Unemployment rate ··· Trend from peak — Core PCE inflation YOY ··· Trend from trough

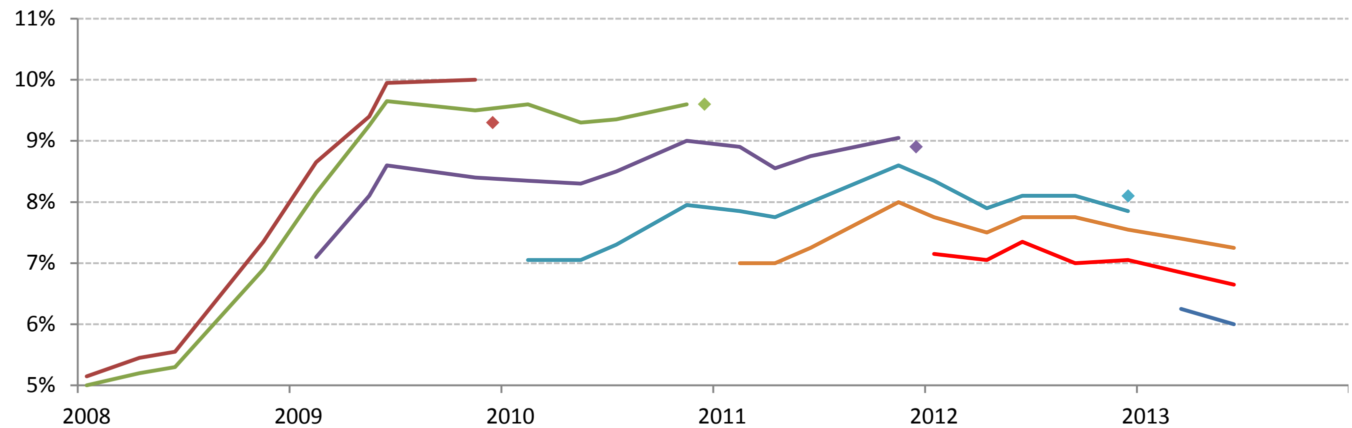


Source: BLS, BEA, TrendMacro calculations

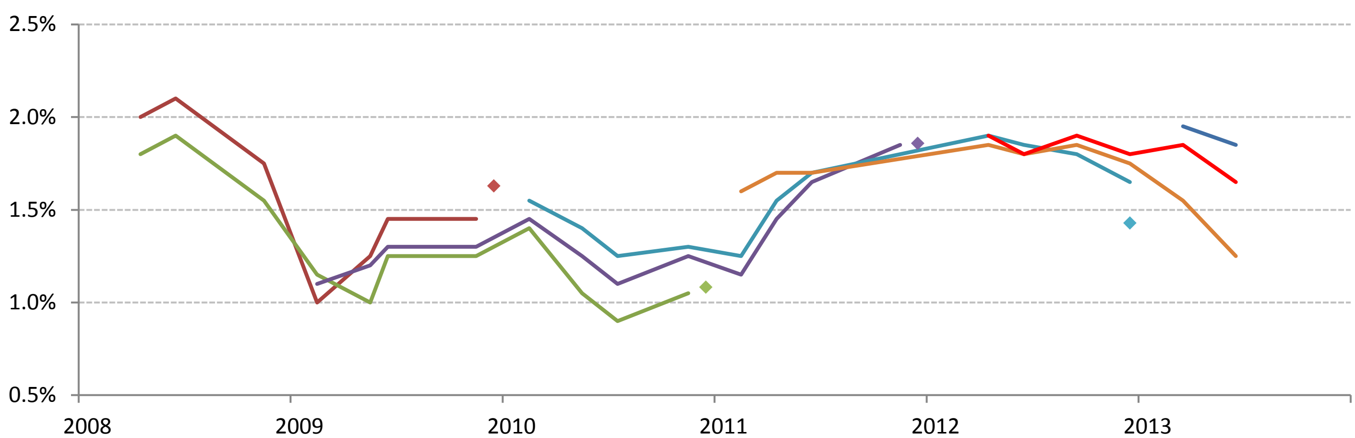
Forecast versus actual: economic projections of the FRB and the presidents

— Forecast ◆ Actual ■ for 2009 ■ for 2010 ■ for 2011 ■ for 2012 ■ for 2013 ■ for 2014 ■ for 2015

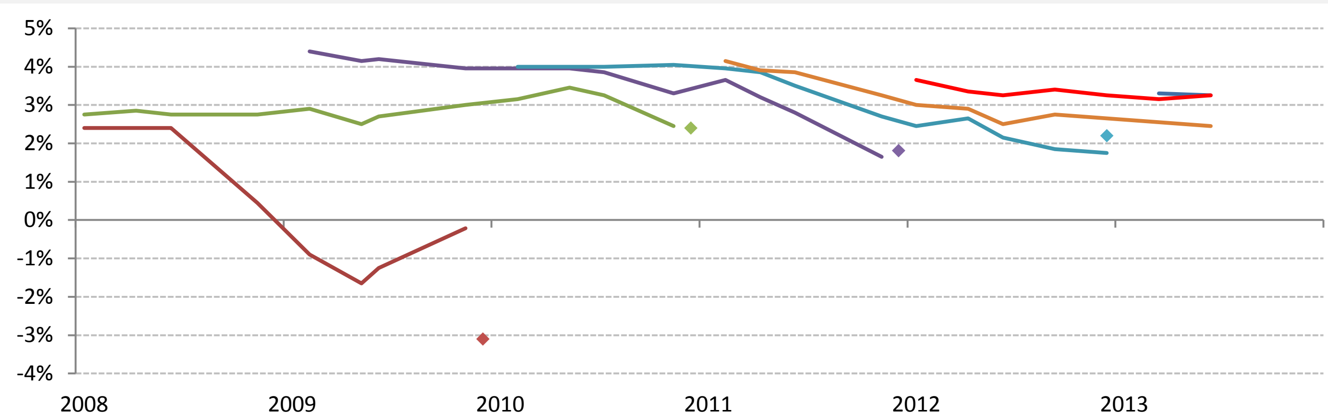
Unemployment



Core PCE inflation



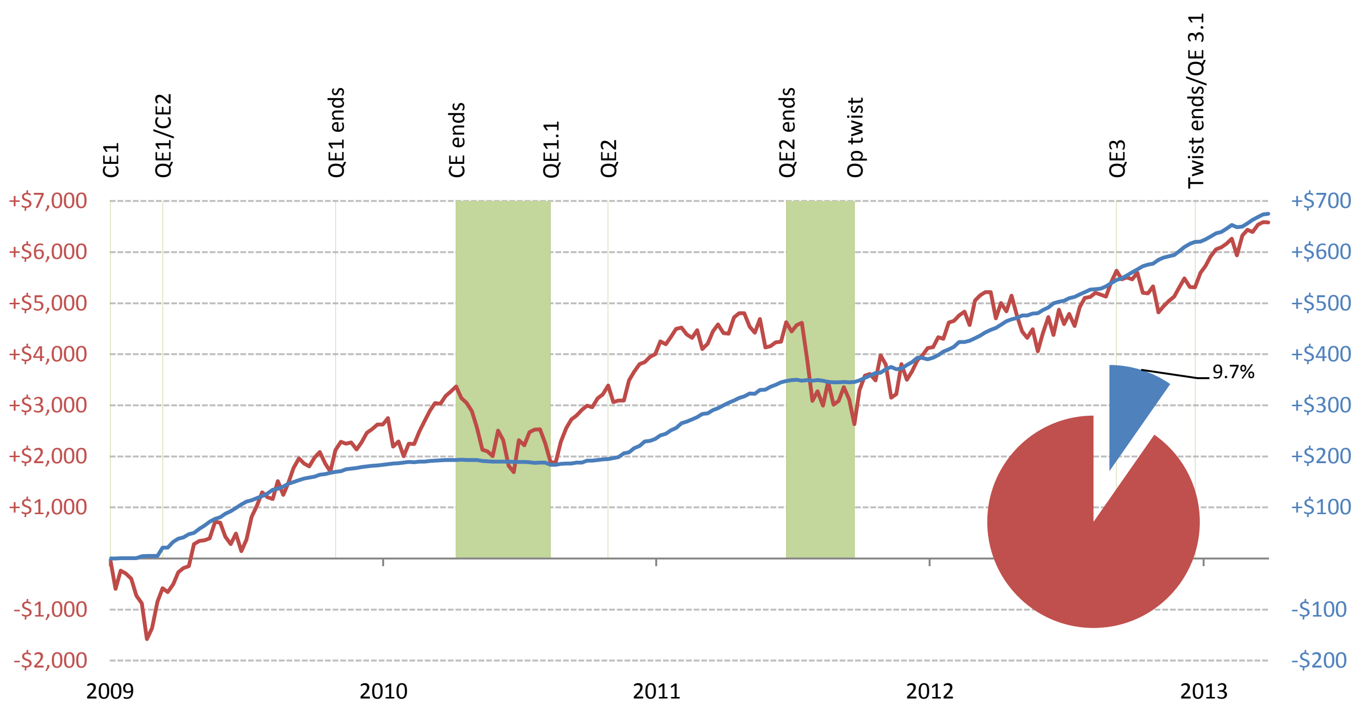
Real GDP



Source: Federal Reserve, BEA, BLS, TrendMacro calculations

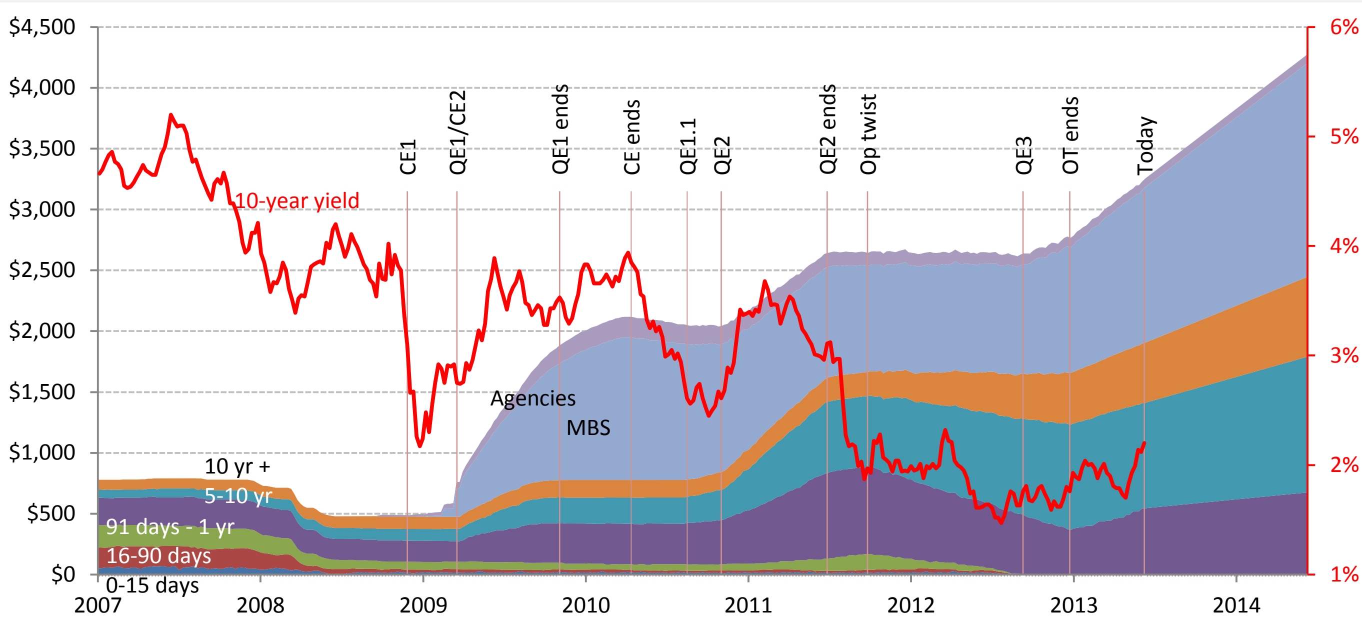
How much of the US stock market is effectively owned by the Fed?

S&P 500 change from January 2009, USD billions — Market cap — Fed balance sheet risk equivalent



Source: Bloomberg, TrendMacro calculations

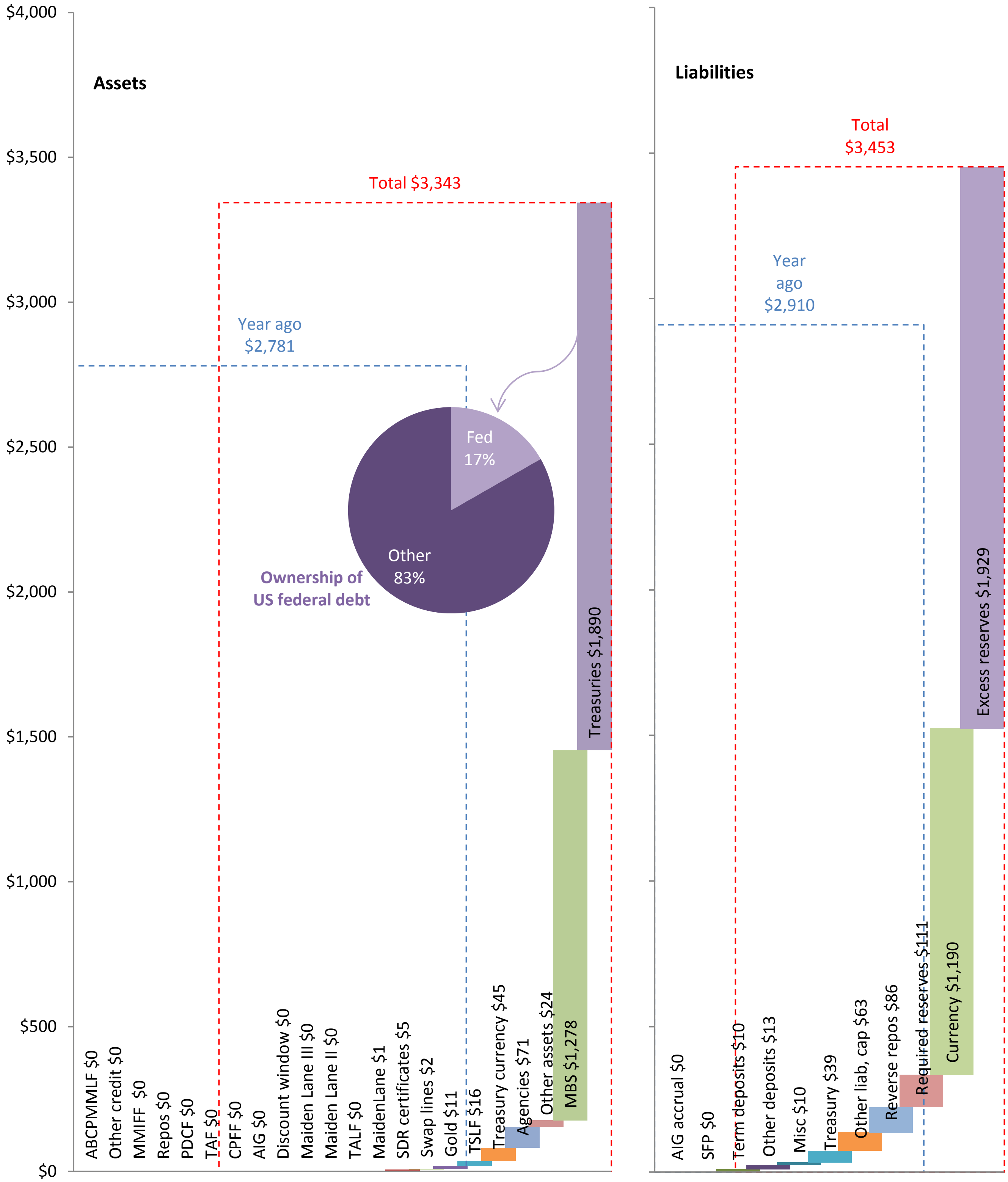
Actual and projected Fed LSAPs (Large-Scale Asset Purchases) vs. Treasury yield



Source: Federal Reserve H.4, H.15, TrendMacro calculations

The Fed's assets, and how they are funded (USD billions)

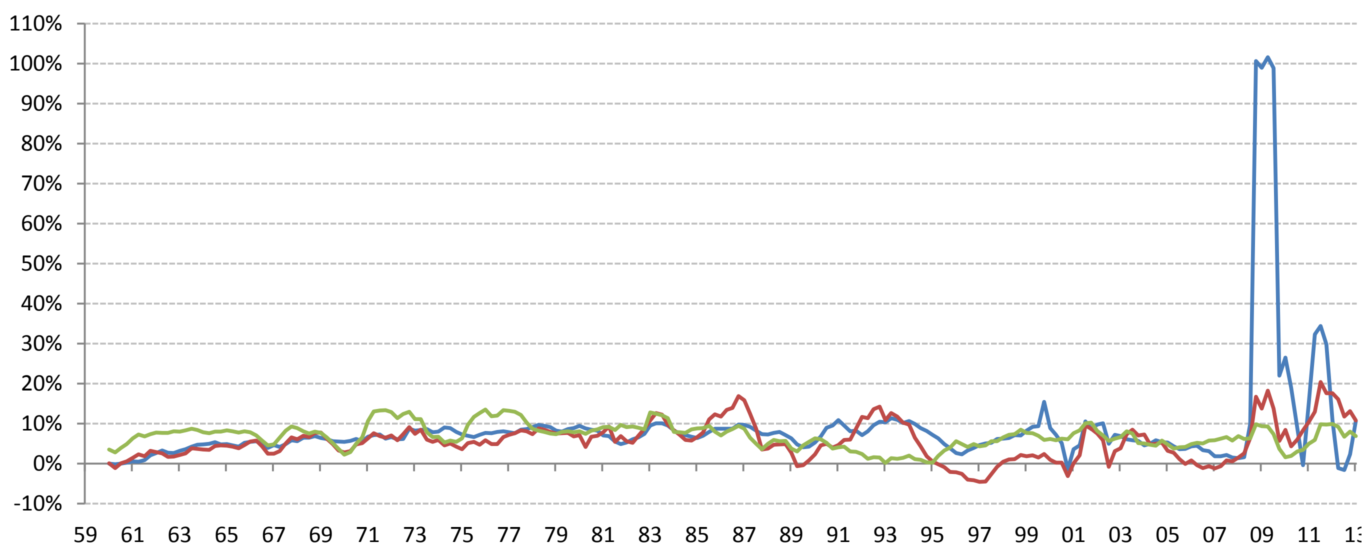
Assets do not perfectly match liabilities because we include unsettled MBS purchases and sales



Source: Federal Reserve H.4, TrendMacro calculations

Money supply growth, YOY quarterly

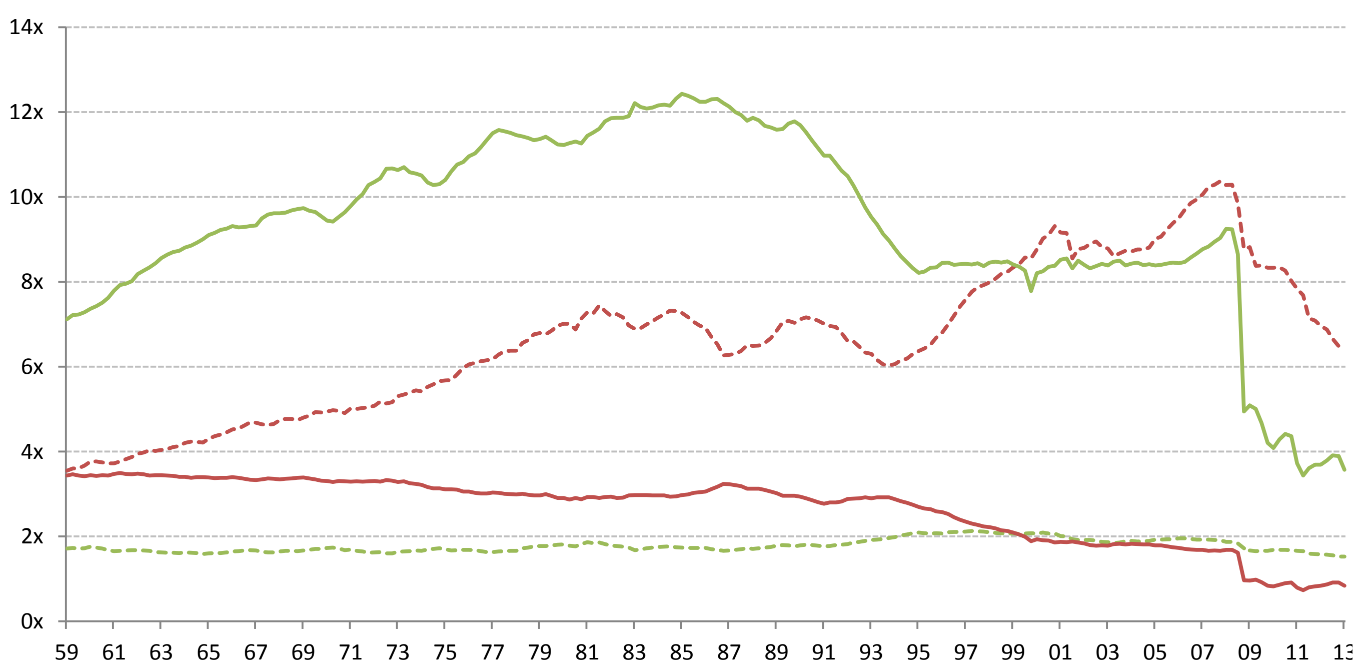
M1 M2 Monetary base



Source: Bloomberg, TrendMacro calculations

Monetary velocity, quarterly

M1 base multiplier M1 output multiplier M2 base multiplier M2 output multiplier



Source: Federal Reserve H.4, H.15, TrendMacro calculations