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

Data Insights: Federal Reserve

Wednesday, October 29, 2014

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

Release Date: ~~September 17~~October 29, 2014

Information received since the Federal Open Market Committee met in ~~July~~September suggests that economic activity is expanding at a moderate pace. ~~On balance, labor~~Labor market conditions improved somewhat further~~; however, the~~, with solid job gains and a lower unemployment rate~~ is little changed and~~. On balance, a range of labor market indicators suggests that ~~there remains significant~~ underutilization of labor resources~~.~~ is gradually diminishing. Household spending ~~appears to be~~is rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow. ~~Fiscal policy is restraining economic growth, although the extent of restraint is diminishing.~~ Inflation has ~~been running~~continued to run below the Committee's longer-run objective. ~~Longer~~Market-based measures of inflation compensation have declined somewhat; survey-based measures of 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 activity will expand at a moderate pace, with labor market indicators and inflation moving toward levels the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for economic activity and the labor market as nearly balanced~~ and~~. Although inflation in the near term will likely be held down by lower energy prices and other factors, the Committee judges that the likelihood of inflation running persistently below 2 percent has diminished somewhat since early this year.

The Committee ~~currently~~ judges that there ~~is~~has been a substantial improvement in the outlook for the labor market since the inception of its current asset purchase program. Moreover, the Committee continues to see sufficient underlying strength in the broader economy to support ongoing ~~improvement in labor market conditions. In light of the cumulative~~ progress toward maximum employment ~~and the improvement in the outlook for labor market conditions since the inception of the current asset purchase program~~in a context of price stability. Accordingly, the Committee decided to ~~make a further measured reduction in the pace of~~conclude its asset ~~purchases. Beginning in October, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $5 billion per month rather than $10 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $10 billion per month rather than $15 billion per~~purchase program this 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. ~~The~~ This policy, by keeping the Committee's ~~sizable and still-increasing~~ holdings of longer-term securities at sizable levels, should help maintain ~~downward pressure on longer-term interest rates, support mortgage markets, and help to make broader~~accommodative financial conditions~~ more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.~~ .

~~The Committee will closely monitor incoming information on economic and financial developments in coming months and 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. If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will end its current program of asset purchases at its next meeting. However, asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases.~~

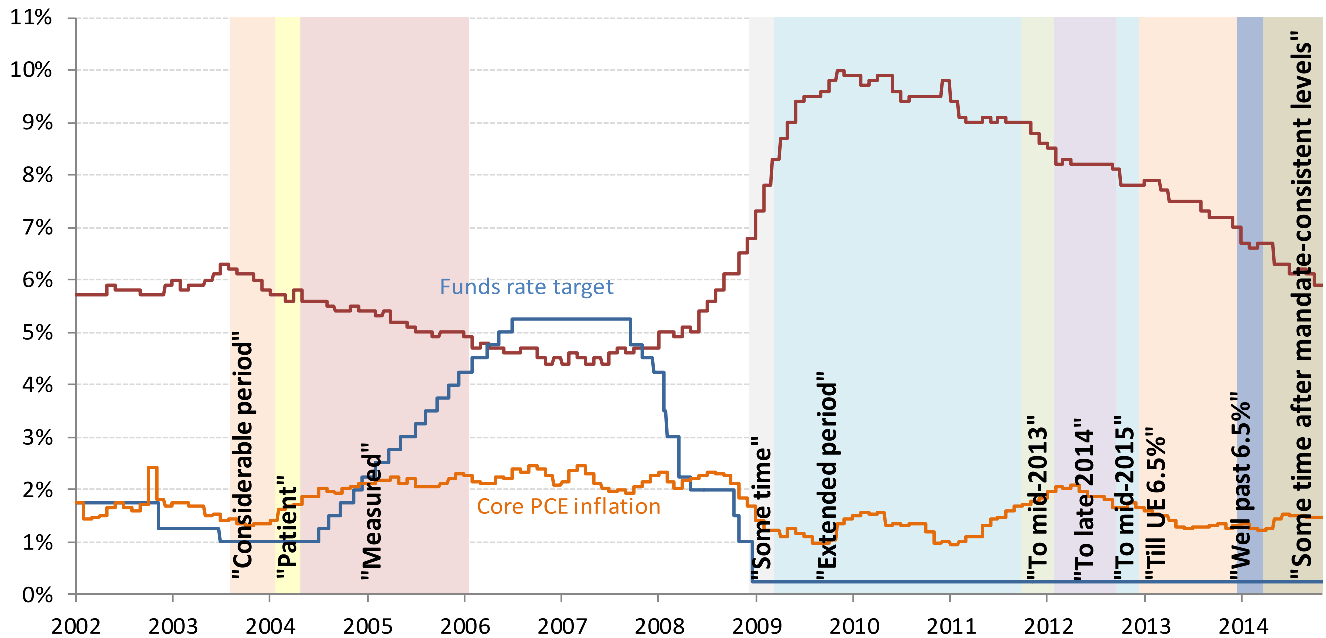
To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that ~~a highly accommodative stance of monetary policy remains appropriate. In determining how long to maintain~~ the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. The Committee ~~continues to anticipate~~anticipates, based on its current assessment~~ of these factors~~, that it likely will be appropriate to maintain the ~~current~~ 0 to 1/4 percent target range for the federal funds rate for a considerable time ~~after~~following the end of its asset purchase program ~~ends~~this month, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored. However, if incoming information indicates faster progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.

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. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Stanley Fischer; ~~Narayana Kocherlakota~~Richard W. Fisher; Loretta J. Mester; Charles I. Plosser; Jerome H. Powell; and Daniel K. Tarullo. Voting against the action ~~were Richard W. Fisher and Charles I. Plosser. President Fisher~~was Narayana Kocherlakota, who believed that~~ the~~, in light of continued ~~strengthening of the real economy, improved~~sluggishness in the inflation outlook ~~for labor utilization and for general price stability, and continued signs of financial~~and the recent slide in market~~ excess, will likely warrant an earlier reduction in monetary accommodation than is suggested by~~-based measures of longer-term inflation expectations, the ~~Committee's stated forward guidance. President Plosser objected~~Committee should commit to ~~the guidance indicating that it likely will be appropriate to maintain~~keeping the current target range for the federal funds rate ~~for "a considerable time after~~at least until the one-to-two-year ahead inflation outlook has returned to 2 percent and should continue the asset purchase program ~~ends," because such language is time dependent and does not reflect the considerable economic progress that has been made toward the Committee's goals.~~ at its current level.

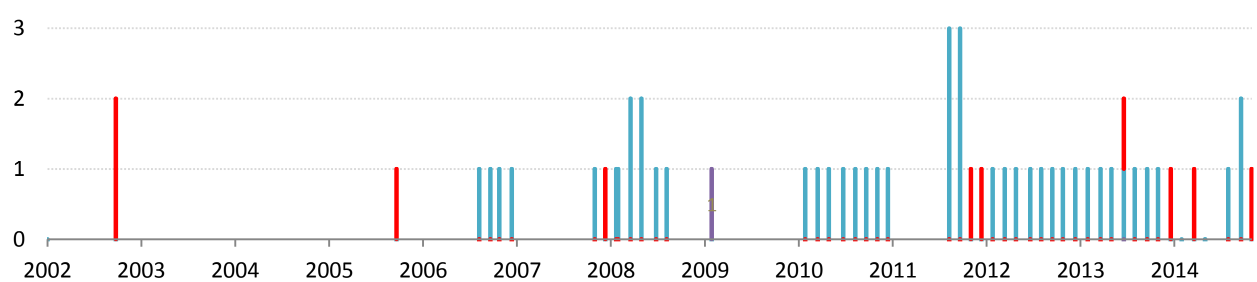
Source: FOMC, TrendMacro analysis

Fedspeak regime change: the evolution of forward guidance



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

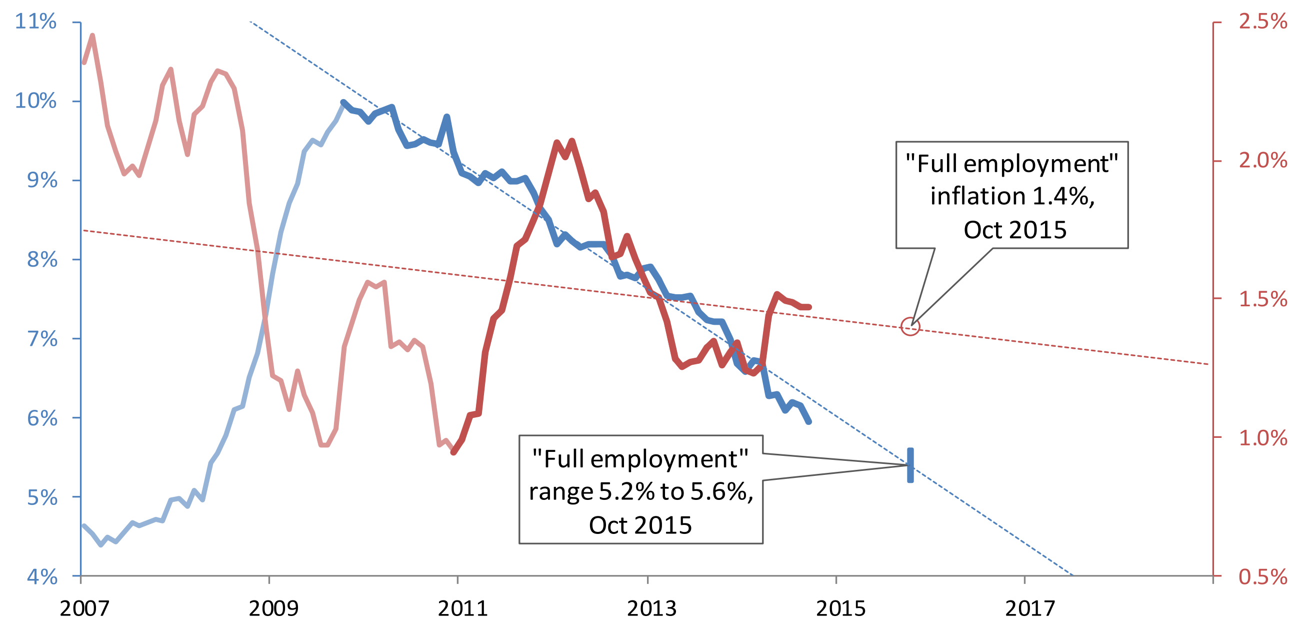
Other voices: number of FOMC decision dissents



Source: FOMC, TrendMacro calculations

Yellen beyond the Evans Rule: the outer limit of the zero bound

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

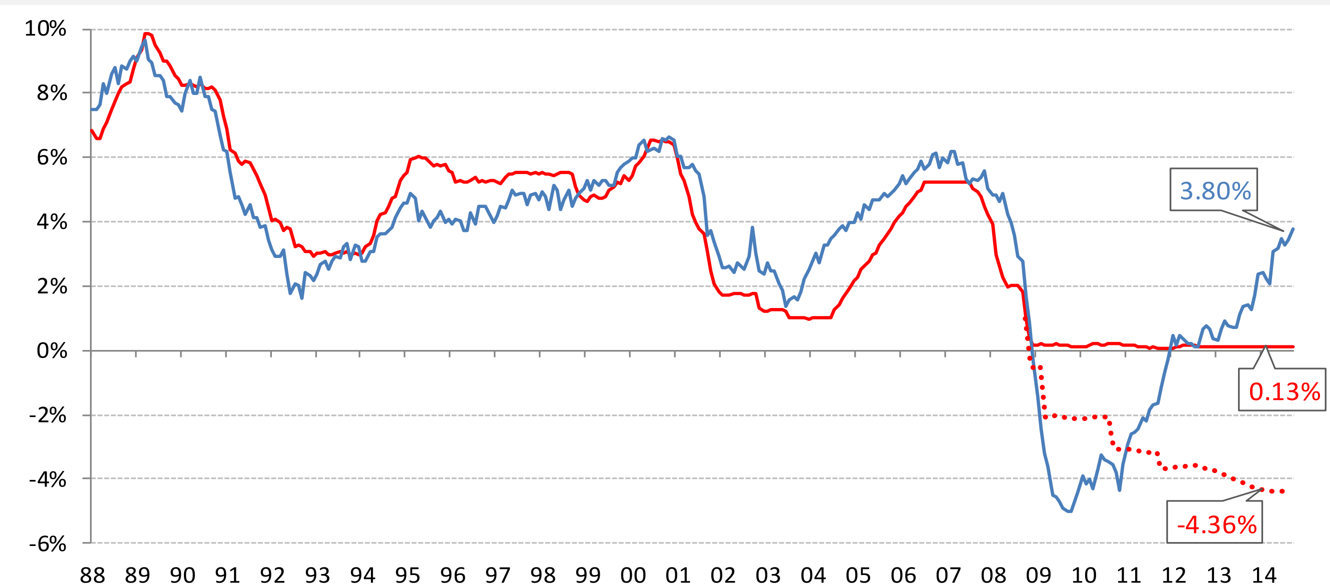


Source: BLS Current Population Survey, TrendMacro calculations

Yellen's 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

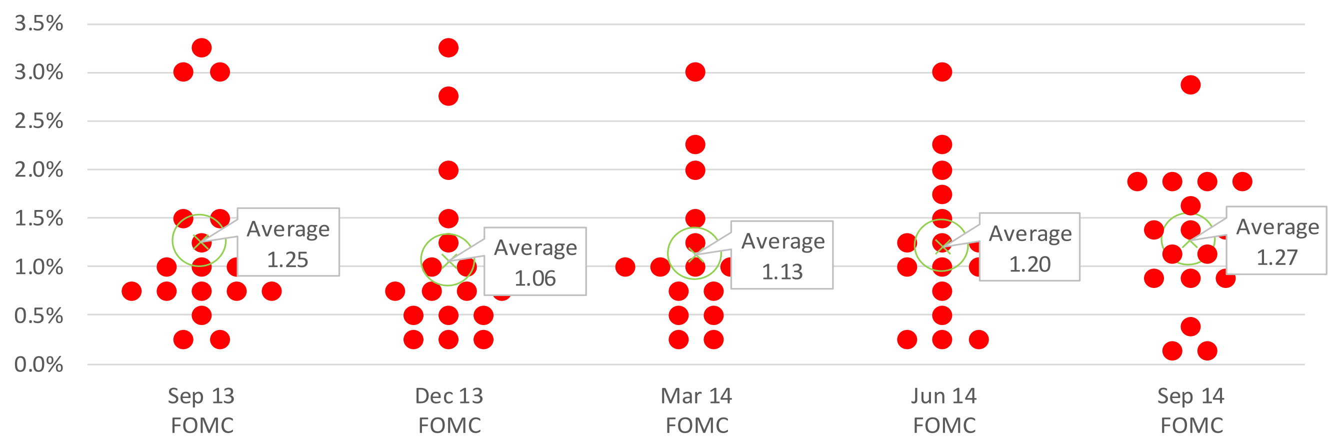


Source: BLS, BEA, TrendMacro calculations

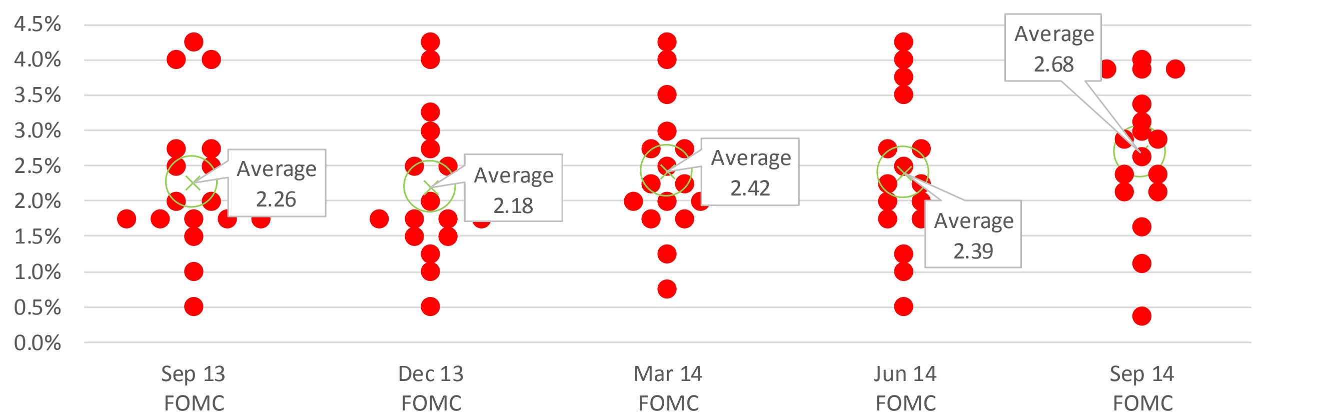
Tracking the "dotplots"

FOMC participants' estimate of "appropriate" target fed funds rate ● Vote by individual participant

For year-end 2015



For year-end 2016



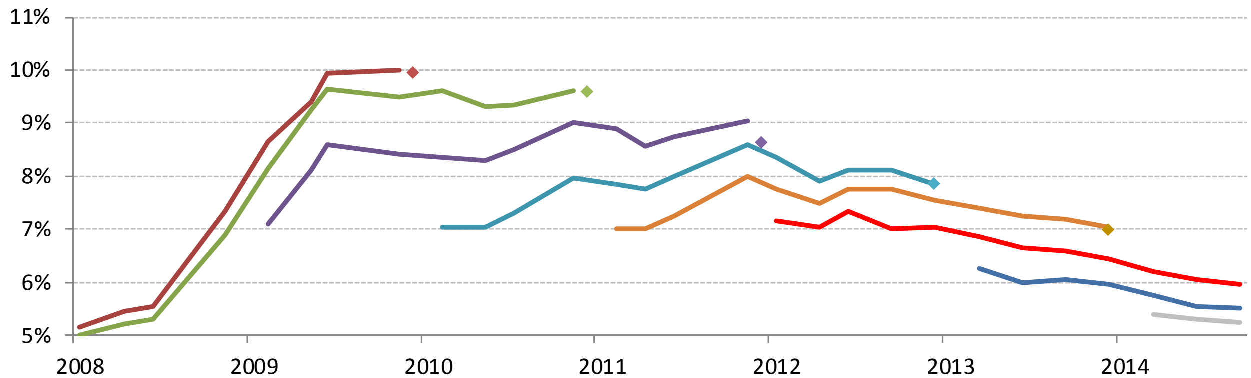
For year-end 2017

Source: Federal Reserve, TrendMacro calculations

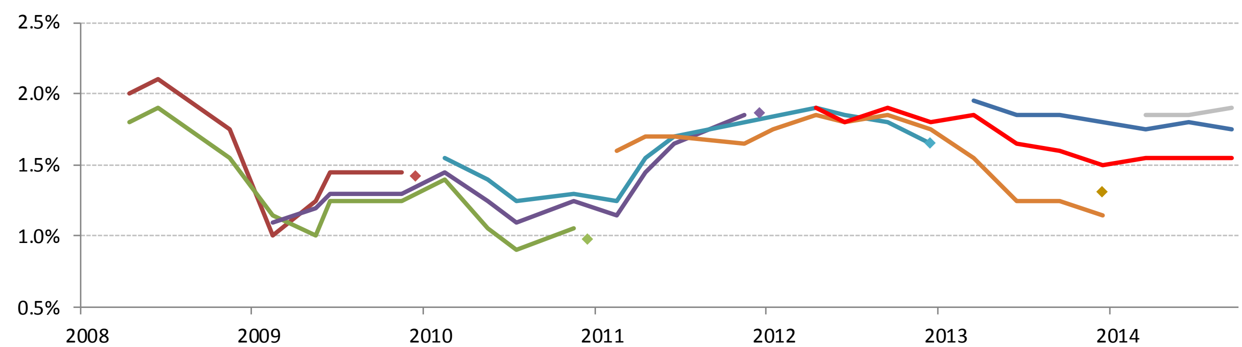
Forecast versus actual: economic projections of the FRB and the presidents

— Forecast ◆ Actual ■ for 2009 ■ 2010 ■ 2011 ■ 2012 ■ 2013 ■ 2014 ■ 2015 ■ 2016

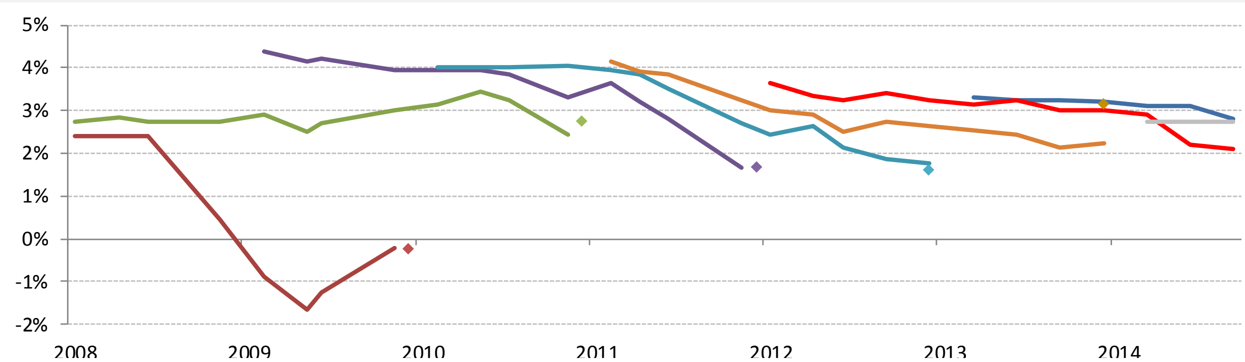
Unemployment



Core PCE inflation



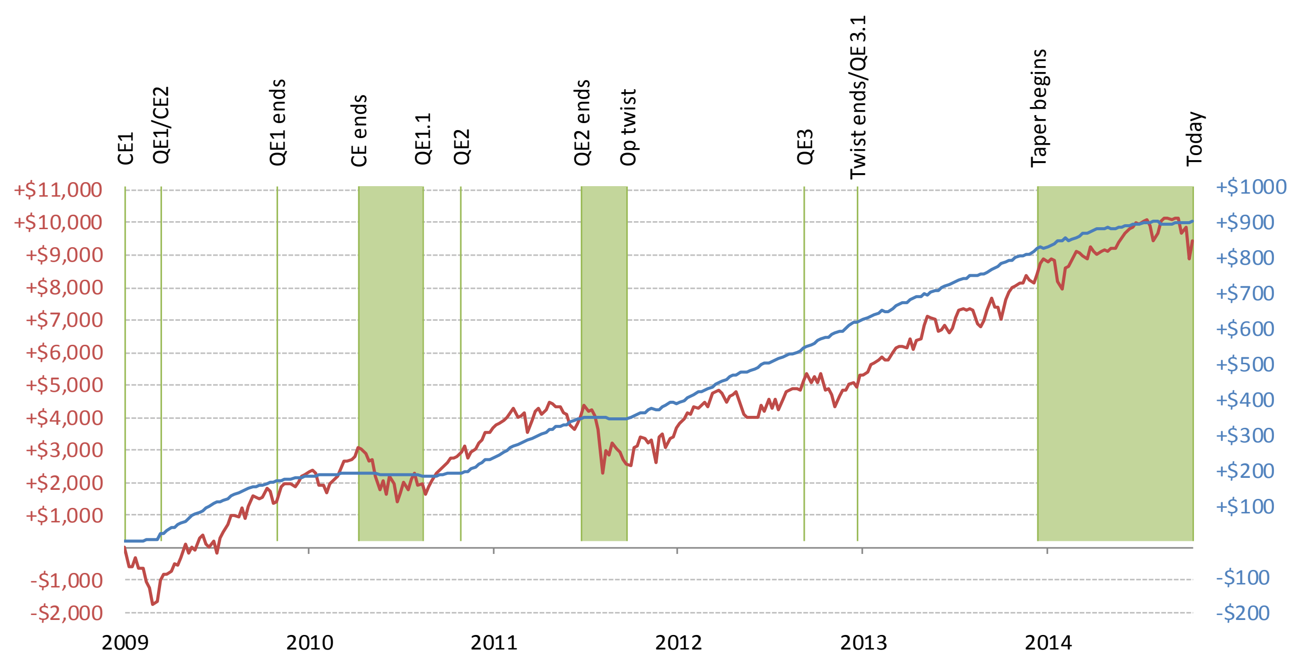
Real GDP



Source: Federal Reserve, BEA, BLS, TrendMacro calculations

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

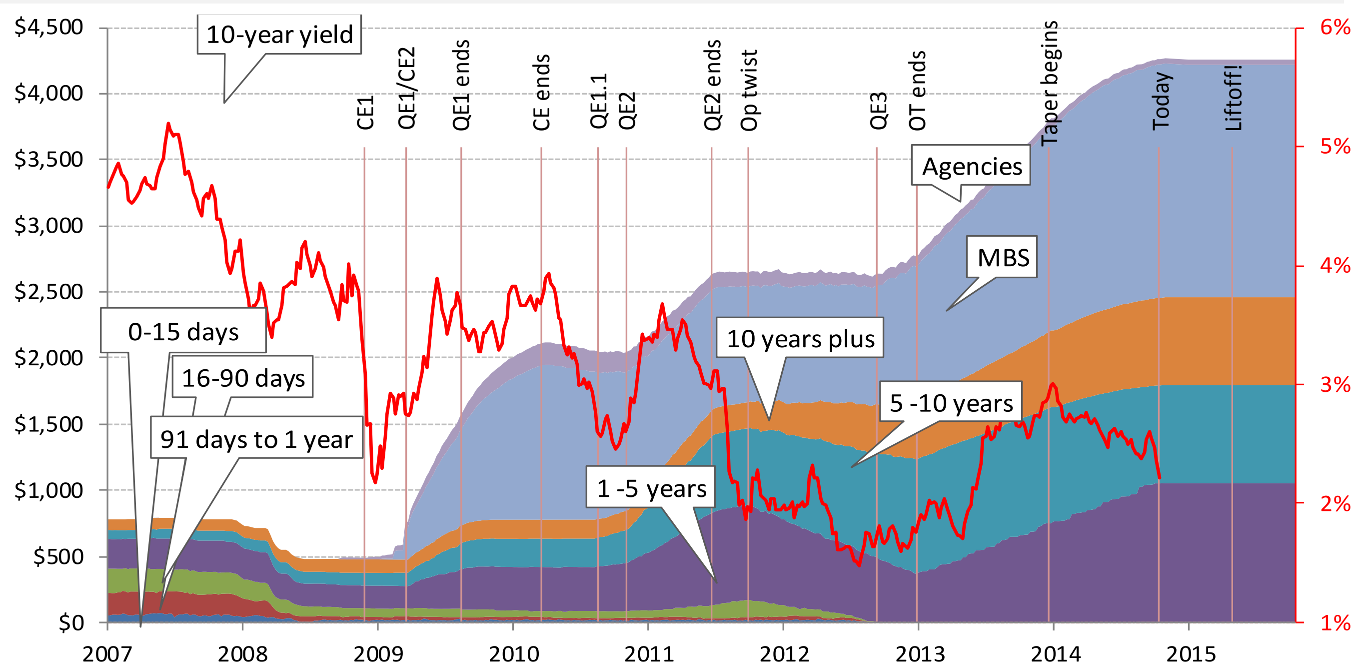
S&P 500 change from January 2009, USD billions — Market cap — Fed balance sheet risk equivalent



Source: Bloomberg, TrendMacro calculations

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

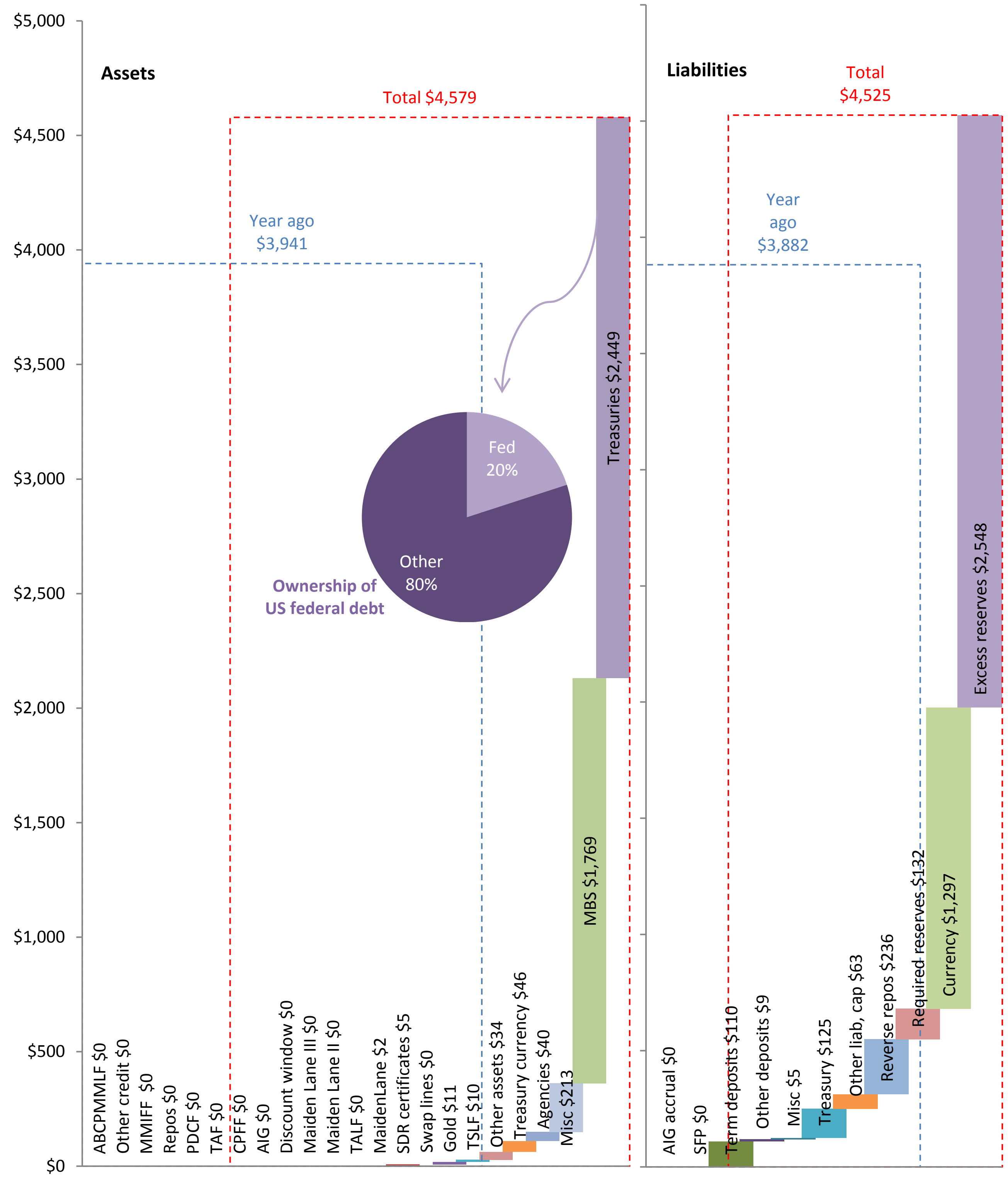
Projected at current run-rates



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

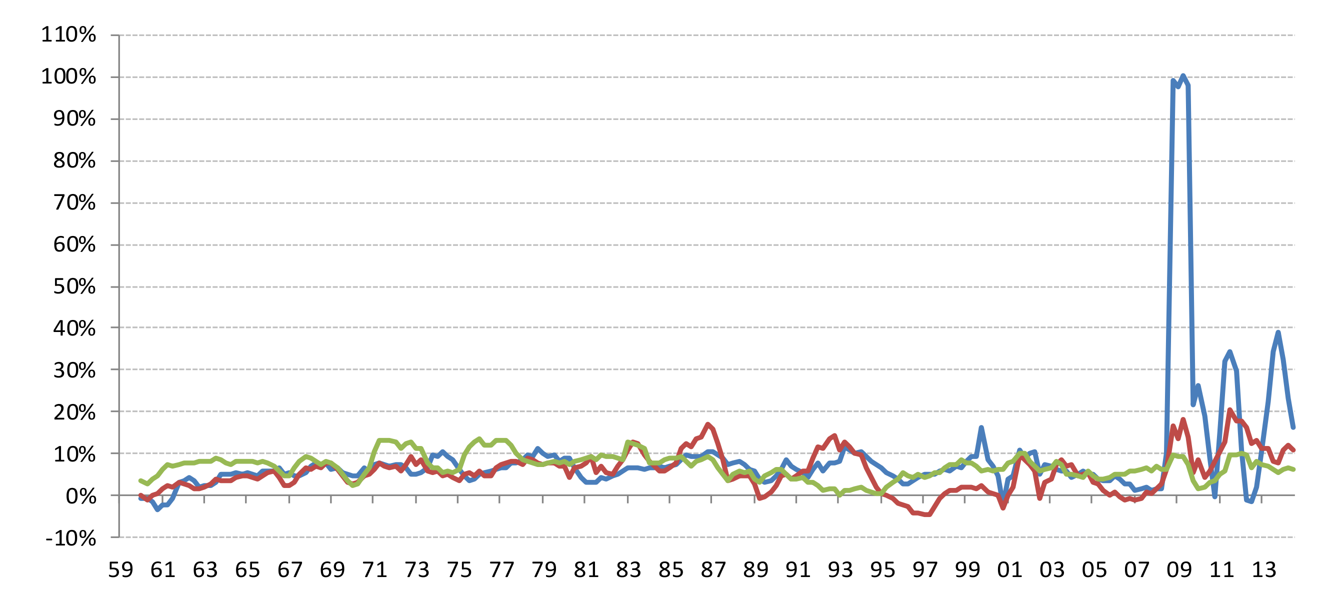
The Fed's assets, and how they are funded (USD billions)

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



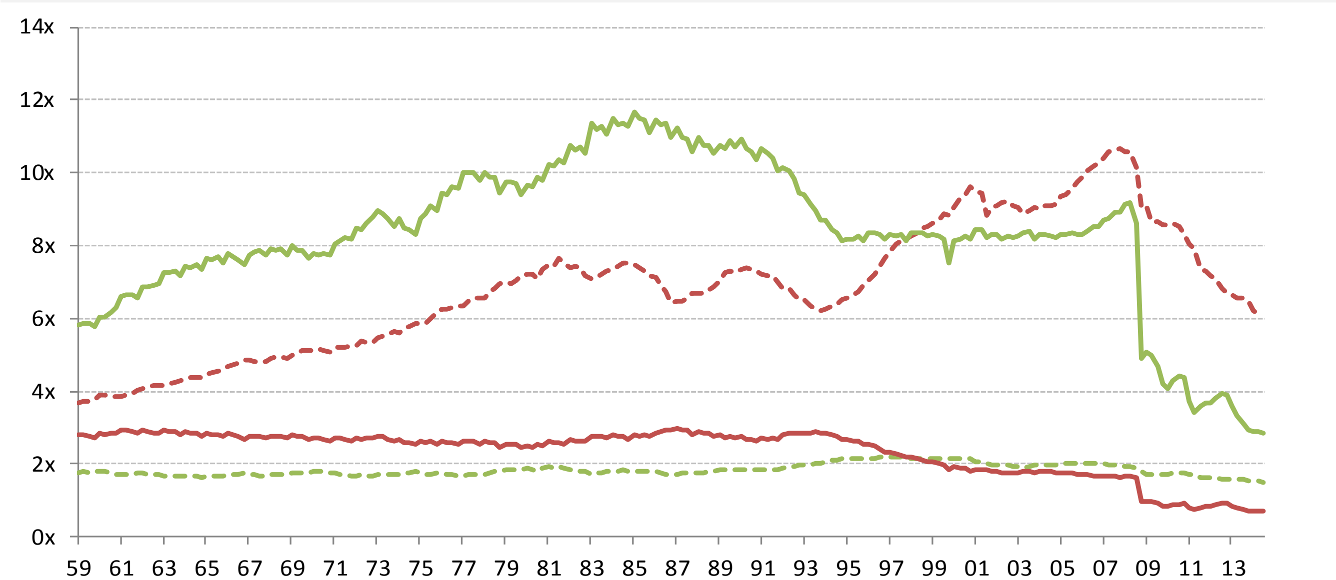
Source: Federal Reserve H.4, US Treasury, TrendMacro calculations

Money supply growth, YOY quarterly



Source: Federal Reserve H.6, TrendMacro calculations

Monetary velocity, quarterly



Source: BEA, Federal Reserve H.6, TrendMacro calculations