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# On the February FOMC

Wednesday, February 2, 2017

**Donald Luskin**

**The Fed will be extremely gradualist as the economy pulls out of "secular stagnation."**

A first look at a red-line mark-up of today's FOMC statement compared to December's seems to show a lot of changes – but it's mostly small adjustments to tone and tense (see "Data Insights: Federal Reserve" February 1, 2017). And the FOMC declined to issue an update to its Statement of Longer-Term Goals and Monetary Policy Strategy, which is always reviewed at the first meeting of the year. This will all come as a great disappointment to Fed-watchers who were expecting the FOMC to say something about the US economic outlook, and its policy stance, now with Trump at the helm.

- Based on the immediate aftermath, as of this writing, markets seem to have taken the FOMC's failure to deal with these concerns as dovish – implying relief from fears arising from the widely held belief, mistaken in our view, that the Fed will likely tighten away any growth gains from Trumponomics (see "On the December FOMC" December 14, 2016 and "Fun Facts about the Fed's Dots" December 15, 2016).
- The only wholly new concept in today's FOMC statement was: "Measures of consumer and business sentiment have improved of late." We don't think it's a stretch to connect that with the presidential election, but the Fed certainly didn't do so.
- Other than that, the only other substantive changes were two tweaks to the way the FOMC frames its expectations for inflation.
- First, today's statement removes "declines in energy prices and in prices of non-energy imports" from as an excuse for why inflation remains "below the Committee's 2 percent longer-run objective." That's because neither of those excuses are operative anymore, with both now in substantial uptrends, not "declines." No alternate excuse is offered.
- Later in the statement the FOMC still expects that "inflation will rise to 2 percent over the medium term," but eliminates as its reason for this prediction the expectation that "the transitory effects of past declines in energy and import prices dissipate." That reasoning had to be dropped, because they've now *already* "dissipated." Yet Core PCE inflation has been stuck for the last six months – that is, throughout the "dissipation" – at about 1.7% year-on-year.
- So energy and import prices are no longer an excuse for below-target inflation – nor their "dissipation" a justification for expecting

**Update to strategic view**

**US FED, US MACRO:** The FOMC acknowledges an improvement in sentiment, but has nothing directly to say about the aftermath of the election. It's dropped its excuse of low energy and import prices for why inflation is still below target – and now has to predict a return to that target even though energy and import prices have already sharply risen. The FOMC's stumbling exegesis of such things is increasingly irrelevant, though, as its center of intellectual gravity shifts toward the evaluation of policy in the context of the "natural" or "neutral" rate of interest. That policy stance will keep the Fed on the track of extreme gradualism as the economy pulls out of "secular stagnation."

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the end of below-target inflation. Yet the FOMC still expects the end of the below-target inflation. We really aren't sure why. Especially when the statement notes that inflation expectations "remain low" and are "little changed."

- *We think all this stumbling about and tortured exegesis of macroeconomic phenomena is, at this point, a nearly thoughtless ritual that the FOMC feels compelled to go through, because markets expect it. But in fact the FOMC, or at least its most thoughtful and elite members, have moved on.*
- *We continue to think that the balance of intellectual weight on the FOMC has shifted away from the traditional "balance of risks" model toward, instead, a measurement of where the policy rate stands in relation to the "natural" or "neutral" rate of interest* (again, see "On the December FOMC").
- We are seeing this approach increasingly dominate explanations of policy given by Chair Janet Yellen when she has the luxury of speaking solo, and at length. We'll know for sure that it has been deeply enshrined as the Fed's consensus policy pole-star when we see it make its way into a brief group-thinked document like an FOMC statement.
- For strategic purposes, that doesn't have to be the Fed's official public stance – it just has to be its actual stance. We think it is. And it implies extreme gradualism when, as we expect, the economy gradually lifts itself out of the era of "secular stagnation" (see "2017: It's Bigger than The Donald" December 30, 2016).

## Bottom line

The FOMC acknowledges an improvement in sentiment, but has nothing directly to say about the aftermath of the election. It's dropped its excuse of low energy and import prices for why inflation is still below target – and now has to predict a return to that target even though energy and import prices have already sharply risen. The FOMC's stumbling exegesis of such things is increasingly irrelevant, though, as its center of intellectual gravity shifts toward the evaluation of policy in the context of the "natural" or "neutral" rate of interest. That policy stance will keep the Fed on the track of extreme gradualism as the economy pulls out of "secular stagnation."

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