Rodney's Take

December 18, 2023

Connecting the Dots

My son is a naval lieutenant on a destroyer in San Diego. He loves it, particularly when they do exercises that involve maneuvers a ship that size shouldn't be able to do. His commanding officer wanted to make a point of something, so she commanded the helm (headed by my son at that moment) to execute a man down procedure, which starts with a nearly 90-degree turn. That's not a maneuver you'd expect a 509-foot ship moving at more than 30 knots to be able to do. But it can.

I think of the Federal Reserve as the largest "money ship" on the planet, and yet it can still turn on a dime if the commander (Chair Jay Powell) wishes. During the pandemic, the Fed printed trillions of dollars in a matter of days. While the Fed let $95 billion in bonds per month mature last March, the central bankers then did an about-face and pumped $400 billion into the economy. The Fed can change direction in an instant. We would do well to remember that.

Along with its monetary policy statement, the Fed releases a Summary of Economic Projections (SEP), which includes each central banker's anonymous forecast of GDP, unemployment, the Personal Consumption Expenditures Index (PCE), overnight rates, and a few other things. The Fed reports the information as an average, along with the average from the last quarter, and also as a "dot chart" so that we can see the dispersion of the forecasts. Last quarter (September), the SEP showed that the bankers expected the overnight rate to end 2024 at 5.1%, which implied we'd get one rate cut next year. In December, the bankers expected the overnight rate to end next year at 4.6%, which implies we'll get three rate cuts next year. In September, the unemployment rate was expected to end 2023 at 3.8%, rise to 4.1% next year, and stay there through 2025. Maybe.

The SEP also shows that in September, the bankers expected real GDP to expand by 2.1% this year and personal consumption expenditures to grow by 3.3%. For December, those forecasts had changed to 2.6% and 2.8%, respectively. In short, the central bank sees the economy growing a bit faster, unemployment rising a bit, and overnight rates and inflation falling more than expected. It would be awesome if that happened.

We know inflation fell, because prices for goods dropped as the supply chain got back on track and part shortages eased. With unemployment near 50-year lows and workers up and down the ladder demanding higher pay, it's hard to see how prices for services will drop. The Fed worried about inflation for 18 months and now is focused on staving off a recession. Its latest GDP forecast for 2024 is 1.5%. If GDP grows more quickly than anticipated, unemployment remains low, and inflation remains stuck above 3%, the central bankers might change their minds. If they turn their attention back to inflation, all their estimates could change on a dime. Just like with the destroyer, we might be startled at how quickly the Fed can recast monetary policy.

Take advantage of the Fed's pivot to a dovish monetary policy stance, but be diligent in watching the economy. You don't want to find yourself the "man overboard" when the Fed takes a different tack.

Rodney

Got a question or comment? You can contact us at info@hsdent.com