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Last Week in Fedspeak / 1.19.16 — **More Concern about Inflation and Inflation Expectations**

This Week in Fedspeak **recaps how dovish or hawkish each speech and interview was based on both our qualitative and quantitative assessments and outlines how our monetary policy call has changed.**

- Last week was busy with seven Fed officials speaking; the chatter was more consistent with 3 hikes in 2016 than with 4.
- Concern about inflation expectations slipping appears to be growing, and speakers emphasized that actual inflation is the key to the number of moves we can expect in 2016.
- Global risks are back on the table, but policymakers said that domestic growth fundamentals are favorable and point to 2% to 2½% growth; this is enough to keep the unemployment rate falling and justify continued rate hikes in 2016.

Our Judgmental Assessment of Themes

The outlook for growth, labor market conditions, and inflation continues to support a gradual pace of 3 or 4 moves this year, but the FOMC needs to see signs that inflation is on an upward trajectory before continuing to raise rates after March—if it does raise rates in March. Additionally, increasing concerns about global risks and inflation expectations are tipping the scale toward 3 moves, not 4.

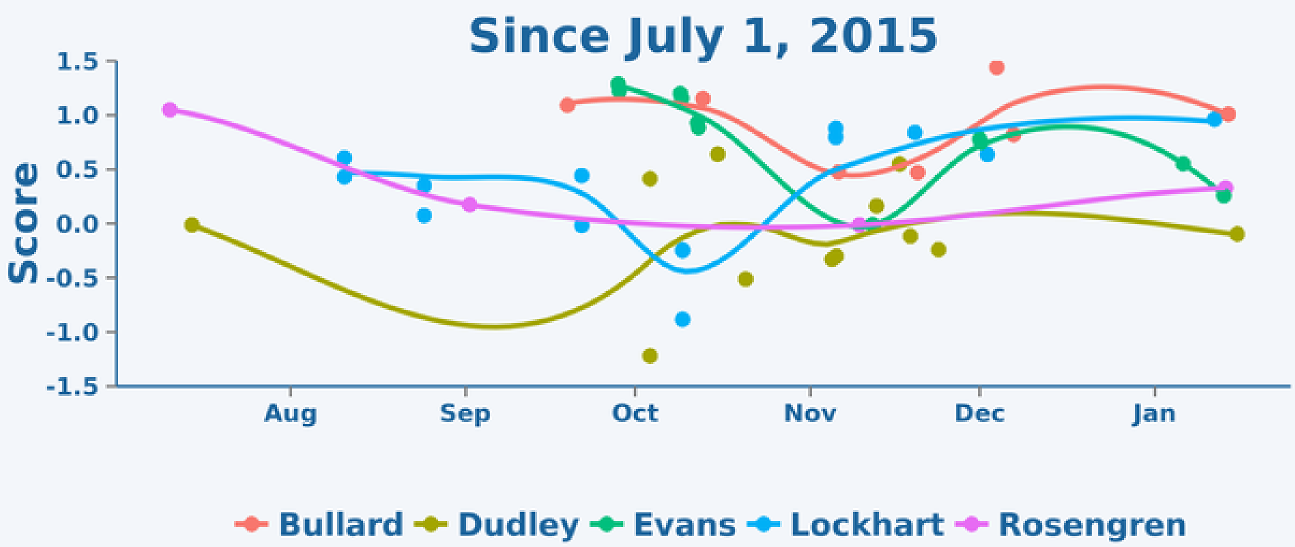
Takeaways from key speeches

- Kaplan (January 11): Thinks the idea of four hikes in 2016 (from the median dots) is not "baked in the cake" and feels that China and global financial markets pose potential concerns.
- Lockhart (January 11): Perceives inflation expectations as well-anchored, but will look for hard evidence in the inflation data to confirm expectations that actual inflation will return to 2 percent.
- Rosengren (January 13): Believes unemployment might have to fall below the NAIRU for inflation to get to 2% in the next few years.
- Bullard (January 14): Sees the possibility of lower oil prices passing through to actual inflation through falling inflation expectations and suggests that policymakers might not want to treat oil shocks as only temporary.
- Evans (January 14): Is nervous about inflation expectations not being as firmly anchored as policymakers thought and is concerned about downside risks from a China slowdown.

- Dudley (January 15): Thinks the outlook remains good, but is concerned about inflation expectations becoming unanchored to the downside.
- Williams (January 15): Sees the need for a very gradual removal of accommodation because the economy is not at its strongest yet and faces risks from abroad.

Trends in Fed sentiment

Here we present the Prattle Fed Sentiment Index coupled with Larry's assessment of those scores and some additional insights.



The graph above depicts the sentiment score of every speech given by Bullard, Dudley, Evans, Lockhart, and Rosengren over the last six months.[1] The scores represent the relative hawkishness or dovishness of that speech in comparison to all Fed communications in recent history (since 1998). We graphically demonstrate how changes in each speaker's score from one speech to the next indicates their relative level of hawkishness (above 0) or dovishness (below 0); dots indicate the score for each individual speech while the trend lines represent the smoothed trend in sentiment for each speaker over the last six months. In assessing these scores, there is, of course, hawkish bias as the FOMC was talking about beginning to raise rates over this period.

[1] There was no text for the remarks by President Williams and not enough speeches by President Kaplan yet to assign scores.

Sentiment Implications from Speeches January 11-15

- The scoring indicates that Rosengren began the second half of the year hawkish, but became less hawkish through late-2015, before turning slightly more hawkish ahead of the December meeting. He became less hawkish in last week's speech.
- Lockhart was quite hawkish over the summer, but became less so, toward neutral, in September and October. He then adopted a hawkish posture in November and scored even more hawkish in last week's speech.
- Evans was surprisingly hawkish in early October but returned to true dovish form by mid-November and provided the second most dovish speech last week.
- Dudley registered as the most dovish throughout this period. He appeared dovish ahead of the September meeting, then slightly hawkish before the December meeting, and his speeches since have been near neutral.
- Not surprisingly, Bullard registered as the most hawkish of the group over this period, but he became much less hawkish last week compared to his previous talk. The content of his speech last week suggests that he has lowered his view of the appropriate pace of hikes this year. Given that Bullard has a record of moving between hawkish and dovish positions, depending on the direction of his concerns about inflation, this move is potentially telling about the Committee's views on inflation expectations and the appropriate pace of policy.
- The sentiment expressed in recent speeches confirms that each speaker continues to favor tighter policy this year, but also that the pace of that tightening may not be as rapid as previously suggested.

Bottom Line

Last week we changed our FOMC call from four to three moves in 2016. That reflected our reading of the data and our real-time tracking of GDP growth in Q4 and the prospect of still very modest growth in Q2. Our assessment of FOMC communications, of course, also plays a key role in our assessment of near term monetary policy. The combination of data, real-time projections, and FOMC communications all pushed us in the direction of three moves this year.

In case you missed them, here are links to recent commentaries:

December Retail Sales Were Bad, Not Just Disappointing

Labor Market Strength Eases Growth Concerns

Yes, It Was a Dovish Hike

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