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Friday Finish – US Economics | North America

Don't Connect The Dots

Following the FOMC meeting, it's worth underscoring again that the Fed's dot plot does not reflect the consensus on the Committee. Only the statement does, and it kept a tightening bias but is not nearly as hawkish as the shift upward in the dot plot implies.

From the desk of the US Chief Economist

First my shameless plea: You may have been bombarded with requests during the open window of the Institutional Investor All-America Research Team Survey. If your inbox looks anything like mine, it's not pleasant. But I wouldn't ask for your vote if it weren't important to me, my team, and the Firm. **Voting will close soon. If you have enjoyed the research from your friendly US Economics team at Morgan Stanley, please do take the time to vote. Click [here to vote](#) (please choose the All-America Research Team Survey).**

Why does it seem that the Fed's projections produce a big market reaction, only to have it reverse course following Chair Powell's press conference? I fielded this excellent investor question in the aftermath of the FOMC meeting this week, and I gave what I believe is a simple answer. The projections are delivered without context, which Chair Powell then provides 30 minutes later. A reversal in market pricing following the Chair's remarks suggests there was a misperception of what the projections mean for the future path of policy. **Until the Q&A, investors are in an information vacuum and in the market version of Gestalt psychology, tend to fill in the blanks.**

This week it was a decidedly hawkish shift upward in the policy path projections that drove the initial market reaction – a sharp sell-off in US Treasuries. The sell-off then faded as Chair Powell de-emphasized the importance of the dots in the Q&A. His remarks – like those he and his predecessors have often delivered since the inception of the dot plot – reminded listeners that the dot plot is not the consensus view on the Committee of the most likely path for policy, and only the statement conveys the consensus. **And the consensus view is that additional policy firming may be appropriate depending on how economic and financial conditions evolve.**

On the Friday before the meeting, FOMC participants – in this case 18 of them – write down their individual forecasts for growth, unemployment, inflation, and the likely rates path for the Fed staff to compile. I sit on economic advisory boards of similar size and turn in a forecast that then gets compiled into a median view. Forecasting by committee is inherently flawed and often not internally consistent. I could have the same outlook for the economy as another member of my committee but envision a different policy outcome. **The dot plot is**

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simply the median of the mode of each individual participant's assessment of the appropriate path for policy based on their own forecast for the economy.

An examination of the short history of the dot plot confirms Chair Powell's assertion that it has not been very accurate in predicting the future path of policy. A couple of cases in point: In December 2014, a majority of the 17 participants projected liftoff from the zero lower bound in 2Q 2015, but the first rate increase occurred in December 2015. In December 2015, the dot plot showed a median expectation for 100bps of additional hikes in 2016, but the Fed ultimately delivered just one. In June 2016, St. Louis Fed President Bullard decided to stop turning in a longer-run dot and began flat-lining his projection over the medium-term forecast horizon. In a [Blog post](#) he explained why, calling out the "mismatch between what the FOMC is saying via the dot plot and what the FOMC is doing," and contending that it is "causing confusion" and "eroding the credibility" of the Fed. To this day he does not turn in a longer-run dot.

The FOMC has left the door open to future hikes should they be warranted. We don't believe the incoming data will justify further moves and think the Fed is done here at a peak rate of 5.1%. **Next week everyone will be riveted on Chair Powell's semi-annual testimony before the House Financial Services Committee on Wednesday, June 21 and the Senate Banking Committee the following day.** Given the proximity to the FOMC meeting, the likelihood of a surprise from Powell is low. That said, there is always room for a surprise in a live Q&A environment.

Enjoy your weekend.

Incorporating the monthly data on retail sales, import and export prices, and industrial production this week, we keep our 2Q23 real GDP tracking at 0.6%.

Data I'm watching next week: [Key Data Watch](#) Calendar.

Housing Starts (Tuesday, 8:30am): We forecast housing starts declined 1.5%M to a 1,379k unit pace. Single-family starts are expected to rise slightly, while multi-family starts are expected to drive housing starts lower.

Leading Indicators (Thursday, 10:00am): We forecast the Leading Index to fall by 0.87%M in May, vs its prior reading. This follows negative contributions from a decline in ISM activity and consumer confidence. However, low jobless claims, higher equity prices are expected to offset some of weakness.

Existing Homes Sales (Thursday, 10:00am): We forecast existing home sales in May rose 0.4%M vs. the prior month. This would raise the year-over-year change from -24.0%Y to -21.5%Y. Driving our forecast have been pending home sales remaining flat and a decline in mortgage applications for purchase through May.

Weekend Reading/Listening:

- [Thematic Thursday: Life in the Multipolar World \(15 Jun 2023\)](#)
- [US Economics & Global Macro Strategy: FOMC Reaction: Don't Connect the Dots \(15 Jun 2023\)](#)
- [Podcast | Thoughts on the Market: Mid-Year Strategy Outlook: Risk/Reward in Currency and Commodities \(12 Jun 2023\)](#)
- [Global Economic Briefing: The Weekly Worldview: The Sun Rises in the East \(12 Jun 2023\)](#)

Past Friday Finish Commentary:

- [Friday Finish – US Economics: Answering Your Questions on Jobless Claims \(9 Jun 2023\)](#)
- [Friday Finish – US Economics: The Law of Inertia \(2 Jun 2023\)](#)
- [Friday Finish – US Economics: When Little Pent-Up Demand Is Left \(26 May 2023\)](#)
- [Friday Finish – US Economics: Roadmap to a June Hike \(19 May 2023\)](#)
- [Friday Finish – US Economics: Sharper Focus on a Soft Landing \(12 May 2023\)](#)
- [Friday Finish – US Economics: No Cliff Diving Allowed \(5 May 2023\)](#)
- [Friday Finish – US Economics: More Support for a Soft Landing \(28 Apr 2023\)](#)

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