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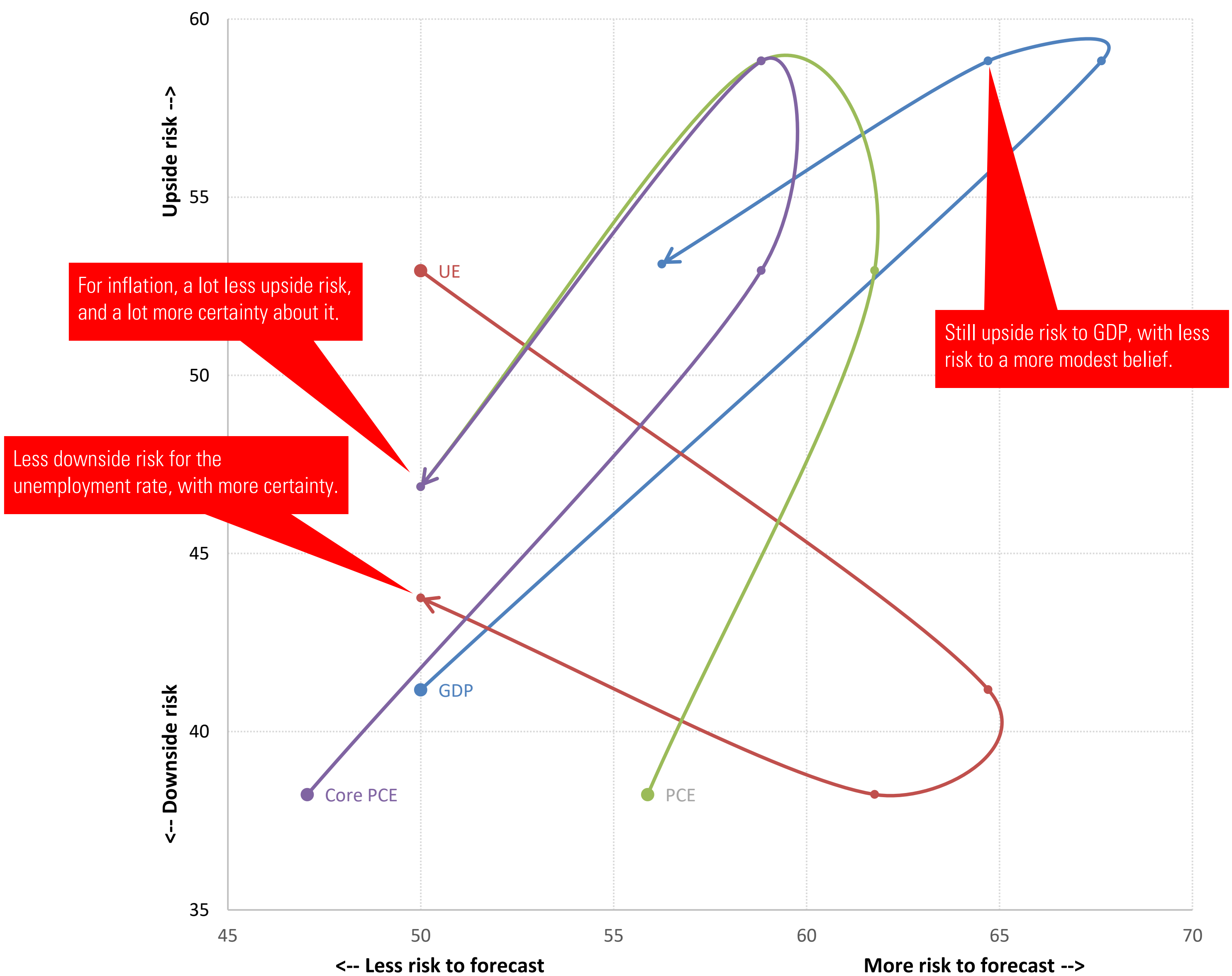
Data Insights: FOMC Minutes

Wednesday, July 5, 2017

Evolving "uncertainty"

Diffusion indices of forecast risks in Summary of Economic Projections

From ● September 16 FOMC to → June 17 FOMC



Source: FOMC, TrendMacro calculations

June minutes: key signaling language

System Open Market Account Reinvestment Policy

The Chair…noted that participants appeared to have reached a consensus on an approach that involved specifying caps on the monthly amount of principal payments from securities holdings that would not be reinvested; these caps would rise over the period of a year, after which they would remain constant...

…Participants generally saw the incoming information on spending and labor market indicators as consistent, overall, with their expectations and indicated that their views of the outlook for economic growth and the labor market had changed only slightly since the May FOMC meeting. …In light of surprisingly low recent readings on inflation, participants expected that inflation on a 12-month basis would remain somewhat below 2 percent in the near term.

…Labor market conditions continued to strengthen in recent months. …Monthly increases in nonfarm payrolls averaged 160,000 since the beginning of the year, down from 187,000 per month in 2016... A few participants interpreted this slowing in payroll growth as an expected development that reflected a tight labor market.

…Recent readings on headline and core PCE price inflation had come in lower than participants had expected…partly because of factors that appeared to be transitory. …However, several participants expressed concern that progress toward the Committee's 2 percent longer-run inflation objective might have slowed and that the recent softness in inflation might persist. Such persistence might occur in part because upward pressure on inflation from resource utilization may be limited, as the relationship between these two variables appeared to be weaker than in previous decades.

…Overall, participants continued to see the near-term risks to the economic outlook as roughly balanced. Participants again noted the uncertainty regarding the possible enactment, timing, and nature of changes to fiscal and other government policies and saw both upside and downside risks to the economic outlook associated with such changes. …With regard to the outlook for inflation, some participants emphasized downside risks, particularly in light of the recent low readings on inflation along with measures of inflation compensation and some survey measures of inflation expectations that were still low. However, a couple of participants expressed concern that a substantial undershooting of the longer-run normal rate of unemployment could pose an appreciable upside risk to inflation or give rise to macroeconomic or financial imbalances that eventually could lead to a significant economic downturn.

…participants…also noted that, according to some measures, financial conditions had eased even as the Committee reduced policy accommodation and market participants continued to expect further steps to tighten monetary policy. …Some participants suggested that increased risk tolerance among investors might be contributing to elevated asset prices more broadly; a few participants expressed concern that subdued market volatility, coupled with a low equity premium, could lead to a buildup of risks to financial stability.

…One participant did not believe it was appropriate to raise the federal funds rate target range at this meeting; this participant suggested that the Committee should maintain the target range for the federal funds rate at 3/4 to 1 percent until the inflation rate was actually moving toward the Committee's 2 percent longer-run objective.

…Participants expressed a range of views about the appropriate timing of a change in reinvestment policy. Several preferred to announce a start to the process within a couple of months; in support of this approach, it was noted that the Committee's communications had helped prepare the public for such a step. However, some others emphasized that deferring the decision until later in the year would permit additional time to assess the outlook for economic activity and inflation. A few of these participants also suggested that a near-term change to reinvestment policy could be misinterpreted as signifying that the Committee had shifted toward a less gradual approach to overall policy normalization.

Several participants indicated that the reduction in policy accommodation arising from the commencement of balance sheet normalization was one basis for believing that, if economic conditions evolved broadly as anticipated, the target range for the federal funds rate would follow a less steep path than it otherwise would. However, some other participants suggested that they did not see the balance sheet normalization program as a factor likely to figure heavily in decisions about the target range for the federal funds rate. A few of these participants judged that the degree of additional policy firming that would result from the balance sheet normalization program was modest.

Participants generally reiterated their support for continuing a gradual approach to raising the federal funds rate. …However, a few participants who supported an increase in the target range at the present meeting indicated that they were less comfortable with the degree of additional policy tightening through the end of 2018 implied by the June SEP median federal funds rate projections. These participants expressed concern that such a path of increases in the policy rate, while gradual, might prove inconsistent with a sustained return of inflation to 2 percent.

Several participants endorsed a policy approach, such as that embedded in many participants' projections, in which the unemployment rate would undershoot their current estimates of the longer-term normal rate for a sustained period. They noted that the longer-run normal rate of unemployment is difficult to measure and that recent evidence suggested resource pressures generated only modest responses of nominal wage growth and inflation. …It was also suggested that the symmetry of the Committee's inflation goal might be underscored if inflation modestly exceeded 2 percent for a time, as such an outcome would follow a long period in which inflation had undershot the 2 percent longer-term objective.

Source: FOMC, TrendMacro analysis