TrendMacro

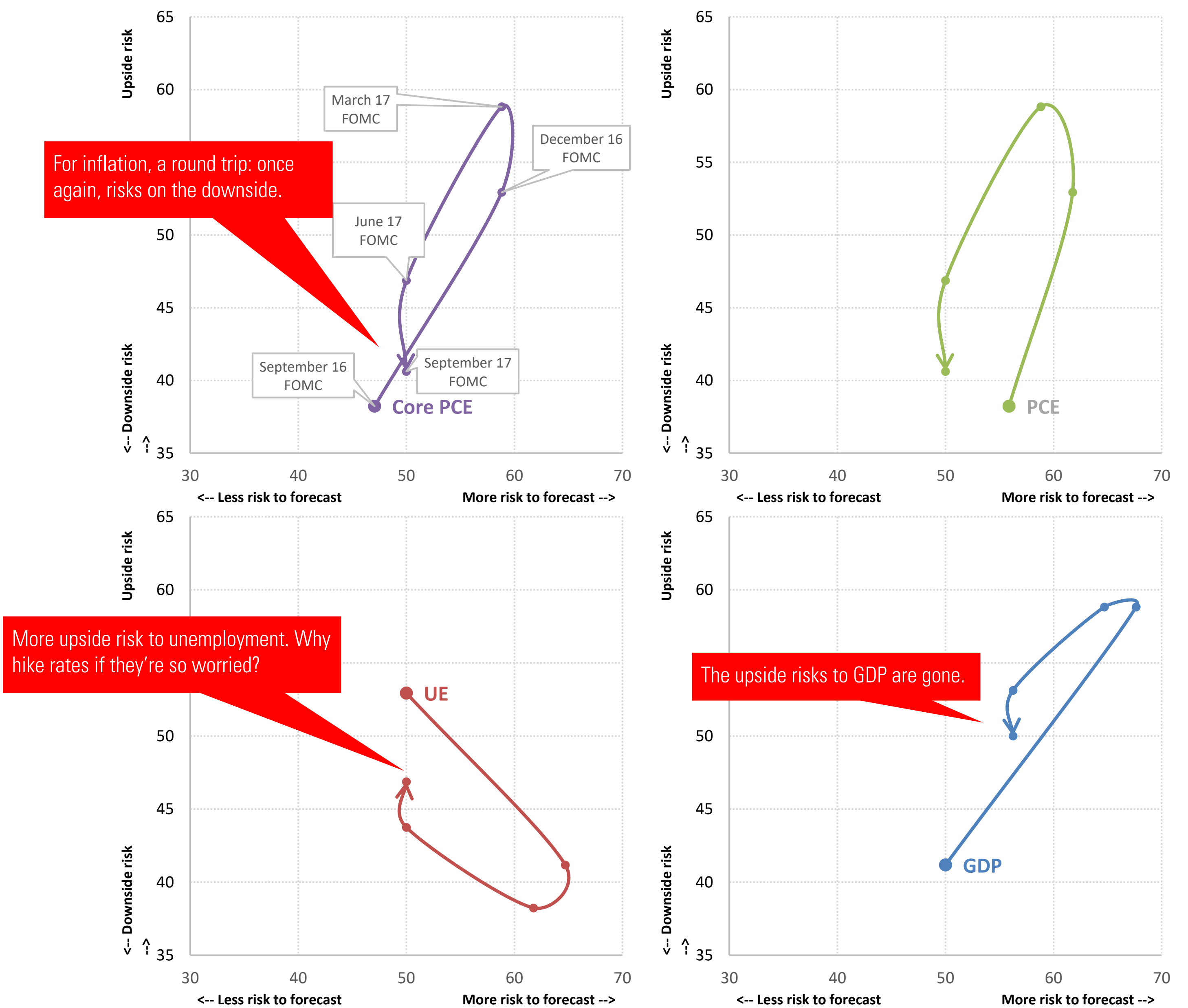
Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

Data Insights: FOMC Minutes

Wednesday, October 11, 2017

Evolving "uncertainty" Diffusion indices of forecast risks in Summary of Economic Projections

From ● September 16 FOMC to → September 17 FOMC



Source: FOMC, TrendMacro calculations

September minutes: key signaling language

...Participants acknowledged that Hurricanes Harvey, Irma, and Maria would affect economic activity in the near term. They expected growth of real GDP in the third quarter to be held down by the severe disruptions caused by the storms but to rebound beginning in the fourth quarter as rebuilding got under way and economic activity in the affected areas resumed. Similarly, employment would be temporarily depressed by the hurricanes, but, abstracting from those effects, employment gains were anticipated to remain solid, and the unemployment rate was expected to decline a bit further by year-end.

Based on the estimated effects of past major hurricanes that made landfall in the United States, participants judged that the recent storms were unlikely to materially alter the course of the national economy over the medium term. Moreover, they generally viewed the information on spending, production, and labor market activity that became available over the intermeeting period, which was mostly not affected by the hurricanes, as suggesting little change in the outlook for economic growth and the labor market over the medium term. Consequently, they continued to expect that, with gradual adjustments in the stance of monetary policy, economic activity would expand at a moderate pace and labor market conditions would strengthen somewhat further. In the aftermath of the hurricanes, higher prices for gasoline and some other items were likely to boost inflation temporarily. Apart from that effect, inflation on a 12-month basis was expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term.

…A number of participants reported that their business contacts appeared to have become more confident about the economic outlook, and it was noted that the National Federation of Independent Business reported that greater optimism among small businesses had contributed to a sharp increase in the proportion of small firms planning increases in their capital expenditures…

Increases in most aggregate measures of hourly wages and labor compensation remained subdued, and several participants commented that the absence of broad-based upward wage pressures suggested that the sustainable rate of unemployment might be lower than they currently estimated…

It was noted that other advanced economies were also experiencing low inflation, which might suggest that common global factors could be contributing to persistence of below-target inflation in the United States and abroad. Several participants commented on the importance of longer-run inflation expectations to the outlook for a return of inflation to 2 percent. A number of indicators of inflation expectations, including survey statistics and estimates derived from financial market data, were generally viewed as indicating that longer-run inflation expectations remained reasonably stable, although a few participants saw some of these measures as low or slipping.

Participants raised a number of important considerations about the implications of persistently low inflation for the path of the federal funds rate over the medium run. Several expressed concern that the persistence of low rates of inflation might imply that the underlying trend was running below 2 percent, risking a decline in inflation expectations. If so, the appropriate policy path should take into account the need to bolster inflation expectations in order to ensure that inflation returned to 2 percent and to prevent erosion in the credibility of the Committee's objective. It was also noted that the persistence of low inflation might result in the federal funds rate staying uncomfortably close to its effective lower bound. However, a few others pointed out the need to consider the lags in the response of inflation to tightening resource utilization and, thus, increasing upside risks to inflation as the labor market tightened further.

… several noted that in preparing their projections for this meeting, they had taken on board the likelihood that convergence to the Committee's symmetric 2 percent inflation objective might take somewhat longer than they anticipated earlier…

In their discussion of monetary policy, all participants agreed that the economy had evolved broadly as they had anticipated at the time of the June meeting and that the incoming data had not materially altered the medium-term economic outlook. Consistent with those assessments, participants saw it as appropriate, at this meeting, to announce implementation of the plan for reducing the Federal Reserve's securities holdings that the Committee released in June. Many underscored that the reduction in securities holdings would be gradual and that financial market participants appeared to have a clear understanding of the Committee's planned approach for a gradual normalization of the size of the Federal Reserve's balance sheet. Consequently, participants generally expected that any reaction in financial markets to the start of balance sheet normalization would likely be limited.

With the medium-term outlook little changed, inflation below 2 percent, and the neutral rate of interest estimated to be quite low, all participants thought it would be appropriate for the Committee to maintain the current target range for the federal funds rate at this meeting, and nearly all supported again indicating in the postmeeting statement that a gradual approach to increasing the federal funds rate will likely be warranted. Nevertheless, many participants expressed concern that the low inflation readings this year might reflect not only transitory factors, but also the influence of developments that could prove more persistent, and it was noted that some patience in removing policy accommodation while assessing trends in inflation was warranted. A few of these participants thought that no further increases in the federal funds rate were called for in the near term or that the upward trajectory of the federal funds rate might appropriately be quite shallow. Some other participants, however, were more worried about upside risks to inflation arising from a labor market that had already reached full employment and was projected to tighten further. Their concerns were heightened by the apparent easing in financial conditions that had developed since the Committee's policy normalization process was initiated in December 2015. These participants cautioned that an unduly slow pace in removing policy accommodation could result in an overshoot of the Committee's inflation objective in the medium term that would likely be costly to reverse or could lead to an intensification of financial stability risks or to other imbalances that might prove difficult to unwind.

Consistent with the expectation that a gradual rise in the federal funds rate would be appropriate, many participants thought that another increase in the target range later this year was likely to be warranted if the medium-term outlook remained broadly unchanged. Several others noted that, in light of the uncertainty around their outlook for inflation, their decision on whether to take such a policy action would depend importantly on whether the economic data in coming months increased their confidence that inflation was moving up toward the Committee's objective. A few participants thought that additional increases in the federal funds rate should be deferred until incoming information confirmed that the low readings on inflation this year were not likely to persist and that inflation was clearly on a path toward the Committee's symmetric 2 percent objective over the medium term. All agreed that they would closely monitor and assess incoming data before making any further adjustment to the federal funds rate.

Source: FOMC, TrendMacro analysis