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

Data Insights: FOMC Minutes

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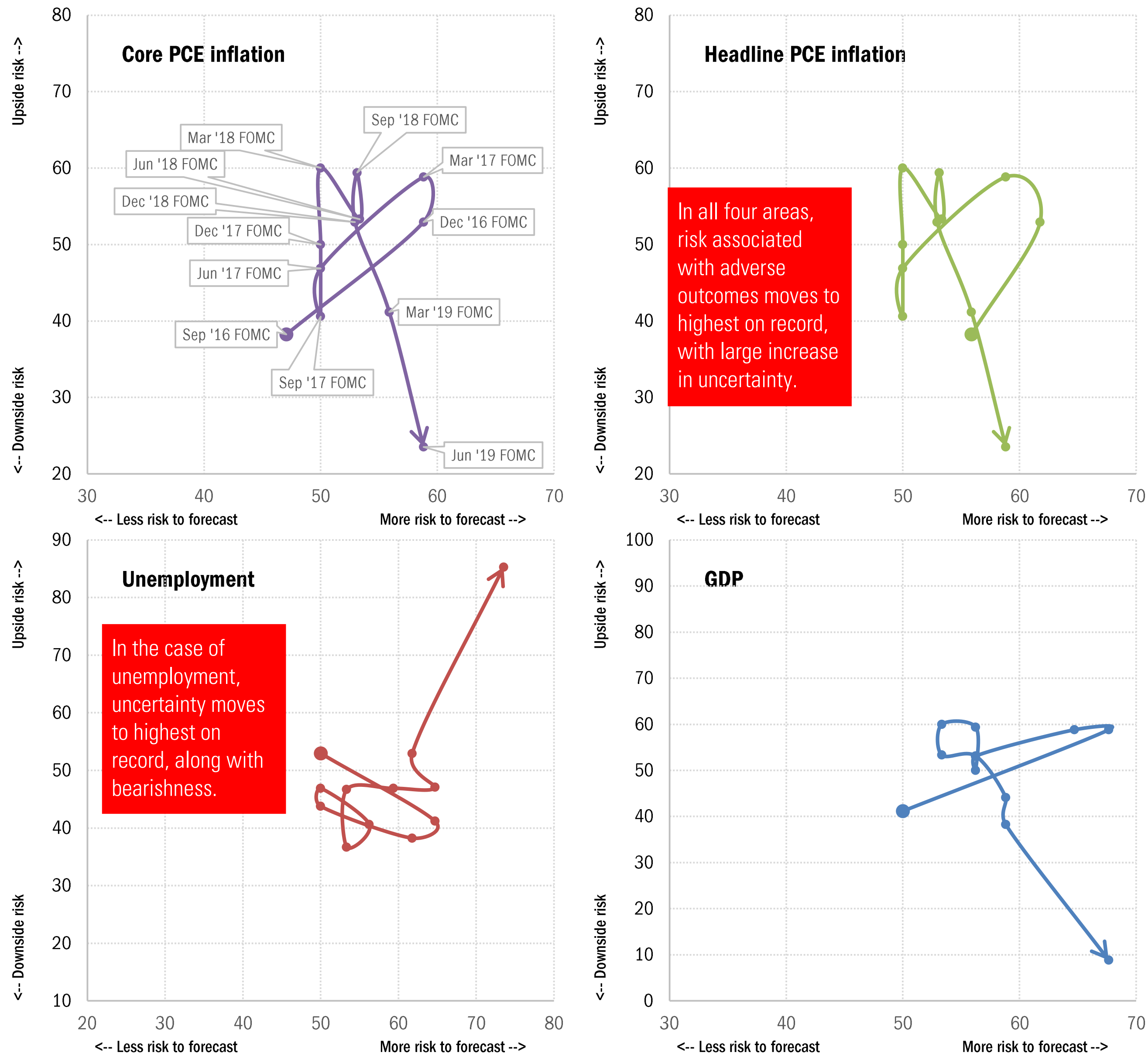
Evolving "uncertainty" Diffusion indices of forecast-risks in Summary of Economic Projections

From ● September 2016 FOMC to → June 2019 FOMC



Source: FOMC, TrendMacro calculations

June minutes: key signaling language

Investors' concerns about downside risks to the economic outlook weighed on financial markets over the intermeeting period. Market participants cited negative news about international trade tensions and, to a lesser extent, soft U.S. and foreign economic data as factors that contributed to these developments...

FOMC communications following the May meeting had little net effect on yields, though they rose modestly following the Chair's press conference...

Longer-term Treasury yields fell considerably over the period, with the declines driven primarily by negative headlines about trade tensions between the United States and two major trading partners, China and Mexico. Softer-than-expected domestic economic news, such as the weaker-than-expected employment data, also contributed to the declines. The spread between 10-year and 3-month Treasury yields fell to the bottom decile of its distribution since 1971. Measures of inflation compensation derived from Treasury Inflation-Protected Securities also decreased notably over the period along with declines in oil prices.

Major U.S. equity price indexes declined, on net, over the intermeeting period. Equity prices fell notably over the first few weeks of the period, primarily in response to the escalation of trade tensions with China and Mexico. Firms with high China exposure and those in cyclical sectors—such as energy, information technology, industrials, communication services, and banks—posted particularly large losses. However, later in the period, stock prices regained a significant portion of their losses amid an easing of trade tensions with Mexico and expectations of a more accommodative stance of policy . . .

The staff viewed the uncertainty around its projections for real GDP growth, the unemployment rate, and inflation as generally similar to the average of the past 20 years, although uncertainty was seen to have increased since the previous forecast. Moreover, the staff also judged that the risks to the forecast for real GDP growth had tilted to the downside, with a skew to the upside for the unemployment rate. The increased uncertainty and shift to downside risks around the projection reflected the staff's assessment that international trade tensions and foreign economic developments seemed more likely to move in directions that could have significant negative effects on the U.S. economy than to resolve more favorably than assumed. With the risks to the forecast for economic activity tilted to the downside, the risks to the inflation projection were also viewed as having a downward skew...

Participants judged that uncertainties and downside risks surrounding the economic outlook had increased significantly over recent weeks. While they continued to view a sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, many participants attached significant odds to scenarios with less favorable outcomes. Moreover, nearly all participants in their submissions to the Summary of Economic Projections (SEP), had revised down their assessment of the appropriate path of the federal funds rate over the projection period that would be consistent with their modal economic outlook. Many participants noted that, since the Committee's previous meeting, the economy appeared to have lost some momentum and pointed to a number of factors supporting that view including recent weak indicators for business confidence, business spending and manufacturing activity; trade developments; and signs of slowing global economic growth. Many participants noted that they viewed the risks to their growth and inflation projections, such as those emanating from greater uncertainty about trade, as shifting notably over recent weeks and that risks were now weighted to the downside.

Participants discussed at some length the softness in various indicators of business fixed investment in the second quarter. Incoming data on shipments and orders of new capital goods looked weak and recent readings from some manufacturing surveys had dropped sharply. Private sector analysts had marked down their forecasts for longer-term corporate profit growth. Manufacturing production had posted declines so far this year. In addition, contacts reported that softer export sales, weaker economic activity abroad, and elevated levels of uncertainty regarding the global outlook were weighing on business sentiment and leading firms to reassess plans for investment spending. Several participants noted comments from business contacts reporting that their base case now assumed that uncertainties about the global outlook would remain prominent over the medium term and would continue to act as a drag on investment. Several participants also noted reports from some business contacts in the manufacturing sector suggesting that they were putting capital expenditures or hiring plans on hold and were reevaluating their global supply chains in light of trade uncertainties. A couple of participants, however, pointed to signs that investment might pick up, including reports from some contacts that their orders and shipments remained strong and that some contacts planned to hire more workers. A few participants also noted ongoing challenges in the agricultural sector, including those associated with increased trade uncertainty, weak export markets, wet weather, and severe flooding. A few participants remarked on the decline in energy prices and the associated reduction in activity in the energy sector

In their discussion of the household sector, participants noted that available data on consumer spending had been solid, supported by a strong labor market and rising incomes. Several participants also noted that measures of consumer sentiment remained upbeat, and a couple noted that their business contacts confirmed the view that consumer spending had rebounded from the weak patch earlier in the year. Several participants, however, noted that tariffs could eventually become a drag on consumer durables spending, especially if additional tariffs on consumer goods were imposed, and that they would be monitoring incoming data for signs of this effect. A couple of participants noted that the continued softness in the housing sector was a concern, even though the decline in mortgage rates since last fall was expected to provide stronger impetus for activity; a couple of participants were somewhat optimistic that residential investment would pick up.

In their discussion of the labor market, participants cited evidence that conditions remained strong, including the very low unemployment rate and the fact that job gains had been solid, on average, in recent months. That said, job gains in May were weaker than expected and, in light of other developments, participants judged that it would be important to closely monitor incoming data for any signs of softening in labor market conditions. Reports from business contacts pointed to continued strong labor demand, with many firms planning to hire more workers. Economy-wide wage growth was seen as being broadly consistent with modest average rates of labor productivity growth in recent years. However, a few participants noted that there were limited signs of upward pressure on wage inflation. A few participants cited the combination of muted inflation pressures, moderate wage growth, and expanding employment as a possible indication that some slack remained in the labor market.

Partly reflecting that combination of developments, several participants had revised down their SEP estimates of the longer-run normal rate of unemployment.

Participants noted that readings on overall inflation and inflation for items other than food and energy had come in lower than expected over recent months. In light of recent softer inflation readings, perceptions of downside risks to growth, and global disinflationary pressures, many participants viewed the risks to the outlook for inflation as weighted to the downside. Several participants indicated that, while headline inflation had been close to 2 percent last year, it was noteworthy that inflation had softened this year despite continued strong labor market conditions. Participants generally noted that they revised down their SEP projections of inflation for the current year in light of recent data. They still anticipated that the overall rate of inflation would firm somewhat and move up to the Committee's longer-run symmetric objective of 2 percent over the next few years. Consistent with that view, several participants commented that alternative measures of inflation that removed the influence of unusually large changes in the prices of individual items in either direction were running around 2 percent. However, a number of participants anticipated that the return to 2 percent would take longer than previously projected even with an assumed path for the federal funds rate that was lower than in their previous projections.

In their discussion of indicators of inflation expectations, participants generally observed that market-based measures of inflation compensation had declined and were at low levels. Some participants also noted that recent readings on some survey measures of consumers' inflation expectations had declined or stood at historically low levels. Many participants further noted that longer-term inflation expectations could be somewhat below levels consistent with the Committee's 2 percent inflation objective, or that the continued weakness in inflation could prompt expectations to slip further. These developments might make it more difficult to achieve their inflation objective on a sustained basis. However, several participants remarked that inflation expectations appeared to be at levels consistent with the Committee's 2 percent inflation objective.

Participants generally agreed that downside risks to the outlook for economic activity had risen materially since their May meeting, particularly those associated with ongoing trade negotiations and slowing economic growth abroad. Other downside risks cited by several participants included the possibility that federal budget negotiations could result in a sharp reduction in government spending or that negotiations to raise the federal debt limit could be prolonged. A couple of participants observed that an economic deterioration in the United States, if it occurred, might be amplified by significant debt burdens for many firms. A few participants remarked that an upside risk to the outlook for economic activity and inflation included a scenario in which trade negotiations were resolved favorably and business sentiment rebounded sharply.

In their discussion of financial developments, participants observed that the increase in uncertainty surrounding the global outlook had affected risk sentiment in financial markets. While overall financial conditions remained supportive of growth, those conditions appeared to be premised importantly on expectations that the Federal Reserve would ease policy in the near term to help offset the drag on economic growth stemming from uncertainties about the global outlook and other downside risks. Participants also discussed the decline in yields on longer-term Treasury securities in recent months. Many participants noted that the spread between the 10-year and 3-month Treasury yields was now negative, and several noted that their assessment of the risk of a slowing in the economic expansion had increased based on either the shape of the yield curve or other financial and economic indicators. A few participants pointed to the growth in debt issuance by nonfinancial corporations and still generally high asset valuations as developments that warranted continued monitoring...

With regard to the outlook for monetary policy beyond this meeting, nearly all participants had revised down their assessment of the appropriate path for the federal funds rate over the projection period in their SEP submissions, and some had marked down their estimates of the longer-run normal level of the funds rate as well. Many participants indicated that the case for somewhat more accommodative policy had strengthened. Participants widely noted that the global developments that led to the heightened uncertainties about the economic outlook were quite recent. Many judged additional monetary policy accommodation would be warranted in the near term should these recent developments prove to be sustained and continue to weigh on the economic outlook. Several others noted that additional monetary policy accommodation could well be appropriate if incoming information showed further deterioration in the outlook. Participants stated a variety of reasons that would call for a lower path of the federal funds rate. Several participants noted that a near-term cut in the target range for the federal funds rate could help cushion the effects of possible future adverse shocks to the economy and, hence, was appropriate policy from a risk-management perspective. Some participants also noted that the continued shortfall in inflation risked a softening of inflation expectations that could slow the sustained return of inflation to the Committee's 2 percent objective. Several participants pointed out that they had revised down their estimates of the longer-run normal rate of unemployment and, as a result, saw a smaller upward contribution to inflation pressures from tight resource utilization than they had earlier. A few participants were concerned that inflation expectations had already moved below levels consistent with the Committee's symmetric 2 percent objective and that it was important to provide additional accommodation in the near term to bolster inflation expectations. A few participants judged that allowing inflation to run above 2 percent for some time could help strengthen the credibility of the Committee's commitment to its symmetric 2 percent inflation objective.

Some participants suggested that although they now judged that the appropriate path of the federal funds rate would follow a flatter trajectory than they had previously assumed, there was not yet a strong case for a rate cut from current levels. They preferred to gather more information on the trajectory of the economy before concluding that a change in policy stance is warranted. A few participants expressed the view that with the economy still in a favorable position in terms of the dual mandate, an easing of policy in an attempt to increase inflation a few tenths of a percentage point risked overheating the labor markets and fueling financial imbalances. Several participants observed that the trimmed mean measure of PCE price inflation constructed by the Federal Reserve Bank of Dallas had stayed near 2 percent recently, underscoring the view that the recent low readings on inflation will prove transitory...

Mr. Bullard dissented because he believed that the current stance of monetary policy could be better positioned to foster progress toward the Committee's statutory objectives of maximum employment and stable prices. Particularly in light of persistent low readings on inflation and from indicators of inflation expectations along with the risks to the U.S. outlook associated with global economic developments, he noted that a policy rate reduction at the current meeting would help re-center inflation and inflation expectations at levels consistent with the Committee's symmetric 2 percent inflation objective and simultaneously provide some insurance against unexpected developments that could slow U.S. economic growth.

Source: Federal Reserve Board