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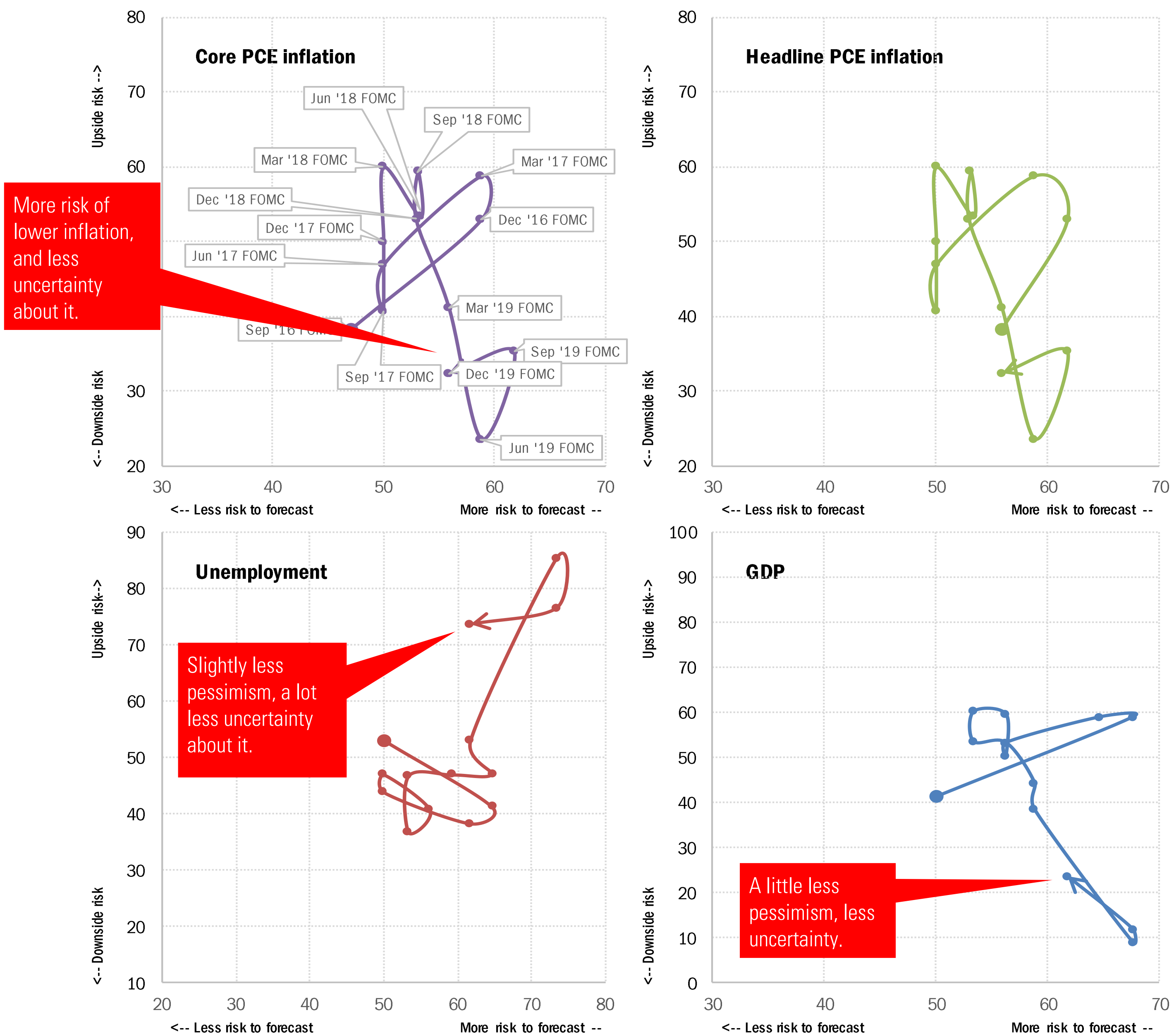
Data Insights: FOMC Minutes

Friday, January 3, 2020

Evolving "uncertainty"

Diffusion indices of forecast risks in Summary of Economic Projections

From ● September 2016 FOMC to → December 2019 FOMC



Source: FOMC, TrendMacro calculations

Participants continued to discuss issues related to the ongoing review of the Federal Reserve's monetary policy strategy, tools, and communication practices. The staff summarized the feedback received through the Fed Listens initiative, a series of 14 public-facing events conducted around the country with a broad range of individuals and groups. These events engaged with the public directly on issues pertaining to the dual-mandate objectives of maximum employment and stable prices. Representatives from underserved communities who participated in the Fed Listens events generally saw the current strong labor market as providing significant benefits to their communities, most notably by creating greater opportunities for individuals who have experienced difficulty finding jobs in the past. Nevertheless, these representatives noted that the benefits from current labor market conditions flowing to people in their communities were less than those implied by national statistics, and they expressed concerns that the recent gains might not be sustained in the event of an economic downturn. Business representatives reported experiencing challenges finding qualified workers and described several initiatives to attract and retain workers, including training programs and a willingness to employ individuals who are unlikely to have been considered in less favorable labor market conditions. Inflation developments elicited fewer comments at these events and were generally seen as posing less of a challenge than labor market conditions. Representatives of retirees mentioned difficulties associated with the rising costs of health care and prescription drugs, whereas those representing low- and middle-income communities pointed to the rising costs of basic necessities such as housing, utilities, and food. Business representatives emphasized the importance of low and stable inflation for planning and decisionmaking. Event participants were concerned about rising costs of living and generally perceived low inflation as desirable from that perspective. Event participants were asked about monetary policymakers' concerns regarding overall inflation running persistently below 2 percent; they noted that the Federal Reserve could better communicate its reasons for these concerns. When asked about the effects of changes in interest rates, representatives of underserved communities said that such changes had little effect on many members of their communities who have limited or no access to credit. Representatives of retirees conveyed a more negative view of low interest rates, given the greater reliance of wealthier retirees on interest income. Business representatives generally found the low interest rate environment beneficial.

. . .Participants generally saw the feedback from Fed Listens events as reinforcing the importance of sustaining the economic expansion so that the effects of a persistently strong job market reach more of those who, in the past, had experienced difficulty finding employment. Several participants mentioned that sustaining strong labor market conditions helps workers build skills and cement their attachment to the labor force in a manner that might reduce the scarring effects of future downturns and might increase the maximum sustainable level of employment over the longer run. A number of participants also emphasized that sustaining strong labor market conditions is helpful for meeting the Committee's symmetric 2 percent inflation goal.

Some participants spoke to some of the challenges associated with assessing the maximum level of employment. A few participants noted that aggregate statistics mask significant heterogeneity in labor market outcomes. A few others pointed to the continued absence of significant wage and price pressure—traditionally seen as a symptom of a tight labor market—even as the unemployment rate had moved below most estimates of its longer-run level. A few participants raised the possibility that the maximum sustainable level of employment had increased as the expansion continued to draw workers who would otherwise not be in the labor force.

Regarding inflation, participants recognized that segments of the public generally do not regard the fact that aggregate inflation is running modestly below the Committee's 2 percent goal as a problem. A few participants noted that the public's view on this issue was understandable from the perspective of households and businesses going about their daily lives in an economy with low and stable inflation. That said, a couple of participants cautioned that inflation could emerge as a concern among members of the public if it became more volatile or ran at levels substantially away from the Committee's goal. Many participants also warned about the macroeconomic consequences of not achieving 2 percent on a sustained basis. In particular, if inflation ran persistently below the Committee's objective, longer-term inflation expectations could drift down, resulting in lower actual inflation. With lower inflation, nominal interest rates would be lower as well and therefore closer to the

ELB. As a result, the scope for monetary policy to support the economy in a future downturn through interest rate cuts would be reduced, a situation that would likely worsen economic outcomes for households and businesses. In light of these considerations, participants generally agreed that they need to communicate more clearly to the public their rationale for, and commitment to, achieving 2 percent inflation on a sustained basis and of ensuring that longer-run inflation expectations are anchored at levels consistent with this objective. To ensure the effectiveness of these and other communications, several participants stressed that the Federal Reserve needs to adapt its communications to various audiences. A few participants emphasized that communications about the Committee's resolve to return inflation to 2 percent need to be backed with actions and results to ensure that the public sees these communications as credible.

…The System Open Market Account manager…turned next to a review of money market developments since the October meeting, starting with an update on the implementation of the Committee's strategy to ensure ample reserves. Reserve management purchases of Treasury bills continued at a pace of $60 billion per month, with propositions remaining strong and little discernible effect on market functioning. While these purchases accumulated, the Desk continued to conduct regular repurchase agreement (repo) operations in order to maintain reserves at or above the level that prevailed in early September. Repos outstanding from these Desk operations totaled roughly $215 billion per day, consisting of both overnight and term operations.

As reserve levels increased, the distribution of reserves across bank types became comparable with where it was in early September. The federal funds rate and other overnight money market rates fell modestly and were close to the interest on excess reserves (IOER) rate for most of the period. The intraday dispersion of rates was also lower than when reserves were at similar levels before September. In addition to helping keep reserves ample, repo operations likely have reduced pressures in money markets and the dispersion in money market rates.

With respect to conditions around year-end, the manager noted that forward measures of market pricing continued to indicate expectations of temporary upward pressures on some secured rates. Money market rates are often volatile around year-end, and Federal Reserve operations are not intended to eliminate all year-end pressures but rather to ensure that reserve supply remains ample and to mitigate the risk that such pressures could adversely affect the implementation of monetary policy. The Desk had already conducted three longer-term repo operations spanning year-end—for a total of $75 billion—and planned to announce an additional longer-term operation, as well as increase the amount of overnight repo offered around the year-end date. The manager reported that the Desk is closely monitoring reserves and money market conditions and that it is prepared to adjust plans as needed.

The manager discussed two operational considerations around policy implementation. The first involved the risk that future Treasury bill purchases could have a larger effect on liquidity in the Treasury bill market in light of expected seasonal declines in bill issuance and the Federal Reserve's growing ownership share of outstanding bills. If this risk were to materialize, the Federal Reserve could consider expanding the universe of securities purchased for reserve management purposes to include coupon-bearing Treasury securities with a short time to maturity. Purchases of these short-dated securities would not affect broader financial conditions or the stance of monetary policy. The manager also discussed expectations to gradually transition away from active repo operations next year as Treasury bill purchases supply a larger base of reserves. The calendar of repo operations starting in mid-January could reflect a gradual reduction in active repo operations. The manager indicated that some repos might be needed at least through April, when tax payments will sharply reduce reserve levels.

As reserves remain ample, the manager noted that it may become appropriate at some point to implement a technical adjustment to the IOER rate and the offered rate on overnight reverse repurchase (ON RRP) agreements. Should conditions warrant this adjustment, the IOER rate could move closer to the middle of the target range for the federal funds rate, and the ON RRP rate could be realigned with the bottom of the target range.

The manager also noted that the Federal Reserve Bank of New York communicated to its customers that the remuneration rate on the foreign repo pool will be revised to be generally equivalent to the overnight reverse repo rate. This action may reduce activity in the pool to some extent and increase the level of reserves.

…Participants agreed that the labor market had remained strong over the intermeeting period and that economic activity had risen at a moderate rate. Job gains had been solid, on average, in recent months, and the unemployment rate had remained low. Although household spending had risen at a strong pace, business fixed investment and exports had remained weak. On a 12-month basis, overall inflation and inflation for items other than food and energy were running below 2 percent. Market-based measures of inflation compensation remained low; survey-based measures of longer-term inflation expectations were little changed.

Participants generally expected sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. This outlook reflected, at least in part, the support provided by the current stance of monetary policy. Nevertheless, global developments, related to both persistent uncertainty regarding international trade and weakness in economic growth abroad, continued to pose some risks to the outlook, and inflation pressures remained muted.

…With respect to the business sector, participants saw trade developments and concerns about the global economic growth outlook as the main factors contributing to weak business investment and exports. Participants generally expected these factors to continue to damp business investment and exports. They expressed similar concerns about activity in manufacturing industries. A few participants noted that the current weakness in capital expenditures could lead to a slower pace of productivity growth in future years. A few others observed that businesses were diversifying their supply chains or investing in technology to adapt to persistent uncertainty regarding international trade, which might mitigate the effects of such uncertainty on future business spending.

A number of participants commented on challenges facing the energy and agriculture sectors. A few participants remarked that activity in the energy sector was especially weak, reflecting low petroleum prices, low profitability, and tight financing conditions for energy-producing firms. Several participants noted that the agricultural sector also faced a number of difficulties, including those associated with trade developments, weak export demand, and challenging financial positions for many farmers. A couple of participants noted that farm subsidies from the federal government were offsetting a portion of the financial strain on farmers.

Participants judged that conditions in the labor market remained strong, with the unemployment rate at a 50-year low, job gains remaining solid, and some measures of labor force participation increasing further. The unemployment rate was likely to remain low going forward, and various participants remarked that there were some indications that further strengthening in overall labor market conditions was possible without creating undesirable pressures on resources. In particular, a number of participants noted that the labor force participation rate could rise further still. Moreover, measures of wage growth had generally remained moderate. However, a few participants commented that increases in the labor force would likely moderate as slack in the labor market diminished. In addition, a couple of participants remarked that the preliminary benchmark revision released in August by the Bureau of Labor Statistics had indicated that payroll employment gains would likely show less momentum coming into this year once those revisions are incorporated in published data early next year. A couple of other participants thought it was important to better understand the quality of jobs being created. Business contacts in many Districts indicated continued strong labor demand, with firms reporting difficulties in finding qualified workers or broadening their recruiting to include traditionally marginalized groups. A number of participants noted that wage pressures were evident for some industries in their Districts, and a couple of participants commented that firms were responding to those pressures in a variety of ways, including investing in technology that could serve as a substitute for labor.

In their discussion of inflation developments, participants noted that recent readings on overall and core PCE inflation, measured on a 12-month change basis, had continued to run below 2 percent. Survey-based measures of longer-term inflation expectations were little changed, and market-based measures of inflation compensation remained low. A few participants commented on factors that may temporarily exert upward pressure on some measures of inflation in the coming months. Assessing all these factors, participants generally expected that inflation would return to the 2 percent objective as the economic expansion continued and resource utilization remained high. However, weakness abroad and subdued global inflation pressures were cited as sources of risk to this assessment. Participants who expressed less confidence that inflation would return promptly to the 2 percent objective commented that inflation had averaged less than 2 percent over the past several years even as resource utilization had increased or that global or technology-related factors were exerting downward pressure on inflation that could be difficult to overcome.

Participants also discussed risks regarding the outlook for economic activity. While many saw the risks as tilted somewhat to the downside, some risks were seen to have eased over recent months. In particular, there were some tentative signs that trade tensions with China were easing, and the probability of a no-deal Brexit was judged to have lessened further. In addition, there were indications that the prospects for global economic growth may be stabilizing. A number of participants observed that the domestic economy was showing resilience in the face of headwinds from global developments. Moreover, statistical models designed to gauge the probability of recession using financial market data, including those based on information from the Treasury yield curve, suggested that the likelihood of a recession occurring over the medium term had fallen noticeably in recent months. However, new uncertainties had emerged regarding trade policy with Argentina, Brazil, and France, and political tensions in Hong Kong persisted.

…A number of participants agreed that maintaining the current stance of monetary policy would give the Committee some time to assess the full effects on the economy of its policy decisions and communications over the course of this year along with other information bearing on the economic outlook. Participants also discussed how maintaining the current stance of policy for a time could be helpful for cushioning the economy from the global developments that have been weighing on economic activity and for returning inflation to the Committee's symmetric objective of 2 percent. Participants generally expressed concerns regarding inflation continuing to fall short of 2 percent. Although a number of participants noted that some of the factors currently holding down inflation were likely to prove transitory, various participants were concerned that indicators were suggesting that the level of longer-term inflation expectations was too low.

A few participants raised the concern that keeping interest rates low over a long period might encourage excessive risk-taking, which could exacerbate imbalances in the financial sector. These participants offered various perspectives on the relationship between financial stability and policies that keep interest rates persistently low. They remarked that such policies could be inconsistent with sustaining maximum employment, could make the next recession more severe than otherwise, or could strengthen the case for the active use of macroprudential tools to guard against emerging imbalances.

…With regard to the postmeeting statement, members agreed to state that they judged that "the current stance of monetary policy is appropriate" to support the achievement of the Committee's policy objectives. Members discussed their options regarding references to global developments and muted inflation pressures in the statement. In their judgment, these factors, cited in previous postmeeting statements as part of the rationale for adjusting the stance of policy, remained salient features of the outlook. Accordingly, they agreed to cite them in the sentence indicating that "the Committee will continue to monitor the implications of incoming information for the economic outlook." With the retention of these references to global developments and muted inflation pressures, members agreed that the text on uncertainties about the outlook could be removed. A few members suggested that the language stating that monetary policy would support inflation "near" 2 percent could be misinterpreted as suggesting that policymakers were comfortable with inflation running below that level; they preferred language that referred to returning inflation to the Committee's symmetric 2 percent objective. Other members thought that the reference to "near" 2 percent was intended to encompass modest deviations of inflation above and below 2 percent.

Source: Federal Reserve Board