Trend Macro

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Data Insights: FOMC Minutes

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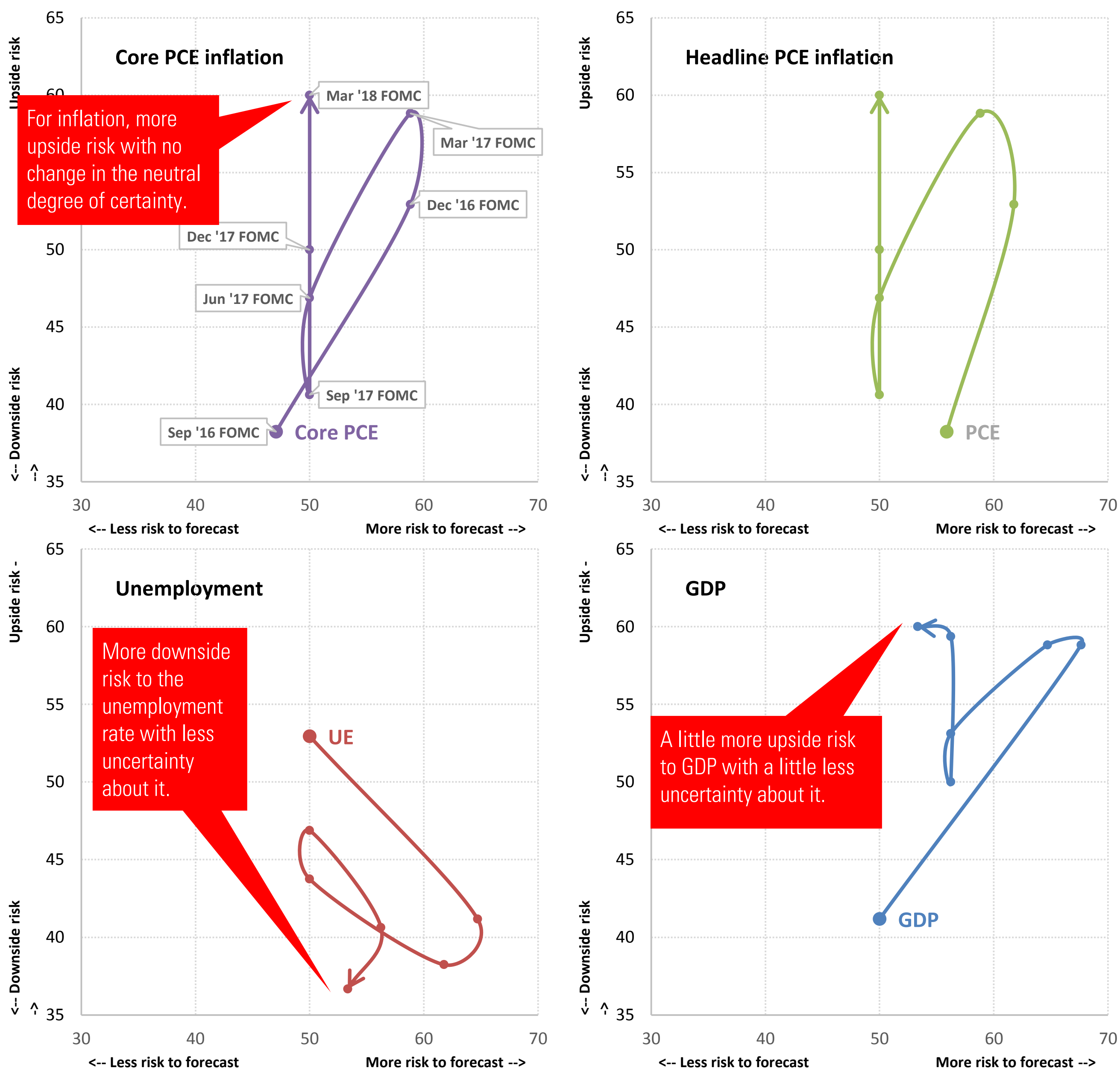
Evolving "uncertainty"

Diffusion indices of forecast risks in Summary of Economic Projections
From ● September 16 FOMC to → December 17 FOMC



Source: FOMC, TrendMacro calculations

March minutes: key signaling language

…meeting participants agreed that information received since the FOMC met in January indicated that economic activity had been rising at a moderate rate and that the labor market had continued to strengthen. Job gains had been strong in recent months, and the unemployment rate had stayed low. On a 12-month basis, both overall inflation and inflation for items other than food and energy continued to run below 2 percent. Market-based measures of inflation compensation had increased in recent months but remained low...

Participants noted incoming data suggesting some slowing in the rate of growth of household spending and business fixed investment after strong fourth-quarter readings. However, they expected that the first-quarter softness would be transitory, pointing to a variety of factors, including delayed payment of some personal tax refunds, residual seasonality in the data, and more generally to strong economic fundamentals.

…Participants expected that, with further gradual increases in the federal funds rate, economic activity would expand at a solid rate during the remainder of this year and a moderate pace in the medium term, and that labor market conditions would remain strong. Inflation on a 12-month basis was expected to move up in coming months and to stabilize around the Committee's 2 percent objective over the medium term. Several participants noted that the 12-month PCE price inflation rate would likely shift upward when the March data are released because the effects of the outsized decline in the prices of cell phone service plans in March of last year will drop out of that calculation. Near-term risks to the economic outlook appeared to be roughly balanced, but participants agreed that it would be important to continue to monitor inflation developments closely.

Many participants reported considerable optimism among the business contacts in their Districts, consistent with a firming in business expenditures. ...

A number of participants reported concern among their business contacts about the possible ramifications of the recent imposition of tariffs on imported steel and aluminum. Participants did not see the steel and aluminum tariffs, by themselves, as likely to have a significant effect on the national economic outlook, but a strong majority of participants viewed the prospect of retaliatory trade actions by other countries, as well as other issues and uncertainties associated with trade policies, as downside risks for the U.S. economy. Contacts in the agricultural sector reported feeling particularly vulnerable to retaliation.

Tax changes enacted late last year and the recent federal budget agreement, taken together, were expected to provide a significant boost to output over the next few years. However, participants generally regarded the magnitude and timing of the economic effects of the fiscal policy changes as uncertain, partly because there have been few historical examples of expansionary fiscal policy being implemented when the economy was operating at a high level of resource utilization. A number of participants also suggested that uncertainty about whether all elements of the tax cuts would be made permanent, or about the implications of higher budget deficits for fiscal sustainability and real interest rates, represented sources of downside risk to the economic outlook. A few participants noted that the changes in tax policy could boost the level of potential output.

…Most participants described labor market conditions as strong, noting that payroll gains had remained well above the pace regarded as consistent with absorbing new labor force entrants over time, the unemployment rate had stayed low, job openings had been high, or that initial claims for unemployment insurance benefits had been low. Many participants observed that the labor force participation rate had been higher recently than they had expected, helping to keep the unemployment rate flat over the past few months despite strong payroll gains. The firmness in the overall participation rate--relative to its demographically driven downward trend--and the rising participation rate of prime-age adults were regarded as signs of continued strengthening in labor market conditions. A few participants thought that these favorable developments could continue for a time, whereas others expressed doubts. A few participants warned against inferring too much from comparisons of the current low level of the unemployment rate with historical benchmarks, arguing that the much higher levels of education of today's workforce--and the lower average unemployment rate of more highly educated workers than less educated workers--suggested that the U.S. economy might be able to sustain lower unemployment rates than was the case in the 1950s or 1960s.

…In some Districts, reports from business contacts or evidence from surveys pointed to a pickup in wages, particularly for unskilled or entry-level workers. However, business contacts or national surveys led a few participants to conclude that some businesses facing labor shortages were changing job requirements so that they matched more closely the skills of available workers, increasing training, or offering more flexible work arrangements, rather than increasing wages in a broad-based fashion. Regarding wage growth at the national level, several participants noted a modest increase, but most still described the pace of wage gains as moderate; a few participants cited this fact as suggesting that there was room for the labor market to strengthen somewhat further.

… Many participants stated that recent readings from indicators on inflation and inflation expectations increased their confidence that inflation would rise to the Committee's 2 percent objective in coming months and then stabilize around that level; others suggested that downside risks to inflation were subsiding. In contrast, a few participants cautioned that, despite increases in market-based measures of inflation compensation in recent months and the stabilization of some survey measures of inflation expectations, the levels of these indicators remained too low to be consistent with the Committee's 2 percent inflation objective.

In their discussion of developments in financial markets, some participants observed that financial conditions remained accommodative despite the rise in market volatility and repricing of assets that had occurred in February. Many participants reported that their contacts had taken the previous month's turbulence in stride, although a few participants suggested that financial developments over the intermeeting period highlighted some downside risks associated with still-high valuations for equities or from market volatility more generally. A few participants expressed concern that a lengthy period in which the economy operates beyond potential and financial conditions remain highly accommodative could, over time, pose risks to financial stability.

…all participants expected inflation on a 12-month basis to move up in coming months. This expectation partly reflected the arithmetic effect of the soft readings on inflation in early 2017 dropping out of the calculation; it was noted that the increase in the inflation rate arising from this source was widely expected and, by itself, would not justify a change in the projected path for the federal funds rate. Most participants commented that the stronger economic outlook and the somewhat higher inflation readings in recent months had increased the likelihood of progress toward the Committee's 2 percent inflation objective. A few participants suggested that a modest inflation overshoot might help push up longer-term inflation expectations and anchor them at a level consistent with the Committee's 2 percent inflation objective. A number of participants offered their views on the potential benefits and costs associated with an economy operating well above potential for a prolonged period while inflation remained low. On the one hand, the associated tightness in the labor market might help speed the return of inflation to the Committee's 2 percent goal and induce a further increase in labor force participation; on the other hand, an overheated economy could result in significant inflation pressures or lead to financial instability.

...With regard to the medium-term outlook for monetary policy, all participants saw some further firming of the stance of monetary policy as likely to be warranted. Almost all participants agreed that it remained appropriate to follow a gradual approach to raising the target range for the federal funds rate. Several participants commented that this gradual approach was most likely to be conducive to maintaining strong labor market conditions and returning inflation to 2 percent on a sustained basis without resulting in conditions that would eventually require an abrupt policy tightening. A number of participants indicated that the stronger outlook for economic activity, along with their increased confidence that inflation would return to 2 percent over the medium term, implied that the appropriate path for the federal funds rate over the next few years would likely be slightly steeper than they had previously expected. Participants agreed that the longer-run normal federal funds rate was likely lower than in the past, in part because of secular forces that had put downward pressure on real interest rates. Several participants expressed the judgment that it would likely become appropriate at some point for the Committee to set the federal funds rate above its longer-run normal value for a time. Some participants suggested that, at some point, it might become necessary to revise statement language to acknowledge that, in pursuit of the Committee's statutory mandate and consistent with the median of participants' policy rate projections in the SEP, monetary policy eventually would likely gradually move from an accommodative stance to being a neutral or restraining factor for economic activity. However, participants expressed a range of views on the amount of policy tightening that would likely be required over the medium term to achieve the Committee's goals. Participants agreed that the actual path of the federal funds rate would depend on the economic outlook as informed by incoming data.

Source: Federal Reserve Board