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Data Insights: FOMC Minutes

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May minutes: key signaling language

… Market participants pointed to a range of factors contributing to the decline in stock prices, including concerns about the outlook for trade policy both in the United States and abroad, the potential for increased regulatory oversight of U.S. technology companies, and incoming data suggesting some moderation in global economic growth. The rise in nominal U.S. Treasury yields was associated with an increase in inflation compensation that, in turn, seemed to reflect a firming in inflation data as well as a notable rise in crude oil prices. Judging from federal funds futures quotes, the expected path of the federal funds rate changed relatively little over the intermeeting period. While term LIBOR (London interbank offered rates) had widened relative to comparable-maturity OIS (overnight index swap) rates in recent months, the cost of dollar funding through the foreign exchange swap market had not risen to the same degree…

… participants generally agreed that it could become appropriate to make a small technical adjustment in the Federal Reserve's approach to implementing monetary policy by setting the IOER rate modestly below the top of the target range for the federal funds rate. Such an adjustment would be consistent with the Committee's statement in the Policy Normalization Principles and Plans that it would be prepared to adjust the details of the approach to policy implementation during the period of normalization in light of economic and financial developments. Many participants judged that it would be useful to make such a technical adjustment sooner rather than later. Participants generally agreed that it would be desirable to make that adjustment at a time when the FOMC decided to increase the target range for the federal funds rate; that timing would simplify FOMC communications and emphasize that the IOER rate is a helpful tool for implementing the FOMC's policy decisions but does not, in itself, convey the stance of policy. While additional technical adjustments in the IOER rate could become necessary over time, these were not expected to be frequent. A number of participants also suggested that, before too long, the Committee might want to further discuss how it can implement monetary policy most effectively and efficiently when the quantity of reserve balances reaches a level appreciably below that seen in recent years.

…The staff projection for U.S. economic activity prepared for the May FOMC meeting continued to suggest that the economy was expanding at an above-trend pace. Real GDP growth, which slowed in the first quarter, was expected to pick up in the second quarter and to outpace potential output growth through 2020. The unemployment rate was projected to decline further over the next few years and to continue to run below the staff's estimate of its longer-run natural rate over this period…

The staff projected that total PCE inflation would be near the Committee's 2 percent objective over the next several years. Total PCE inflation was expected to run slightly below core inflation in 2019 and 2020 because of a projected decline in energy prices.

…In their discussion of the economic situation and the outlook, meeting participants agreed that information received since the FOMC met in March indicated that the labor market had continued to strengthen and that economic activity had been rising at a moderate rate. Job gains had been strong, on average, in recent months, and the unemployment rate had stayed low. Recent data suggested that growth of household spending had moderated from its strong fourth-quarter pace, while business fixed investment had continued to grow strongly. On a 12-month basis, both overall inflation and inflation for items other than food and energy had moved close to 2 percent. Market-based measures of inflation compensation remained low; survey-based measures of longer-term inflation expectations were little changed, on balance.

Participants viewed recent readings on spending, employment, and inflation as suggesting little change, on balance, in their assessments of the economic outlook. Real GDP growth slowed somewhat less in the first quarter than anticipated at the time of the March meeting, and participants expected that the moderation in the growth of consumer spending early in the year would prove temporary. They noted a number of economic fundamentals were currently supporting continued above-trend economic growth; these included a strong labor market, federal tax and spending policies, high levels of household and business confidence, favorable financial conditions, and strong economic growth abroad. Participants generally expected that further gradual increases in the target range for the federal funds rate would be consistent with solid expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Participants generally viewed the risks to the economic outlook to be roughly balanced.

…Participants generally reported that their business contacts were optimistic about the economic outlook. However, in a number of Districts, contacts expressed concern about the possible adverse effects of tariffs and trade restrictions, including the potential for postponing or pulling back on capital spending. Labor markets were generally strong, and contacts in a number of Districts reported shortages of workers in specific industries or occupations. In some cases, labor shortages were contributing to upward pressure on wages. In many Districts, business contacts experienced rising costs of nonlabor inputs, particularly trucking, rail, and shipping rates and prices of steel, aluminum, lumber, and petroleum-based commodities. Reports on the ability of firms to pass through higher costs to customers varied across Districts. Activity in the energy sector remained strong, and crude oil production was expected to continue to expand in response to rising global demand. In contrast, in agricultural areas, low crop prices continued to weigh on farm income. It was noted that the potential for higher Chinese tariffs on key agricultural products could, in the longer run, hurt U.S. competitiveness.

…Many participants commented that overall wage pressures were still moderate or were strong only in industries and occupations experiencing very tight labor supply; several of them noted that recent wage developments provided little evidence of general overheating in the labor market. With economic growth anticipated to remain above trend, participants generally expected the unemployment rate to remain below, or to decline further below, their estimates of its longer-run normal rate. Several participants also saw scope for a strong labor market to continue to draw individuals into the workforce. However, a few others questioned whether tight labor markets would have a lasting positive effect on labor force participation.

The 12-month changes in overall and core PCE prices moved up in March, to 2 percent and 1.9 percent, respectively. Most participants viewed the recent firming in inflation as providing some reassurance that inflation was on a trajectory to achieve the Committee's symmetric 2 percent objective on a sustained basis. In particular, the recent readings appeared to support the view that the downside surprises last year were largely transitory. Some participants noted that inflation was likely to modestly overshoot 2 percent for a time. However, several participants suggested that the underlying trend in inflation had changed little, noting that some of the recent increase in inflation may have represented transitory price changes in some categories of health care and financial services, or that various measures of underlying inflation, such as the 12-month trimmed mean PCE inflation rate from the Federal Reserve Bank of Dallas, remained relatively stable at levels below 2 percent. In discussing the outlook for inflation, many participants emphasized that, after an extended period of low inflation, the Committee's longer-run policy objective was to return inflation to its symmetric 2 percent goal on a sustained basis. Many saw tight resource utilization, the pickup in wage increases and nonlabor input costs, and stable inflation expectations as supporting their projections that inflation would remain near 2 percent over the medium term. But a few cautioned that, although market-based measures of inflation compensation had moved up over recent months, in their view these measures, as well as some survey-based measures, remained at levels somewhat below those that would be consistent with an expectation of sustained 2 percent inflation as measured by the PCE price index.

… With regard to trade policies, a number of participants viewed the range of possible outcomes for economic activity and inflation to be particularly wide, depending on what actions were taken by the United States and how U.S trading partners responded. And some participants observed that while these policies were being debated and negotiations continued, the uncertainty surrounding trade issues could damp business sentiment and spending. In their discussion of the outlook for inflation, a few participants also noted the risk that, if global oil prices remained high or moved higher, U.S. inflation would be boosted by the direct effects and pass-through of higher energy costs.

… a couple of participants noted that after the bout of financial market volatility in early February, the use of investment strategies predicated on a low-volatility environment may have become less prevalent, and that some investors may have become more cautious. However, asset valuations across a range of markets and leverage in the nonfinancial corporate sector remained elevated relative to historical norms, leaving some borrowers vulnerable to unexpected negative shocks. With regard to the ability of the financial system to absorb such shocks, several participants commented that regulatory reforms since the crisis had contributed to appreciably stronger capital and liquidity positions in the financial sector. In this context, a few participants emphasized the need to build additional resilience in the financial sector at this point in the economic expansion.

…All participants expressed the view that it would be appropriate for the Committee to leave the target range for the federal funds rate unchanged at the May meeting. Participants concurred that information received during the intermeeting period had not materially altered their assessment of the outlook for the economy. Participants commented that above-trend growth in real GDP in recent quarters, together with somewhat higher recent inflation readings, had increased their confidence that inflation on a 12-month basis would continue to run near the Committee's longer-run 2 percent symmetric objective. That said, it was noted that it was premature to conclude that inflation would remain at levels around 2 percent, especially after several years in which inflation had persistently run below the Committee's 2 percent objective. In light of subdued inflation over recent years, a few participants observed that adjustments in the stance of policy should take account of the possibility that longer-term inflation expectations have drifted a bit below levels consistent with the Committee's 2 percent inflation objective. Most participants judged that if incoming information broadly confirmed their current economic outlook, it would likely soon be appropriate for the Committee to take another step in removing policy accommodation. Overall, participants agreed that the current stance of monetary policy remained accommodative, supporting strong labor market conditions and a return to 2 percent inflation on a sustained basis.

With regard to the medium-term outlook for monetary policy, all participants reaffirmed that adjustments to the path for the policy rate would depend on their assessments of the evolution of the economic outlook and risks to the outlook relative to the Committee's statutory objectives. Participants generally agreed with the assessment that continuing to raise the target range for the federal funds rate gradually would likely be appropriate if the economy evolves about as expected. These participants commented that this gradual approach was most likely to be conducive to maintaining strong labor market conditions and achieving the symmetric 2 percent inflation objective on a sustained basis without resulting in conditions that would eventually require an abrupt policy tightening. A few participants commented that recent news on inflation, against a background of continued prospects for a solid pace of economic growth, supported the view that inflation on a 12-month basis would likely move slightly above the Committee's 2 percent objective for a time. It was also noted that a temporary period of inflation modestly above 2 percent would be consistent with the Committee's symmetric inflation objective and could be helpful in anchoring longer-run inflation expectations at a level consistent with that objective.

Meeting participants also discussed the recent flatter profile of the term structure of interest rates. Participants pointed to a number of factors contributing to the flattening of the yield curve, including the expected gradual rise of the federal funds rate, the downward pressure on term premiums from the Federal Reserve's still-large balance sheet as well as asset purchase programs by other central banks, and a reduction in investors' estimates of the longer-run neutral real interest rate. A few participants noted that such factors could make the slope of the yield curve a less reliable signal of future economic activity. However, several participants thought that it would be important to continue to monitor the slope of the yield curve, emphasizing the historical regularity that an inverted yield curve has indicated an increased risk of recession.

Participants commented on how the Committee's communications in its postmeeting statement might need to be revised in coming meetings if the economy evolved broadly as expected. A few participants noted that if increases in the target range for the federal funds rate continued, the federal funds rate could be at or above their estimates of its longer-run normal level before too long. In addition, a few observed that the neutral level of the federal funds rate might currently be lower than their estimates of its longer-run level. In light of this, some participants noted it might soon be appropriate to revise the forward-guidance language in the statement indicating that the "federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run" or to modify the language stating that "the stance of monetary policy remains accommodative." Participants expressed a range of views on the amount of further policy firming that would likely be required over the medium term to achieve the Committee's goals. Participants indicated that the Committee, in making policy decisions over the next few years, should conduct policy with the aim of keeping inflation near its longer-run symmetric objective while sustaining the economic expansion and a strong labor market. Participants agreed that the actual path of the federal funds rate would depend on the economic outlook as informed by incoming information.

Source: Federal Reserve Board