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Data Insights: FOMC Minutes

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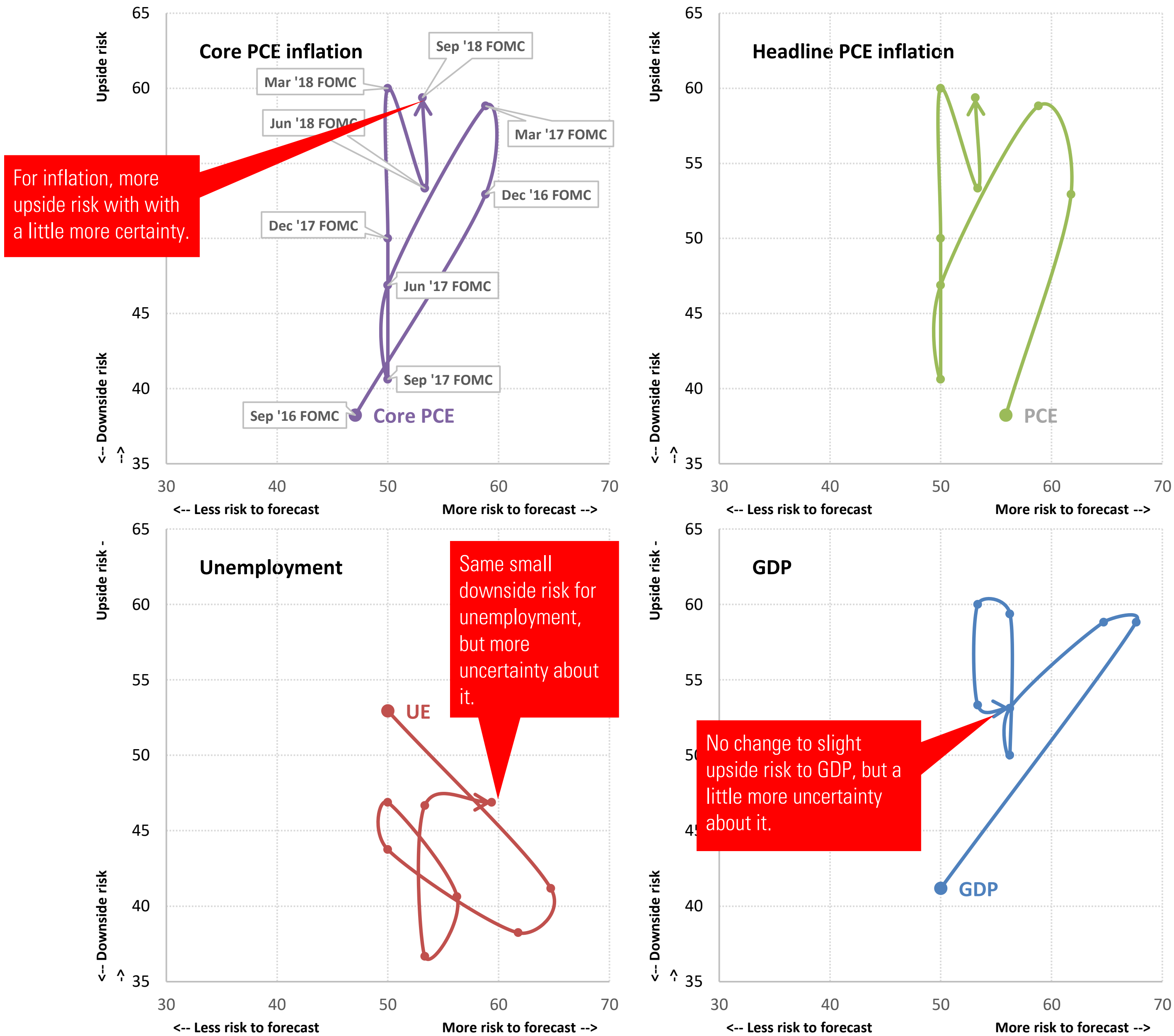
Evolving "uncertainty"   Diffusion indices of forecast risks in Summary of Economic Projections

From ● September 2016 FOMC to → September 2018 FOMC



Source: FOMC, TrendMacro calculations

September minutes: key signaling language

…Meeting participants noted that a number of communities suffered devastating losses associated with Hurricane Florence. Despite the magnitude of the storm-related destruction, participants expected the imprint on the level of overall economic activity at the national level to be relatively modest, consistent with the experience following several previous major storms.

Based on recent readings on spending, employment, and inflation, almost all participants saw little change in their assessment of the economic outlook, although a few of them judged that recent data pointed to a pace of economic activity that was stronger than they had expected earlier this year. Participants noted a number of favorable economic factors that were supporting above-trend GDP growth; these included strong labor market conditions, stimulative federal tax and spending policies, accommodative financial conditions, solid household balance sheets, and continued high levels of household and business confidence. A number of participants observed that the stimulative effects of the changes in fiscal policy would likely diminish over the next several years. A couple of participants commented that recent strong growth in GDP may also be due in part to increases in the growth rate of the economy's productive capacity.

… Several participants noted that the household saving rate had been revised up significantly in the most recent estimates published by the Bureau of Economic Activity. A few of those participants remarked that the upward revision in the saving rate could be viewed as evidence of the strength of the financial position of the household sector and could be a factor that would further support solid expansion of consumption spending. However, a couple of participants noted that the higher saving rate may not be a precursor to higher future consumption growth. For example, the higher saving rate may indicate some greater caution on the part of consumers, greater inequality of income and wealth--which would imply a lower aggregate propensity to spend--or changing consumer behavior in a low interest rate environment. With regard to residential investment, a few participants noted weak residential construction activity at the national or District level, which was attributed in part to higher interest rates or supply constraints.

Participants noted that business fixed investment had grown strongly so far this year. A few commented that recent changes in federal tax policy had likely bolstered investment spending. Contacts in most sectors remained optimistic about their business prospects, and surveys of manufacturing activity were broadly favorable. Despite this optimism, a number of contacts cited factors that were causing them to forego production or investment opportunities in some cases, including labor shortages and uncertainty regarding trade policy. In particular, tariffs on aluminum and steel were cited as reducing new investment in the energy sector. Contacts also suggested that firms were attempting to diversify the set of countries with which they trade--both imports and exports--as a result of uncertainty over tariff policy. Contacts in the agricultural industry reported that tariffs imposed by China had resulted in lower crop prices, further depressing incomes in that sector, although a new federal program was expected to offset some income losses.

In their discussion of labor markets, participants generally agreed that conditions continued to strengthen. Contacts in many Districts reported tight labor markets, with difficulty finding qualified workers. In some cases, firms were coping with labor shortages by increasing salaries, benefits, or workplace amenities in order to attract and retain workers. Other business contacts facing labor shortages were responding by increasing training for less-qualified workers. For the economy overall, participants generally agreed that, on balance, recent data suggested some acceleration in labor costs, but that wage growth remained moderate by historical standards, which was due in part to tepid productivity growth.

Regarding inflation, participants noted that on a 12-month basis, both overall inflation and inflation for items other than food and energy remained near 2 percent. Indicators of longer-term inflation expectations were little changed on balance. In general, participants viewed recent consumer price developments as consistent with their expectation that inflation was on a trajectory to achieve the Committee's symmetric 2 percent objective on a sustained basis. Several participants commented that inflation may modestly exceed 2 percent for a period of time. Reports from business contacts and surveys in a number of Districts also indicated some firming in inflationary pressures. In particular, some contacts indicated that input prices had been bolstered by strong demand or import tariffs. Moreover, several participants reported that firms in their Districts that were facing higher input prices because of tariffs perceived that they had an increased ability to raise the prices of their products. A couple of participants emphasized that because inflation had run below the Committee's 2 percent objective for the past several years, some measures of trend inflation or longer-term inflation expectations were below levels consistent with the 2 percent objective; these participants judged that a modest increase in inflation expectations would be important for achieving the inflation objective on a sustained basis.

... Some participants commented that trade policy developments remained a source of uncertainty for the outlook for domestic growth and inflation. The divergence between domestic and foreign economic growth prospects and monetary policies was cited as presenting a downside risk because of the potential for further strengthening of the U.S. dollar; some participants noted that financial stresses in a few EMEs could pose additional risks if they were to spread more broadly through the global economy and financial markets. With regard to upside risks, participants variously noted that high consumer confidence, accommodative financial conditions, or greater-than- expected effects of fiscal stimulus could lead to stronger-than-expected economic outcomes. Tightening resource utilization and an increasing ability of firms to raise output prices were cited as factors that could lead to higher-than-expected inflation, while lower-than-expected growth, a strengthening of the U.S. dollar, or inflation expectations persistently running below 2 percent were mentioned as risks that could lead to lower inflation.

A few participants offered perspectives on the term structure of interest rates and what a potential inversion of the yield curve might signal about economic prospects in light of the historical regularity that an inverted yield curve has often preceded the onset of recessions in the United States. On the one hand, an inverted yield curve could indicate an increased risk of recession; on the other hand, the low level of term premiums in recent years--reflecting, in part, central bank asset purchases--could temper the reliability of the slope of the yield curve as an indicator of future economic activity. In addition, the recent rise and possible further increases in longer-term interest rates might diminish the likelihood that the yield curve would invert in the near term.

. . . Almost all considered that it was also appropriate to revise the Committee's postmeeting statement in order to remove the language stating that "the stance of monetary policy remains accommodative." Participants discussed a number of reasons for removing the language at this time, noting that the Committee would not be signaling a change in the expected path for policy, particularly as the target range for the federal funds rate announced after the Committee's meeting would still be below all of the estimates of its longer-run level submitted in the September SEP. In addition, waiting until the target range for the federal funds rate had been increased further to remove the characterization of the policy stance as "accommodative" could convey a false sense of precision in light of the considerable uncertainty surrounding all estimates of the neutral federal funds rate.

…Participants offered their views about how much additional policy firming would likely be required for the Committee to sustainably achieve its objectives of maximum employment and 2 percent inflation. A few participants expected that policy would need to become modestly restrictive for a time and a number judged that it would be necessary to temporarily raise the federal funds rate above their assessments of its longer-run level in order to reduce the risk of a sustained overshooting of the Committee's 2 percent inflation objective or the risk posed by significant financial imbalances. A couple of participants indicated that they would not favor adopting a restrictive policy stance in the absence of clear signs of an overheating economy and rising inflation.

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. Many of them noted that future adjustments to the target range for the federal funds rate will depend on the evaluation of incoming information and its implications for the economic outlook. In this context, estimates of the level of the neutral federal funds rate would be only one among many factors that the Committee would consider in making its policy decisions.

Building on comments expressed at previous meetings, a couple of participants indicated that it would be desirable to assess the Committee's strategic approach to the conduct of policy and to hold a periodic and systematic review of the strengths and weaknesses of the Committee's monetary policy framework.

Source: Federal Reserve Board