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

Data Insights: FOMC Minutes

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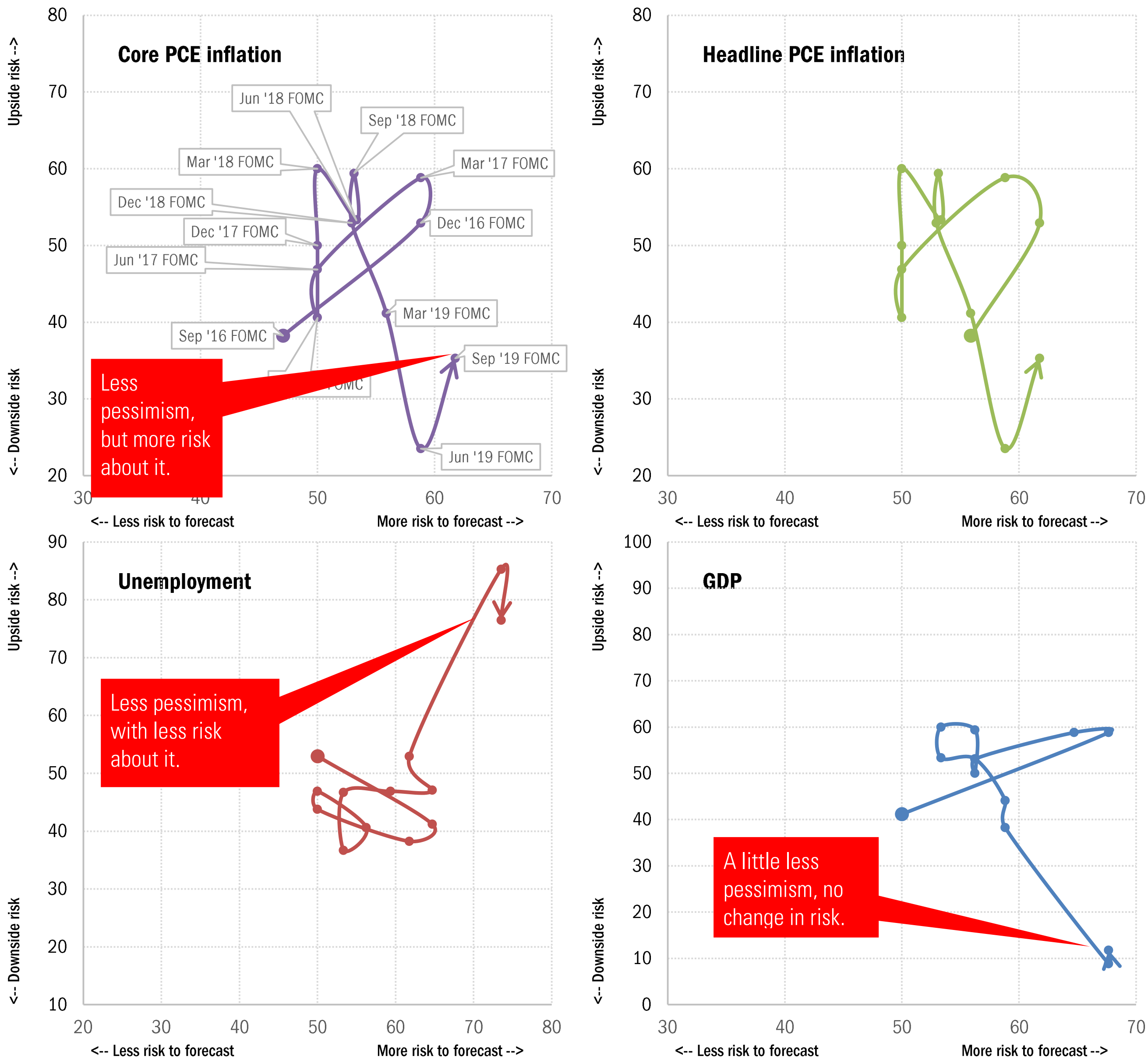
Evolving "uncertainty" Diffusion indices of forecast risks in Summary of Economic Projections

From ● September 2016 FOMC to → September 2019 FOMC



Source: FOMC, TrendMacro calculations

Committee participants continued their discussions related to the ongoing review of the Federal Reserve's monetary policy strategy, tools, and communication practices. …Participants generally agreed with the staff's analysis that the risk of future ELB episodes had likely increased over time, and that future ELB episodes and the reduced effect of resource utilization on inflation could inhibit the Committee's ability to achieve its employment and inflation objectives. The increased ELB risk was attributed in part to structural changes in the U.S. economy that had lowered the longer-run real short-term interest rate and thus the neutral level of the policy rate. In this context, a couple of participants noted that uncertainty about the neutral rate made it especially challenging to determine any appropriate changes to the current framework. In light of a low neutral rate and shortfalls of inflation below the 2 percent objective for several years, some participants raised the concern that the policy space to reduce the federal funds rate in response to future recessions could be compressed further if inflation shortfalls continued and led to a decline in inflation expectations, a risk that was also discussed in the staff analysis. These participants pointed to long, ongoing ELB spells in other major foreign economies and suggested that, to avoid similar circumstances in the United States, it was important to be aggressive when confronted with forces holding inflation below objective. A couple of participants judged that the lack of monetary policy space abroad and the possibility that fiscal space in the United States might be limited reinforced the case for strengthening the FOMC's monetary policy framework as a matter of prudent planning.

With regard to the current monetary policy framework, participants agreed that this framework served the Committee well in the aftermath of the financial crisis. A number of participants noted that the Committee's experience with forward guidance and balance sheet policies would likely allow the Committee to deploy these tools earlier and more aggressively in the event that they were needed. A few indicated that the uncertainty about the effectiveness of these policies was smaller than the uncertainty surrounding the effectiveness of a makeup strategy.

Participants generally agreed that the current framework also served the Committee well by providing a strong commitment to achieving the Committee's maximum-employment and symmetric inflation objectives. Such a commitment was seen as flexible enough to allow the Committee to choose policy actions that best support its objectives in a wide array of economic circumstances. Because of the downside risk to inflation and employment associated with the ELB, most participants were open to the possibility that the dual-mandate objectives of maximum employment and stable prices could be best served by strategies that deliver inflation rates that over time are, on average, equal to the Committee's longer-run objective of 2 percent. Promoting such outcomes may require aiming for inflation somewhat above 2 percent when the policy rate was away from the ELB, recognizing that inflation would tend to be lower than 2 percent when the policy rate was constrained by the ELB. Participants suggested several alternatives for doing so, including strategies that make up for past inflation shortfalls and those that respond more aggressively to below-target inflation than to above-target inflation. In this context, several participants suggested that the adoption of a target range for inflation could be helpful in achieving the Committee's objective of 2 percent inflation, on average, as it could help communicate to the public that periods in which the Committee judged inflation to be moderately away from its 2 percent objective were appropriate. A couple of participants suggested analyzing policies in which there was a target range for inflation whose midpoint was modestly higher than 2 percent or in which 2 percent was an inflation floor; these policies might enhance policymakers' scope to provide accommodation as appropriate when the neutral real interest rate was low.

Although ensuring inflation outcomes averaging 2 percent over time was seen as important, many participants noted that the illustrated makeup strategies delivered only modest benefits in the staff's model simulations. These modest benefits in part reflected that the responsiveness of inflation to resource slack had diminished, making it more difficult to provide sufficient accommodation to push inflation back to the Committee's objective in a timely manner…

Participants generally viewed the baseline economic outlook as positive and indicated that their views of the most likely outcomes for economic activity and inflation had changed little since the July meeting. However, for most participants, that economic outlook was premised on a somewhat more accommodative path for policy than in July. Participants generally had become more concerned about risks associated with trade tensions and adverse developments in the geopolitical and global economic spheres. In addition, inflation pressures continued to be muted. Many participants expected that real GDP growth would moderate to around its potential rate in the second half of the year. Participants agreed that consumer spending was increasing at a strong pace. They also expected that, in the period ahead, household spending would likely remain on a firm footing, supported by strong labor market conditions, rising incomes, and accommodative financial conditions. Several participants indicated that the housing sector was starting to rebound, stimulated by a significant decline in mortgage rates. With regard to the contrast between robust consumption growth and weak investment growth, several participants mentioned that uncertainties in the business outlook and sustained weak investment could eventually lead to slower hiring, which, in turn, could damp the growth of income and consumption.

In their discussion of the business sector, participants saw trade tensions and concerns about the global outlook as the main factors weighing on business investment, exports, and manufacturing production. Participants judged that trade uncertainty and global developments would continue to affect firms' investment spending, and that this uncertainty was discouraging them from investing in their businesses. A couple of participants noted that businesses had the capacity to adjust to ongoing uncertainty concerning trade, and some firms were reconfiguring supply chains and making logistical arrangements as part of contingency planning to mitigate the effects of trade tensions on their businesses.

Participants discussed developments in the manufacturing and the agricultural sectors of the U.S. economy. Manufacturing production remained lower than at the beginning of the year, and recent indicators suggested that conditions were unlikely to improve materially over the near term. Participants saw the ongoing global slowdown and trade uncertainty as contributing importantly to these declines. A few participants noted ongoing challenges in the agricultural sector, including those associated with tariffs, weak export demand, and more intense financial burdens arising from the increase in carryover debt in preceding years. Participants commented on the potential disruption to global oil production arising from the attack on Saudi Arabia's facilities.

…reports from business contacts in many Districts pointed to continued strong labor demand, with some firms still reporting difficulties finding qualified workers and others broadening their recruiting to include traditionally marginalized groups. In some Districts, employers were also expanding training and provision of nonwage benefits, which could help sustain their expansion of hiring against a background of a very tight national labor market without spurring above-trend aggregate wage growth. Some firms were also reluctant to raise wages because of their limited pricing power, while others thought the wages they were offering were in line with the skill sets of the workers available to fill new positions. Participants generally viewed overall wage growth as broadly consistent with modest average rates of labor productivity growth in recent years and as exerting little upward pressure on inflation. A couple of participants noted that, with inflationary pressures remaining muted and wage growth moderate even as employment and spending expanded further, they had again adjusted downward their estimates of the longer-run normal unemployment rate.

In their discussion of inflation developments, participants noted that, despite a recent firming in the incoming data, readings on overall and core PCE inflation had continued to run below the Committee's symmetric 2 percent objective. Furthermore, in light of weakness in the global economy, perceptions of downside risks to growth, and subdued inflation pressures, some participants continued to view the risks to the outlook for inflation as weighted to the downside. Some participants, however, saw the recent inflation data as consistent with their previous assessment that much of the weakness seen early in the year was transitory. In this connection, several participants noted that recent monthly readings, notably for CPI inflation, seemed broadly consistent with the Committee's longer-run inflation objective of 2 percent, while the trimmed mean measure of PCE inflation, constructed by the Federal Reserve Bank of Dallas, remained at 2 percent in July.

…Participants generally judged that downside risks to the outlook for economic activity had increased somewhat since their July meeting, particularly those stemming from trade policy uncertainty and conditions abroad. In addition, although readings on the labor market and the overall economy continued to be strong, a clearer picture of protracted weakness in investment spending, manufacturing production, and exports had emerged. Participants also noted that there continued to be a significant probability of a no-deal Brexit, and that geopolitical tensions had increased in Hong Kong and the Middle East. Several participants commented that, in the wake of this increase in downside risk, the weakness in business spending, manufacturing, and exports could give rise to slower hiring, a development that would likely weigh on consumption and the overall economic outlook. Several participants noted that statistical models designed to gauge the probability of recession, including those based on information from the yield curve, suggested that the likelihood of a recession occurring over the medium term had increased notably in recent months. However, a couple of these participants stressed the difficulty of extracting the right signal from these probability models, especially in the current period of unusually low levels of term premiums.

With regard to developments in financial markets, participants noted that longer-term U.S. Treasury rates had been volatile over the intermeeting period but, on net, had registered a sizable decline. Participants observed that a key source of downward pressure on Treasury rates arose from flight-to-safety flows, driven by downside risks to global growth, escalating trade tensions, and disappointing global data. Low interest rates abroad were also considered an important influence on U.S. longer-term rates. Participants expressed a range of views about the implications of low longer-term Treasury rates. Some participants judged that a prolonged inversion of the yield curve could be a matter of concern. Participants also noted that equity prices had exhibited volatility but had been largely flat, on balance, over the intermeeting period. Several participants cited considerations that led them to be concerned about financial stability, including low risk spreads and a buildup of corporate debt, corporate stock buybacks financed through low-cost leverage, and the pace of lending in the CRE market. However, several others pointed to signs that the financial system remained resilient.

In their consideration of the monetary policy options at this meeting, most participants believed that a reduction of 25 basis points in the target range for the federal funds rate would be appropriate. In discussing the reasons for such a decision, these participants pointed to considerations related to the economic outlook, risk management, and the need to center inflation and inflation expectations on the Committee's longer-run objective of 2 percent.

Participants noted that there had been little change in their economic outlook since the July meeting and that incoming data had continued to suggest that the pace of economic expansion was consistent with the maintenance of strong labor market conditions. However, a couple of participants pointed out that data revisions announced in recent months implied that the economy had likely entered the year with somewhat less momentum than previously thought. In addition, data received since July had confirmed the weakening in business fixed investment and exports. One risk that the economy faced was that the softness recorded of late in firms' capital formation, manufacturing, and exporting activities might spread to their hiring decisions, with adverse implications for household income and spending. Participants observed that such an eventuality was not embedded in their baseline outlook; however, a couple of them indicated that this was partly because they assumed that an appropriate adjustment to the policy rate path would help forestall that eventuality. Several also noted that, because monetary policy actions affected economic activity with a lag, it was appropriate to provide the requisite policy accommodation now to support economic activity over coming quarters.

Participants favoring a modest adjustment to the stance of monetary policy at this juncture cited other risks to the economic outlook that further underscored the case for such a move. As their discussion of risks had highlighted, downside risks had become more pronounced since July: Trade uncertainty had increased, prospects for global growth had become more fragile, and various intermeeting developments had intensified geopolitical risks. Against this background, risk-management considerations implied that it would be prudent for the Committee to adopt a somewhat more accommodative stance of policy. In addition, a number of participants suggested that a reduction at this meeting in the target range for the federal funds rate would likely better align the target range with a variety of indicators of the appropriate policy stance, including those based on estimates of the neutral interest rate. A few participants observed that the considerations favoring easing were reinforced by the proximity of the federal funds rate to the ELB. If policymakers provided adequate accommodation while still away from the ELB, this course of action would help forestall the possibility of a prolonged ELB episode.

Many participants also cited the level of inflation or inflation expectations as justifying a reduction of 25 basis points in the federal funds rate at this meeting.

Inflation had generally fallen short of the Committee's objective for several years and, notwithstanding some stronger recent monthly readings on inflation, the 12-month rate was still below 2 percent. Some estimates of trend inflation were also below 2 percent. Several participants additionally stressed that survey measures of longer-term inflation expectations and market-based measures of inflation compensation were near historical lows and that these values pointed to the possibility that inflation expectations were below levels consistent with the 2 percent objective or could soon fall below such levels. Against this backdrop, participants suggested that a policy easing would help underline policymakers' commitment to the symmetric 2 percent longer-run objective. With inflation pressures muted and U.S. inflation likely being weighed down by global disinflationary forces, policymakers saw little chance of an outsized increase in inflation in response to additional policy accommodation and argued that such an increase, should it occur, could be addressed in a straightforward manner using conventional monetary policy tools.

Several participants favored maintaining the existing target range for the federal funds rate at this meeting. These participants suggested that the baseline projection for the economy had changed very little since the Committee's previous meeting and that the state of the economy and the economic outlook did not justify a shift away from the current policy stance, which they felt was already adequately accommodative. They acknowledged the uncertainties that currently figured importantly in evaluations of the economic outlook, but they contended that the key uncertainties were unlikely to be resolved soon. Furthermore, as they did not believe that these uncertainties would derail the expansion, they did not see further policy accommodation as needed at this time. Changes in the stance of policy, they believed, should instead occur only when the macroeconomic data readily justified those moves. In this connection, a couple of participants suggested that, if it decided to provide more policy accommodation at the present juncture, the Committee might be taking out too much insurance against possible future shocks, leaving monetary policy with less scope to boost aggregate demand in the event that such shocks materialized. A few of the participants favoring an unchanged target range for the federal funds rate also expressed concern that an easing of monetary policy at this meeting could exacerbate financial imbalances.

A couple of participants indicated their preference for a 50 basis point cut in the federal funds rate at this meeting. These participants suggested that a larger policy move would help reduce the risk of an economic downturn and would more appropriately recognize important recent developments, such as slowing job gains, weakening investment, and continued low values of market-based measures of inflation compensation. In addition, these participants stressed the need for a policy stance—possibly one using enhanced forward guidance—that was sufficiently accommodative to make it unlikely that the United States would experience a protracted period of the kind seen abroad in which the economy became mired in a combination of undesirably low inflation, weak economic activity, and near-zero policy rates. They also argued that it was desirable for the Committee to seek and maintain a level of accommodation sufficient to deliver inflation at 2 percent on a sustained basis and that such a policy would be consistent with inflation exceeding 2 percent for a time…

The manager pro tem provided a summary of the most recent developments in money markets. Open market operations conducted on the previous day had helped to ease strains in money markets, but the EFFR had nonetheless printed 5 basis points above the top of the target range. With significant pressures still evident in repo markets and the federal funds market, and in accordance with the FOMC's directive to maintain the federal funds rate within the target range, the Desk conducted another repo operation on the morning of the second day of the meeting. The staff presented a proposal to lower the IOER rate and the overnight reverse repurchase agreement rate by 5 basis points, relative to the target range for the federal funds rate, in order to foster trading of federal funds within the target range.

Participants agreed that developments in money markets over recent days implied that the Committee should soon discuss the appropriate level of reserve balances sufficient to support efficient and effective implementation of monetary policy in the context of the ample-reserves regime that the Committee had chosen. A few participants noted the possibility of resuming trend growth of the balance sheet to help stabilize the level of reserves in the banking system. Participants agreed that any Committee decision regarding the trend pace of balance sheet expansion necessary to maintain a level of reserve balances appropriate to facilitate policy implementation should be clearly distinguished from past large-scale asset purchase programs that were aimed at altering the size and composition of the Federal Reserve's asset holdings in order to provide monetary policy accommodation and ease overall financial conditions. Several participants suggested that such a discussion could benefit from also considering the merits of introducing a standing repurchase agreement facility as part of the framework for implementing monetary policy…

President Bullard dissented because he believed that lowering the target range for the federal funds rate by 50 basis points at this time would provide insurance against further declines in expected inflation and a slowing economy subject to elevated downside risks. In addition, a 50 basis point cut at this time would help promote a more rapid return of inflation and inflation expectations to target. President George dissented because she believed that an unchanged setting of policy was appropriate based on incoming data and the outlook for economic activity over the medium term. Recognizing the risks to the outlook from the effects of trade policy and weaker global activity, President George would be prepared to adjust policy should incoming data point to a materially weaker outlook for the economy. President Rosengren dissented because he judged that monetary policy was already accommodative. In his view, additional accommodation was not needed for an economy in which labor markets are already tight and could pose risks of further inflating the prices of risky assets and encouraging households and firms to take on too much leverage.

Source: Federal Reserve Board