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Data Insights: FOMC Minutes

Wednesday, February 17, 2021

January minutes: key signaling language Featured Important Very important

…Participants noted that the COVID-19 pandemic was causing tremendous human and economic hardship across the United States and around the world. The pace of the recovery in economic activity and employment had moderated in recent months, with weakness concentrated in the sectors of the economy most adversely affected by the resurgence of the virus and by greater social distancing. Weaker demand and earlier declines in oil prices were holding down consumer price inflation. Overall financial conditions remained accommodative, in part reflecting the Federal Reserve's actions to support the economy and the flow of credit to U.S. households and businesses. Participants agreed that the path of the economy would depend significantly on the course of the virus, including progress on vaccinations, and that the ongoing public health crisis would continue to weigh on economic activity, employment, and inflation and posed considerable risks to the economic outlook.

Participants observed that the resurgence in COVID-19 infections and associated social-distancing measures were restraining activity in some sectors, particularly in industries such as travel and leisure and hospitality. Most participants expected that the stimulus provided by the passage of the CAA in December, the likelihood of additional fiscal support, and anticipated continued progress in vaccinations would lead to a sizable boost in economic activity. Even so, participants noted that economic activity and employment were currently well below levels consistent with achieving maximum employment.

Participants commented on improved prospects for household spending over the course of the year, in part reflecting fiscal support. They saw progress on vaccinations as essential for supporting further gains in aggregate consumer spending and for the economic recovery more generally. In commenting on recent data for household spending, most participants discussed the composition of expenditures, with strong spending on many goods, especially durables, and weakness in spending on some services, especially in travel and in leisure and hospitality. The relative strength in consumer spending on goods was supported by fiscal programs such as federal stimulus payments and expanded unemployment benefits as well as by accommodative monetary policy. The weakness in services spending was largely attributed to the pandemic and associated social-distancing measures, which limited spending on services that depend heavily on in-person contact. Increased government transfers to households, combined with reduced outlays on some services, had contributed to a historically large increase in aggregate household savings last year. Participants also observed that residential investment and home sales remained robust; low interest rates were viewed as an important factor supporting the strength in housing activity.

Most participants noted that the economic downturn had not fallen equally on all Americans and that those least able to shoulder the burden—in particular, lower-income and Black and Hispanic households—had been the hardest hit by the pandemic. Many participants stressed that sustained support from fiscal policy would help address the hardships faced by these groups and that monetary policy could also help by promoting the economy's return to maximum employment and price stability.

In their remarks on the business sector, participants commented that business equipment investment had continued to show strength while nonresidential construction remained weak. Participants also discussed the recent strong performance of the manufacturing sector. Many discussed supply chain issues in manufacturing, including those associated with acquiring material inputs and pandemic-related worker shortages and absenteeism. Business contacts reported that firms in goods-producing industries, particularly larger firms and those in the durable goods or housing sectors, were adapting to the pandemic; in contrast, smaller firms and those in industries most adversely affected by the pandemic were finding it more difficult to adapt. Many participants stated that their business contacts were optimistic that continued progress on vaccinations, together with further fiscal support, would result in more improvement in overall business conditions. Several participants noted the increase in agricultural crop prices over 2020 and the associated improvement in farm revenues.

As with overall economic activity, the pace of improvement in the labor market had slowed in recent months. Payroll employment fell in December, as continued job gains in many industries were outweighed by significant layoffs in industries where the resurgence of the virus had weighed heavily on activity. While labor market conditions had improved significantly, on balance, since the spring, some participants noted that if the sizable number of workers who reported having left the labor force since the beginning of the pandemic were to be counted as unemployed, the unemployment rate would be substantially higher. Participants judged that the current low level of labor force participation likely reflected a number of factors, including health concerns and additional childcare responsibilities. Over the medium term, participants expected strong growth in employment, driven by continued progress on vaccinations and an associated rebound of economic activity and of consumer and business confidence, as well as accommodative fiscal and monetary policy. However, participants observed that the economy was far from achieving the Committee's broad-based and inclusive goal of maximum employment and that even with a brisk pace of improvement in the labor market, achieving this goal would take some time.

In their comments about inflation, participants noted that headline PCE price inflation in December, measured on a 12-month basis, was poised to come in well below the Committee's 2 percent longer-term objective. In the relatively near term, a number of participants suggested that there could be increases in the prices of some goods whose production has been subject to supply chain constraints, or soon could be; others anticipated that a possibly abrupt return to normal levels of activity could result in one-time increases in certain prices. Many participants stressed the importance of distinguishing between such one-time changes in relative prices and changes in the underlying trend for inflation, noting that changes in relative prices could temporarily raise measured inflation but would be unlikely to have a lasting effect. Some participants further observed that 12-month PCE inflation was likely to move somewhat above 2 percent for a brief period in the spring as the unusually low monthly observations from last spring roll out of the 12-month calculation. Outside of such near-term fluctuations, participants generally anticipated that inflation would move up along a trajectory consistent with achieving the Committee's objectives over time, supported by stronger economic activity, widespread vaccinations and the associated reduction in social distancing, and accommodative fiscal and monetary policy. Some participants pointed to the continued increase in market-based measures of inflation compensation from the very low levels recorded in the spring as consistent with the view that inflation was likely to move up gradually over time; others noted that survey-based measures were little changed, on net, over the year as a whole.

…While generally acknowledging that the medium-term outlook for real GDP growth and employment had improved, participants continued to see the uncertainty surrounding that outlook as elevated. Participants agreed that the path of the economy depended significantly on the course of the virus and progress on vaccinations. Many participants remarked that the pandemic continued to pose considerable risks to the economic outlook, including risks associated with new virus strains, potential public resistance to vaccination, and potential difficulties in the production and distribution of vaccines. With regard to upside risks, some participants pointed to the possibility that fiscal policy could turn out to be more expansionary than anticipated, that households could display greater willingness to spend out of accumulated savings than expected, or that widespread vaccinations and easing of social distancing could result in a more rapid boost to spending and employment than anticipated. Participants generally viewed the risks to the outlook for inflation as having become more balanced than was the case over most of 2020, although most still viewed the risks as weighted to the downside. As an upside risk to inflation, several participants noted the potential for pandemic-related supply constraints to affect price inflation somewhat more than anticipated or for price increases among industries most adversely affected by the pandemic to be more pronounced than projected.

A number of participants commented on issues related to financial stability. Several participants noted areas of strength. For example, the banking system had shown considerable resilience since the onset of the pandemic. Banks' capital positions had generally remained solid, and earnings were strong. In addition, results from the most recent stress tests indicated that the largest banks could withstand very stressed economic conditions. That said, a few participants stated that it would be important to stay vigilant to ensure that the banking system remained strong and resilient. In addition, several participants noted that the pandemic had highlighted structural vulnerabilities in other parts of the financial system. These included run-prone investment funds in short-term funding and credit markets as well as fragilities in Treasury market functioning; stresses stemming from these vulnerabilities had required substantial intervention by the Federal Reserve in the turbulent market conditions at the onset of the pandemic. A couple of participants commented that it would be important for the appropriate regulatory bodies to address these financial stability vulnerabilities. Regarding asset valuations, some participants commented that equity valuations had risen further, that initial public offering activity was elevated, or that valuations might have been affected by retail investors trading through electronic platforms. In addition, risk spreads on corporate bonds and loans were generally low, even with corporate indebtedness having risen to high levels. A few participants noted that some CRE in sectors that had been most directly affected by the pandemic—such as those involving retail establishments and hotels—faced the prospect of falling prices and increased stress.

…Participants noted that the Committee's current guidance was well suited to the current environment because it describes how policy would respond based on the path of the economy. For example, if progress toward the Committee's goals proved slower than anticipated, the outcome-based guidance would convey the Committee's intention to respond by increasing monetary policy accommodation through maintaining the current level of the target range of the federal funds rate for longer and raising the expected path of the Federal Reserve's balance sheet. In addition, participants noted that the Committee's current outcome-based guidance for both the federal funds rate and balance sheet appeared to be well understood by the public. In that context, participants emphasized that it was important to abstract from temporary factors affecting inflation—such as low past levels of prices dropping out of measures of annual price changes or relative price increases in some sectors brought about by supply constraints or disruptions—in judging whether inflation was on track to moderately exceed 2 percent for some time.

Participants noted that the increase in the Federal Reserve's balance sheet since last March had materially eased financial conditions and was providing substantial support to the economy. The Committee's guidance for asset purchases indicated that asset purchases would continue at least at the current pace until substantial further progress toward its employment and inflation goals had been achieved. With the economy still far from those goals, participants judged that it was likely to take some time for substantial further progress to be achieved. Various participants noted the importance of the Committee clearly communicating its assessment of progress toward its longer-run goals well in advance of the time when it could be judged substantial enough to warrant a change in the pace of purchases.

Source: Federal Reserve Board