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Data Insights: FOMC Minutes

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September minutes: key signaling language Featured Important Very important

… In their discussion of current conditions, participants noted that, with progress on vaccinations and strong policy support, indicators of economic activity and employment had continued to strengthen. The sectors most adversely affected by the pandemic had improved in recent months, but the rise in COVID-19 cases had slowed their recovery. Inflation was elevated, largely reflecting transitory factors. Overall financial conditions remained accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses. Participants noted that the path of the economy continued to depend on the course of the virus. Progress on vaccinations would likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remained.

Participants observed that economic activity had continued to expand in recent months, though at a less rapid pace than in the first half of the year. They marked down their projections of real GDP growth for the year, pointing to a reassessment of the severity and likely duration of supply constraints or of the effects of the spread of the Delta variant on the economy. Still, participants foresaw rapid growth this year, and several highlighted that the economy had shown resilience in the face of the recent wave of infections.

In their discussion of the household sector, participants noted that consumer spending had decelerated in recent months after expanding at a very rapid pace in the first half of the year. The spread of the Delta variant was weighing on spending for some consumer services, and low inventories and high prices due to supply constraints were restraining spending on many goods, most notably motor vehicles. Nonetheless, participants expected the accumulated stock of savings, the release of pent-up demand, and progress on vaccinations to continue to support household spending in coming months. Participants noted that residential construction had been

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restrained by shortages of materials and other inputs and that home sales had been held back by limited supplies of available homes.

With respect to the business sector, participants observed that firms in a number of industries were facing challenges keeping up with strong demand due to widespread supply chain bottlenecks as well as labor shortages. Some participants commented that the recent global wave of COVID-19 infections and associated business shutdowns were exacerbating or prolonging these problems. The supply chain bottlenecks were creating challenges for a number of manufacturers; the problems were seen as especially acute for the motor vehicle industry, where the shortages of semiconductor chips had sharply curtailed production. Retail industries were also facing various bottlenecks, including those stemming from port congestion and delays in ground transportation. Participants noted that their District contacts generally did not expect these bottlenecks to be fully resolved until sometime next year or even later. A couple of participants noted that inventories-to-sales ratios were at or near record-low levels in many industries, and the need to rebuild them would boost business investment going forward. Participants also discussed the developments in oil, gasoline, and agricultural sectors. A couple of participants pointed out that Hurricane Ida significantly affected the oil and gas industries, curtailing U.S. offshore production at a time of low inventories. A couple of other participants noted that elevated crop prices were continuing to boost income in the agricultural sector.

Participants noted that labor market conditions had continued to improve in recent months. The unemployment rate declined further to 5.2 percent in August, and a few participants noted a further pickup in recent months in the level of activity indicator in the Federal Reserve Bank of Kansas City's Labor Market Conditions Indicators. After a rapid pace of almost 1 million per month in June and July, job gains slowed to 235,000 in August as the resurgence of COVID-19 cases weighed on employment in high-contact service sectors, particularly in the leisure and hospitality sector. Meanwhile, the labor force participation rate was little changed, remaining at a lower level than its pre-pandemic values. Some participants noted that the increase in labor force participation that they had expected had not yet materialized in the wake of the reopening of schools and the expiration of the extended unemployment benefits, and that this likely reflected in part concerns about the resurgence of the virus, childcare challenges, and the uncertainties generated by ongoing disruptions to

in-person schooling. Participants expected the labor market to continue to improve in coming months. Several participants indicated that a rise in the labor force participation rate might lag the improvements in other indicators such as the unemployment rate—a pattern consistent with past business cycle recoveries. Participants expressed a range of views regarding the extent to which they expected the labor force participation rate and the EPOP ratio would move back to their pre-pandemic levels. Various participants suggested that a complete return to pre-pandemic conditions was unlikely, as the pandemic had prompted reductions in the workforce that were likely to persist, including a large number of retirements and other departures from the labor force. A number of others, however, assessed that once the COVID-related concerns that were currently weighing on labor force participation passed, the participation rate and the EPOP ratio could return to, or even exceed, the pre-pandemic levels. Some participants remarked that the labor market recovery continued to be uneven across demographic and income groups and across sectors, with the recovery being particularly slow for women with young children and people with lower incomes.

Participants noted that their District contacts had broadly reported having difficulty hiring workers. The labor shortages were causing firms to reduce hours and scale back production while also leading employers to provide incentives to attract and retain workers, including wage increases and signing and retention bonuses. The rate of nominal wage growth had been robust in recent data; for example, average hourly earnings were up 4.9 percent at an annualized rate over the past six months.

In their discussion of inflation, participants observed that the inflation rate was elevated, and they expected that it would likely remain so in coming months before moderating. Participants marked up their inflation projections, as they assessed that supply constraints in product and labor markets were larger and likely to be longer lasting than previously anticipated. Some participants expressed concerns that elevated rates of inflation could feed through into longer-term inflation expectations of households and businesses or saw recent inflation data as suggestive of broader inflation pressures. Several other participants pointed out that the largest contributors to the recent elevated measures of inflation were a handful of COVID-related, pandemic-sensitive categories in which specific, identifiable bottlenecks were at play. This observation suggested that the upward pressure on prices would

abate as the COVID-related demand and supply imbalances subsided. These participants noted that prices in some of those categories showed signs of stabilizing or even turned down of late. Many participants pointed out that the owners' equivalent rent component of price indexes should be monitored carefully, as rising home prices could lead to upward pressure on rents. A few participants noted that there was not yet evidence that robust wage growth was exerting upward pressure on prices to a significant degree, but also that the possibility merited close monitoring.

In their comments on inflation expectations, several participants observed that measures of longer-term inflation expectations, including TIPS- and survey-based measures, had remained in ranges that were viewed as broadly consistent with the Committee's longer-run inflation goal, or that the distribution across households of longer-term expected inflation had remained stable over the past two years. Many participants noted the substantial rise in one- and three-year measures of inflation expectations in the Federal Reserve Bank of New York's Survey of Consumer Expectations or in the one-year measure in the University of Michigan Surveys of Consumers. A few participants remarked that these survey measures tended to be sensitive to movements in actual inflation, or that the recent rise was consistent with previous historical relationships between such measures and actual inflation.

In discussing the uncertainty and risks associated with the economic outlook, participants noted that uncertainty remained high. A number of participants judged that the uncertain course of the virus, supply chain disruptions, and labor shortages complicated the task of interpreting incoming economic data and assessing progress toward the Committee's goals. Participants generally saw the risks to the outlook for economic activity as broadly balanced. Uncertainty around the course of the virus, the resolution of supply constraints, and fiscal measures were cited as presenting both upside and downside risks. In addition, some participants mentioned the risks associated with high asset valuations in the United States and abroad, and a number of participants commented on the importance of resolving the issues involving the federal government budget and debt ceiling in a timely manner. Most participants saw inflation risks as weighted to the upside because of concerns that supply disruptions and labor shortages might last longer and might have larger or more persistent effects on prices and wages than they currently assumed. A few

participants commented that there were also some downside risks for inflation, as the factors that had held inflation down over the previous long expansion were likely still in place.

In their consideration of the stance of monetary policy, participants reaffirmed the Federal Reserve's commitment to using its full range of tools to support the U.S. economy during this challenging time, thereby promoting the Committee's statutory goals of maximum employment and price stability. Participants judged that the current stance of monetary policy remained appropriate to promote maximum employment as well as to achieve inflation that averages 2 percent over time and longer-term inflation expectations that are well anchored at 2 percent. Participants also reiterated that the existing outcome-based guidance implied that the paths of the federal funds rate and the balance sheet would depend on actual progress toward reaching the Committee's maximum-employment and inflation goals.

Participants resumed their discussions on the progress made toward the Committee's goals since December 2020, when the Committee adopted its guidance regarding asset purchases and indicated that purchases would continue at their current pace until substantial further progress had been made toward the Committee's goals of maximum employment and price stability. These purchases had been a critical part of the Federal Reserve's efforts to foster smooth financial market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses as well as the economic recovery. Most participants remarked that the standard of "substantial further progress" had been met with regard to the Committee's price-stability goal or that it was likely to be met soon. With regard to the Committee's maximum-employment goal, participants considered the cumulative degree of improvement in the labor market since December 2020. In doing so, participants cited the progress recorded in a number of individual series, including, among others, the employment-to-population ratio, the unemployment rate, claims for unemployment insurance, job openings, nominal wage growth, and increases in payrolls, as well as in summary measures of the labor situation. Some participants observed that progress on labor force participation was lagging. Many participants noted that although the economic recovery had slowed recently and the August increase in payrolls had fallen short of expectations, the labor market had continued to show improvement since the Committee's previous meeting. A number

of participants assessed that the standard of substantial further progress toward the goal of maximum employment had not yet been attained but that, if the economy proceeded roughly as they anticipated, it may soon be reached. On the basis of the cumulative performance of the labor market since December 2020, a number of other participants indicated that they believed that the test of "substantial further progress" toward maximum employment had been met. Some of these participants also suggested that labor supply constraints were the main impediments to further improvement in labor market conditions rather than lack of demand. They noted that adding monetary policy accommodation at this time would not address such constraints or that the costs of continuing asset purchases might be beginning to exceed their benefits. All participants agreed that it would be appropriate for the current meeting's postmeeting statement to relay the Committee's judgment that, if progress continued broadly as expected, a moderation in the pace of asset purchases may soon be warranted.

Participants also expressed their views on how slowing in the pace of purchases might proceed. In particular, participants commented on an illustrative path, developed by the staff and reflecting participants' discussions at the Committee's July meeting, that gave the speed and composition associated with a tapering of asset purchases. The illustrative tapering path was designed to be simple to communicate and entailed a gradual reduction in the pace of net asset purchases that, if begun later this year, would lead the Federal Reserve to end purchases around the middle of next year. The path featured monthly reductions in the pace of asset purchases, by $10 billion in the case of Treasury securities and $5 billion in the case of agency mortgage-backed securities (MBS). Participants generally commented that the illustrative path provided a straightforward and appropriate template that policymakers might follow, and a couple of participants observed that giving advance notice to the general public of a plan along these lines may reduce the risk of an adverse market reaction to a moderation in asset purchases. Participants noted that, in keeping with the outcome-based standard for initiating a tapering of asset purchases, the Committee could adjust the pace of the moderation of its purchases if economic developments were to differ substantially from what they expected. Several participants indicated that they preferred to proceed with a more rapid moderation of purchases than described in the illustrative examples.

No decision to proceed with a moderation of asset purchases was made at the meeting, but participants generally assessed that, provided that the economic recovery remained broadly on track, a gradual tapering process that concluded around the middle of next year would likely be appropriate. Participants noted that if a decision to begin tapering purchases occurred at the next meeting, the process of tapering could commence with the monthly purchase calendars beginning in either mid-November or mid-December.

Many participants remarked upon risk-management considerations and the way in which these figured into their thinking on asset purchases and the appropriate policy stance. A number of downside risks to the economic outlook were cited, including a potential tightening of financial conditions, the possibility that another rise in COVID-19 cases would slow the economic recovery by more than expected, and the prospect that fiscal policy could become a source of economic headwinds as the effects of previous support measures receded. Upside risks to the economic outlook included the possibility that there would be additional expansionary fiscal actions or that consumer spending would rise by more than expected as households reduced the large volume of savings that they had accumulated during the pandemic. With regard to inflation, upside risks cited included the possibility that elevated levels of inflation would continue for longer than expected, especially if labor and other supply shortages proved more persistent than currently anticipated, or that longer-term inflation expectations might move above levels consistent with the Committee's longer-term inflation objective of 2 percent. Downside risks to inflation included the possibility of a decline in inflation expectations that might occur if the public misconstrued the Federal Reserve's reaction function as less accommodative than it actually was. Several participants expressed concern that the high degree of accommodation being provided by monetary policy, including through continued asset purchases, could increase risks to financial stability.

Participants reaffirmed that the Committee's "substantial further progress" standard regarding its asset purchases was distinct from the criteria given in its forward guidance on the federal funds rate and that a policy shift toward a moderation of asset purchases provided no direct signal about its interest rate policy. Rather, the Committee had articulated a different, and more stringent, test concerning the conditions that would need to be met before it started raising the target range for the

federal funds rate. Various participants stressed that economic conditions were likely to justify keeping the rate at or near its lower bound over the next couple of years. In addition to noting that the economy was still well below maximum employment, several of these participants suggested that there would likely be sustained downward pressure on inflation in the years ahead. These participants stated that, in such circumstances, a major challenge facing policymakers—especially in the presence of the effective lower bound on the federal funds rate—was to maintain a policy stance sufficiently accommodative to keep average inflation at 2 percent and thereby bolster the credibility of the Committee's new policy framework, facilitating the achievement of both maximum employment and price stability. In contrast, a number of participants raised the possibility of beginning to increase the target range by the end of next year because they expected that the labor market and inflation outcomes specified in the Committee's guidance on the federal funds rate might be achieved by that time; some of these participants saw inflation as likely to remain elevated in 2022 with risks to the upside.

Source: Federal Reserve Board