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Data Insights: FOMC Minutes

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November 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 summer's rise in COVID-19 cases had slowed their recovery. Inflation was elevated, largely reflecting factors that were expected to be transitory. Supply and demand imbalances related to the pandemic and the reopening of the economy had contributed to sizable price increases in some sectors. 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 and an easing of supply constraints were expected to support continued gains in economic activity and employment as well as a reduction in inflation, but risks to the economic outlook remained.

Participants observed that growth in economic activity had slowed in the third quarter to a rate significantly below the robust pace seen in the first half of the year. The spread of the Delta variant had contributed to the slowdown in growth in the third quarter by damping household and business spending, holding down labor supply, and intensifying supply chain disruptions. Participants noted that the underlying conditions supporting growth in demand remained strong and that, as the number of COVID-19 cases remained well below the summer's levels, growth in economic activity would likely show a pickup in the fourth quarter. They further foresaw robust growth in 2022, supported by progress on vaccinations and an easing of supply constraints.

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In their discussion of the household sector, participants remarked that demand for most consumer goods had remained strong. They noted that businesses had generally recorded robust sales despite labor shortages and other supply disruptions that had prevented them from fully meeting higher demand for their products. Participants interpreted available data as suggesting that the spread of the Delta variant had slowed the shift of consumer demand toward purchases of services and away from spending on goods, stretching out the full reopening of the economy and intensifying supply and demand imbalances. Participants observed that households had strong balance sheets and that consumer spending would also be supported by accommodative financial conditions. A number of participants noted that there was likely to be a drag on household spending as previous fiscal support faded, or that fiscal policy might provide some support to aggregate demand if the Congress authorized major new federal appropriations.

Participants remarked that supply chain challenges and limited labor availability continued to be major constraints on manufacturing activity and the business sector more broadly. Bottleneck pressures faced by businesses were accompanied by global supply chain disruptions associated with major backlogs in shipments and transportation as well as surging demand for a variety of goods, shortages of labor and other inputs, increases in costs of production, and depleted inventory levels in key sectors. Many business contacts had experienced a worsening of supply chain problems, and participants reported that firms had responded to these challenges by taking a variety of actions, including raising prices, turning away customers, restructuring supply chains, and using alternative, but higher-cost, shipping options. Participants judged that supply constraints would likely continue for longer than they had previously expected.

Participants noted that data received over the intermeeting period indicated that labor market conditions had continued to improve. Al-though the September increase in payrolls had been moderate compared with recent months, the unemployment rate had declined further and previous months' job growth had been revised up. Participants observed that September's rise in payrolls had been held down by a shortage of workers, in part reflecting the ongoing effect of the virus on labor supply decisions. With COVID-19 cases expected to remain below the summer's levels, participants anticipated better payroll numbers in the months ahead. Participants

indicated that District contacts continued to report difficulties in finding and retaining workers and that, in addition to offering higher wages, businesses were turning to increased use of automation.

While recognizing that labor market conditions varied significantly across the country, some participants cited a number of signs that the U.S. labor market was very tight: These included data on quits, job availability, and stronger rates of nominal wage growth reflected in the recent rise in the employment cost index, as well as the readings provided by the Federal Reserve Bank of Kansas City's Labor Market Conditions Indicators. A number of participants observed that the labor force participation rate remained well below the level reached before the pandemic. Several participants judged that labor force participation would be structurally lower than in the past, and a few of these participants cited the high level of retirements recorded since the start of the pandemic. Several other participants suggested that labor supply was currently being depressed by pandemic-related factors such as disruptions related to caregiving arrangements and noted that the importance of such factors would likely diminish as economic and public health conditions improved further.

Participants generally saw the current elevated level of inflation as largely reflecting factors that were likely to be transitory but judged that inflation pressures could take longer to subside than they had previously assessed. They remarked that the Delta wave had intensified the impediments to supply chains and had helped sustain the high level of goods demand, adding to the upward pressure on prices. Participants also observed that increases in energy prices, stronger rates of nominal wage growth, and higher housing rental costs had been forces adding to inflation. Some participants highlighted the fact that price increases had become more widespread. Although participants expected significant inflation pressures to last for longer than they previously expected, they generally continued to anticipate that the inflation rate would diminish significantly during 2022 as supply and demand imbalances abated. Nonetheless, they indicated that their uncertainty regarding this assessment had increased. Many participants pointed to considerations that might suggest that elevated inflation could prove more persistent. These participants noted that average inflation already exceeded 2 percent when measured on a multiyear basis and cited a number of factors—such as businesses' enhanced scope to pass on higher costs to

their customers, the possibility that nominal wage growth had become more sensitive to labor market pressures, or accommodative financial conditions—that might result in inflation continuing at elevated levels. Some other participants, however, remarked that although inflationary pressures were lasting longer than anticipated, those pressures continued to reflect the same pandemic-related imbalances and would likely abate when supply constraints eased. These participants also noted that the most sizable price increases may have already occurred, that there was as yet little evidence of a change in inflation dynamics—such as the development of a wage–price spiral—that would tend to prolong elevated levels of inflation, and that forces already in motion would likely bring inflation down toward 2 percent over the medium term. Participants were attentive to the sizable increase in the cost of living that had taken place this year and the associated burden on U.S. households, particularly those who had limited scope to pay higher prices for essential goods and services.

In their comments on inflation expectations, a number of participants discussed the risk that, in light of recent elevated levels of inflation, the public's longer-term expectations of inflation might increase to a level above that consistent with the Committee's longer-run inflation objective; such a development could make it harder for the Committee to achieve 2 percent inflation over the longer run. A couple of participants pointed to increases in survey- and market-based indicators of expected inflation—including the notable rise in the five-year TIPS-based measure of inflation compensation—as possible signs that inflation expectations were becoming less well anchored. Several other participants, however, remarked that measures of near- and medium-term inflation expectations typically had been sensitive to movements in realized inflation and that they had not exhibited greater sensitivity recently. They additionally pointed out that indicators of longer-term inflation expectations—including the five-year, five-year-forward measure of inflation compensation—continued to display less sensitivity to realized inflation and remained well anchored at levels consistent with the Committee's longer-run 2 percent goal.

Participants observed that uncertainty about the economic outlook remained high. They particularly stressed uncertainties associated with the labor market, including the evolution of labor force participation, and with the length of time required to resolve the supply chain situation. Participants cited upside risks to inflation, including those associated with strong demand for goods and a tight labor market.

Upside risks to economic activity included a potential near-term boost to aggregate demand that could arise from the drawing down of the substantial savings accumulated by households since the beginning of the pandemic. A few participants mentioned an upsurge in COVID-19 cases during the coming winter or an emergence of new virus strains as possibilities that, if they were realized, would damp economic activity and intensify price pressures.

A number of participants commented on issues related to financial stability. A couple of participants noted factors supporting the strength and resilience of the U.S. financial system, including the solid capital and liquidity conditions of banks and the fact that underwriting standards for residential mortgages had not eased substantially in an environment of rising house prices. A few participants emphasized the importance of maintaining strong bank capital positions, particularly at the largest banks. A few participants also cited a number of factors representing potential vulnerabilities to the financial system: These included elevated asset valuations prevailing widely across asset classes, the growing exposure of banks to nonbank financial firms, and the risk of a sudden reduction in the liquidity of collateral used at central counterparty clearing and settlement systems. In the area of cybersecurity, a few participants stressed the importance of greater preparedness against a cyberattack that could disrupt the nation's payments process and financial system. Several participants commented on the financial stability risks—including those relating to maturity and liquidity transformation—associated with stablecoins and on the need for regulators to address these risks. A few participants noted the importance of developing systematic monitoring of the climate-related risks facing the financial system.

In their consideration of the stance of monetary policy, participants agreed that the economy had made substantial further progress toward the Committee's goals since December 2020, when the Committee adopted its guidance regarding asset purchases. The unemployment rate had declined to 4.8 percent in September—about 2 percentage points lower than the level last December—and job openings and other indicators also were pointing to widespread strength in labor demand, consistent with a broad improvement in labor market conditions. Consequently, participants assessed that the criterion of substantial further progress had been met with regard to the Committee's maximum employment goal. In addition, participants generally

judged that the Committee's criterion of substantial further progress had clearly been more than met with respect to inflation. Against this backdrop, all participants judged that, consistent with the Committee's previous policy communications, it would be appropriate to announce at this meeting a reduction in the pace of net asset purchases. Participants generally supported the plan to implement reductions in the pace of net purchases of Treasury securities and agency MBS by $10 billion and $5 billion per month, respectively, over the upcoming intermeeting period and judged that similar reductions in the pace would likely be appropriate in each subsequent month. Some participants preferred a somewhat faster pace of reductions that would result in an earlier conclusion to net purchases. Participants noted that beginning to scale back the pace of net asset purchases was not intended to convey any direct signal regarding adjustments to the target range for the federal funds rate. They highlighted the more stringent criteria for raising the target range, compared with the criteria that applied to beginning to reduce the pace of asset purchases.

Participants stressed that maintaining flexibility to implement appropriate policy adjustments on the basis of risk-management considerations should be a guiding principle in conducting policy in the current highly uncertain environment. Some participants suggested that reducing the pace of net asset purchases by more than $15 billion each month could be warranted so that the Committee would be in a better position to make adjustments to the target range for the federal funds rate, particularly in light of inflation pressures. Various participants noted that the Committee should be prepared to adjust the pace of asset purchases and raise the target range for the federal funds rate sooner than participants currently anticipated if inflation continued to run higher than levels consistent with the Committee's objectives. At the same time, because of the continuing considerable uncertainty about developments in supply chains, production logistics, and the course of the virus, a number of participants stressed that a patient attitude toward incoming data remained appropriate to allow for careful evaluation of evolving supply chain developments and their implications for the labor market and inflation. That said, participants noted that the Committee would not hesitate to take appropriate actions to address inflation pressures that posed risks to its longer-run price stability and employment objectives.

Source: Federal Reserve Board