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

TrendMacro

Data Insights: FOMC Minutes

Wednesday, May 25, 2022

May minutes: key signaling language Featured Important Very important

…In their discussion of current economic conditions, participants noted that, although overall economic activity had edged down in the first quarter, household spending and business fixed investment had remained strong. Job gains had been robust in recent months, and the unemployment rate had declined substantially. Inflation remained elevated, reflecting continued supply and demand imbalances, higher energy prices, and broader price pressures. Participants recognized that the invasion of Ukraine by Russia was causing tremendous human and economic hardship for the Ukrainian people. Participants judged that the implications for the U.S. economy were highly uncertain. The invasion and related events were creating additional upward pressure on inflation and were likely to weigh on economic activity. In addition, participants judged that COVID-related lockdowns in China were likely to exacerbate supply chain disruptions. Against this background, participants stated that they were highly attentive to inflation risks.

Participants commented that after its rapid growth in the last quarter of 2021, real GDP had declined in the first quarter of this year, with net exports and inventory investment making large negative contributions to growth. They noted, however, that these volatile components tended to contain little signal about subsequent growth and that household spending and business fixed investment had remained strong in the first quarter. These advances and the further tightening of labor market conditions were judged consistent with significant underlying momentum in the domestic economy. In line with this judgment, participants expected that real GDP would grow solidly in the current quarter. In their discussion of the economic outlook beyond the near term, participants indicated that they expected that output would expand more moderately this year than in 2021, with growth this year likely near or above its longer-run rate, and that the imbalance between aggregate demand and aggregate supply would diminish over time. Participants saw an appropriate firming of monetary

Copyright 2022 Trend Macrolytics LLC. All rights reserved. This document is not to be forwarded to individuals or organizations not authorized by Trend Macrolytics LLC to receive it. For information purposes only; not to be deemed to be recommendations for buying or selling specific securities or to constitute personalized investment advice. Derived from sources deemed to be reliable, but no warranty is made as to accuracy.

policy as playing a central role in addressing this imbalance and in supporting the Federal Reserve's goals of maximum employment and price stability. An easing of supply bottlenecks, a further rise in labor force participation, and the waning effects of pandemic-related fiscal policy support were cited as additional factors that could help reduce the supply–demand imbalances in the economy and lower inflation over the medium term. That said, the timing and magnitude of these effects were uncertain. Participants recognized the need to adjust the stance of policy depending on how these and other factors played out over time.

In their discussion of the household sector, participants indicated that they expected robust growth in consumption spending. They pointed to several elements supporting this outlook, including strong household balance sheets, wide availability of jobs, and the U.S. economy's resilience in the face of new waves of the virus. The considerable increases in Treasury yields across maturities over the intermeeting period were associated with rising interest rates faced by households, particularly rates on home mortgages. A couple of participants reported that their business contacts continued to see robust housing demand and elevated home prices despite higher mortgage interest rates.

With respect to the business sector, participants cited robust consumer demand, healthy household balance sheets, and inventory rebuilding as factors supportive of business activity and investment. The ability of firms to meet demand continued to be limited by labor shortages and supply chain bottlenecks. Although some participants noted that their business contacts had reported an easing of supply constraints, participants assessed that supply constraints overall were still significant and would likely take some time to be resolved. In addition, the invasion of Ukraine by Russia and COVID-related lockdowns in China were seen as likely to exacerbate supply chain disruptions. A few participants indicated that some of their business contacts were reportedly hesitant to expand capacity or had postponed construction projects.

Participants commented that demand for labor continued to outstrip available supply across many parts of the economy and that their business contacts continued to report difficulties in hiring and retaining workers. They observed that various indicators pointed to a very tight labor market. Employment growth had continued at a strong pace, the unemployment rate had fallen to a near-50-year low, quits and job

openings had remained extremely elevated, and nominal wages had continued to rise rapidly. A few participants noted that there were signs that the pandemic-related factors that had held back labor supply might be abating further, especially in the case of prime-age workers. In addition, a few other participants suggested that the unwelcome erosion of real incomes due to high inflation may have contributed to the increase in labor supply. Many participants indicated that they expected the labor market to remain tight and wage pressures to stay elevated for some time. Several participants raised the possibility that, in light of the exceptionally high ratio of vacancies to job searchers, a moderation in labor demand might serve to reduce vacancies and wage pressures without having significant effects on the unemployment rate.

Participants observed that inflation continued to run well above the Committee's longer-run goal and that inflation pressures were evident in a broad array of goods and services. Various participants remarked on the hardship caused by elevated inflation and heightened inflation uncertainty—including by eroding American families' real incomes and wealth and by making it more difficult for businesses to make production and investment plans. They also pointed out that high inflation could impede the achievement of maximum employment on a sustained basis. Participants noted that developments associated with Russia's invasion of Ukraine, including surges in energy and commodity prices, were adding to near-term inflation pressures. In addition, COVID-related lockdowns in China were likely to disrupt global supply chains, potentially adding further upward pressure on the prices paid by U.S. businesses and consumers. Most participants indicated that their business contacts had continued to report that substantial increases in wages and input prices were being passed through into higher prices to their customers. A few participants added that some of their contacts were starting to report that higher prices were hurting sales. A number of participants observed that recent monthly data might suggest that overall price pressures may no longer be worsening. These participants also emphasized that price pressures remained elevated and that it was too early to be confident that inflation had peaked. Many participants commented that measures of short-term inflation expectations were elevated or that far-forward measures of inflation compensation were near the upper edge of their historical range. Several participants judged that measures of longer-term inflation expectations derived from

surveys of households, professional forecasters, and market participants still appeared to be broadly consistent with the Committee's longer-run inflation objective, likely reflecting respondents' confidence that the Federal Reserve would take the actions necessary to return inflation to 2 percent. They noted that, together with appropriate firming of monetary policy and an eventual easing of supply constraints, well-anchored longer-term inflation expectations would support a return of inflation to levels consistent with the Committee's longer-run goal.

In their discussion of risks to the outlook, participants emphasized that they were highly attentive to inflation risks and would continue to monitor closely inflation developments and inflation expectations. They agreed that risks to inflation were skewed to the upside and cited several such risks, including those associated with ongoing supply bottlenecks and rising energy and commodity prices—both of which were exacerbated by the Russian invasion of Ukraine and COVID-related lockdowns in China. Also mentioned were the risks associated with nominal wage growth continuing to run above levels consistent with 2 percent inflation over time and the extent to which households' high savings since the onset of the pandemic and healthy balance sheets would support greater-than-expected underlying momentum in consumer spending and contribute to upside inflation pressures. In addition, some participants emphasized that persistently high inflation heightened the risk that longer-term inflation expectations could become unanchored; in that case, the task of returning inflation to 2 percent would be more difficult. Uncertainty about real activity was also seen as elevated. Various participants noted downside risks to the outlook, including risks associated with the Russian invasion and COVID-related lockdowns in China and the likelihood of a prolonged rise in energy and commodity prices.

Several participants who commented on issues related to financial stability noted that the tightening of monetary policy could interact with vulnerabilities related to the liquidity of markets for Treasury securities and to the private sector's intermediation capacity. A couple of participants pointed to increased risks in financial markets linked to commodities following Russia's invasion of Ukraine, which had led to higher prices and volatility across a wide range of energy, agricultural, and metal products. These participants observed that the trading and risk-management practices of some key participants in commodities markets were not fully visible to regulatory authorities and noted that central counterparties (CCPs) needed to remain capable of

managing risks associated with heightened volatility or that margin requirements at CCPs could give rise to significant liquidity demands for large banks, broker-dealers, and their clients.

In their consideration of the appropriate stance of monetary policy, all participants concurred that the U.S. economy was very strong, the labor market was extremely tight, and inflation was very high and well above the Committee's 2 percent inflation objective. Against this backdrop, all participants agreed that it was appropriate to raise the target range for the federal funds rate 50 basis points at this meeting. They further anticipated that ongoing increases in the target range for the federal funds rate would be warranted to achieve the Committee's objectives. Participants also agreed that it was appropriate to start reducing the size of the Federal Reserve's balance sheet on June 1, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that would be issued in conjunction with the postmeeting statement. Participants judged that an appropriate firming of the stance of monetary policy, along with an eventual waning of supply–demand imbalances, would help to keep longer-term inflation expectations anchored and bring inflation down over time to levels consistent with the Committee's 2 percent longer-run goal.

All participants reaffirmed their strong commitment and determination to take the measures necessary to restore price stability. To this end, participants agreed that the Committee should expeditiously move the stance of monetary policy toward a neutral posture, through both increases in the target range for the federal funds rate and reductions in the size of the Federal Reserve's balance sheet. Most participants judged that 50 basis point increases in the target range would likely be appropriate at the next couple of meetings. Many participants assessed that the Committee's previous communications had been helpful in shifting market expectations regarding the policy outlook into better alignment with the Committee's assessment and had contributed to the tightening of financial conditions.

All participants supported the plans for reducing the size of the balance sheet. This reduction, starting on June 1, would work in parallel with increases in the target range for the policy rate in firming the stance of monetary policy. A number of participants remarked that, after balance sheet runoff was well under way, it would be appropriate for the Committee to consider sales of agency MBS to enable suitable

progress toward a longer-run SOMA portfolio composed primarily of Treasury securities. Any program of sales of agency MBS would be announced well in advance. Regarding risks related to the balance sheet reduction, several participants noted the potential for unanticipated effects on financial market conditions.

Participants agreed that the economic outlook was highly uncertain and that policy decisions should be data dependent and focused on returning inflation to the Committee's 2 percent goal while sustaining strong labor market conditions. At present, participants judged that it was important to move expeditiously to a more neutral monetary policy stance. They also noted that a restrictive stance of policy may well become appropriate depending on the evolving economic outlook and the risks to the outlook. Participants observed that developments associated with Russia's invasion of Ukraine and the COVID-related lockdowns in China posed heightened risks for both the United States and economies around the world. Several participants commented on the challenges that monetary policy faced in restoring price stability while also maintaining strong labor market conditions. In light of the high degree of uncertainty surrounding the economic outlook, participants judged that risk-management considerations would be important in deliberations over time regarding the appropriate policy stance. Many participants judged that expediting the removal of policy accommodation would leave the Committee well positioned later this year to assess the effects of policy firming and the extent to which economic developments warranted policy adjustments….

Source: Federal Reserve Board