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

TrendMacro

Data Insights: FOMC Minutes

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September minutes: key signaling language Featured Important Very important

…In their discussion of current economic conditions, participants noted that recent indicators had pointed to modest growth in spending and production. Job gains had been robust in recent months, and the unemployment rate had remained low. Inflation remained elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures. Participants recognized that Russia's war against Ukraine was causing tremendous human and economic hardship. Participants judged that the war and related events were creating additional upward pressure on inflation and were weighing on global economic activity. Against this background, participants remained highly attentive to inflation risks.

With regard to the economic outlook, participants noted that recent data pointed to modest growth in economic activity over the second half of this year. Participants observed that recent indicators of consumer spending and business investment suggested modest increases in those spending categories but noted that activity in interest-sensitive sectors weakened appreciably. Participants revised down their projections of real GDP growth for this year from their projections in June. Several participants noted that the continued strength in the labor market, as well as the data on gross domestic income, raised the possibility that the current GDP data could understate the strength in economic activity this year. Participants generally anticipated that the U.S. economy would grow at a below-trend pace in this and the coming few years, with the labor market becoming less tight, as monetary policy assumed a restrictive stance and global headwinds persisted. Participants noted that a period of below-trend real GDP growth would help reduce inflationary pressures and set the stage for the sustained achievement of the Committee's objectives of maximum employment and price stability.

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In their discussion of the household sector, participants noted that consumer spending grew moderately, reflecting strength in the labor market, the elevated level of household savings accumulated during the pandemic, and a strong aggregate household-sector balance sheet. Several participants noted that spending appeared to have held up relatively well, especially among higher-income households. These participants also noted that the composition of spending by low-to-moderate-income households—who were affected to a greater degree by high food, energy, and shelter prices—was changing, with discretionary expenditures being cut and purchases shifting to lower-cost options. Participants observed that the notable slowdown in residential investment and other interest-sensitive spending had continued, reflecting the effect of the Committee's monetary policy actions and tighter financial conditions.

With regard to the business sector, participants observed that growth in investment spending appeared modest. Several participants mentioned that manufacturing activity had slowed. A couple of participants noted that businesses were constrained in undertaking new capital projects, as they faced higher financing costs, persistent challenges associated with supply bottlenecks, and hiring difficulties resulting from the continued tightness of the labor market.

Participants discussed how they perceived challenging supply conditions to be evolving. Many participants remarked that their business contacts were reporting signs of relief in supply bottlenecks, such as declines in shipping costs and delivery times and rising inventories, while several participants saw little improvement in the supply situation. Participants saw supply bottlenecks as likely continuing for a while longer, and a couple commented that constraints on production were increasingly taking the form of labor shortages rather than parts shortages.

Participants observed that the labor market had remained very tight, as evidenced by a historically low unemployment rate, elevated job vacancies and quit rates, a low pace of layoffs, robust employment gains, and high nominal wage growth. A few participants remarked that employers facing particularly acute labor shortages were those associated with professional occupations, service industries, skilled trades, and smaller firms. Some participants noted a number of developments consistent with the labor market moving toward better balance, including a lower rate of job turnover, a

moderation in employment growth, and an increase in the labor force participation rate for prime-age workers. However, several participants assessed that the scope for further improvement in labor force participation was likely limited, especially in view of the sizable contribution that retirements had made to the previous decline in the participation rate.

Participants anticipated that the supply and demand imbalances in the labor market would gradually diminish and the unemployment rate would likely rise somewhat, importantly reflecting the effects of tighter monetary policy. Participants judged that a softening in the labor market would be needed to ease upward pressures on wages and prices. Participants expected that the transition toward a softer labor market would be accompanied by an increase in the unemployment rate. Several commented that they considered it likely that the transition would occur primarily through reduced job vacancies and slower job creation. A couple of participants remarked that, in light of challenges in hiring, businesses might be less willing to reduce their staffing levels in the event of a weakening in general economic activity. A few participants particularly stressed the high uncertainty associated with the expected future path of the unemployment rate and commented that the unemployment rate could rise by considerably more than in the staff forecast.

Participants observed that inflation remained unacceptably high and well above the Committee's longer-run goal of 2 percent. Participants commented that recent inflation data generally had come in above expectations and that, correspondingly, inflation was declining more slowly than they had previously been anticipating. Price pressures had remained elevated and had persisted across a broad array of product categories. Energy prices had declined in recent months but remained considerably higher than in 2021, and upside risks to energy prices remained. Several participants noted the continued elevated rates of increase in core goods prices. These participants considered this development as potentially indicating that the shift of household spending from goods to services might be having a smaller effect on goods prices than they expected or that the supply bottlenecks and labor shortages were taking longer to be resolved. Participants commented that they expected inflation pressures to persist in the near term. Numerous contributing factors were cited as supporting this view, including labor market tightness and the resulting upward

pressure on nominal wages, continuing supply chain disruptions, and the persistent nature of increases in services prices, particularly shelter prices.

With respect to the medium term, participants judged that inflation pressures would gradually recede in coming years. Various factors were cited as likely to contribute to this outcome, including the Committee's tightening of its policy stance, a gradual easing of supply and demand imbalances in labor and product markets, and the likelihood that weaker consumer demand would result in a reduction of business profit margins from their current elevated levels. A few participants reported that business contacts in certain retail sectors—such as used cars and apparel—were planning to cut prices in order to help reduce their inventories. Several participants commented that while households across the income distribution were burdened by elevated inflation, those at the lower end of the income distribution were particularly harmed, as a larger share of their income was spent on housing and other necessities.

In assessing inflation expectations, participants noted that longer-term expectations appeared to remain well anchored, as reflected in a broad range of surveys of households, businesses, and forecasters as well as measures obtained from financial markets. Participants remarked that the Committee's affirmation of its strong commitment to its price-stability objective, together with its forceful policy actions, had likely helped keep longer-run inflation expectations anchored. Some stressed that a more prolonged period of elevated inflation would increase the risk of inflation expectations becoming unanchored, making it much more costly to bring inflation down. A few participants discussed the increased dispersion of longer-term inflation expectations across respondents in various surveys, with an increase in the number of respondents reporting relatively low expectations of future inflation acknowledged as a key driver of the increased dispersion but with a couple of participants citing higher inflation expectations among some survey respondents as a cause for concern and a reason not to be complacent about longer-term inflation expectations remaining well anchored.

Participants agreed that the uncertainty associated with their economic outlooks was high and that risks to their inflation outlook were weighted to the upside. Some participants noted rising labor tensions, a new round of global energy price increases,

further disruptions in supply chains, and a larger-than-expected pass-through of wage increases into price increases as potential shocks that, if they materialized, could compound an already challenging inflation problem. A number of participants commented that a wage–price spiral had not yet developed but cited its possible emergence as a risk.

Participants broadly judged the risks to real GDP growth to be weighted to the downside, with various global headwinds most prominently cited as contributing factors. These global headwinds included heightened risk of recession in Europe, a slowdown in economic activity occurring in China, and the ongoing global economic implications of Russia's war against Ukraine. Several participants noted that the monetary policy tightening under way in many other economies would affect global financial markets and foreign real GDP growth, with the potential for spillovers to the U.S. economy.

In their consideration of the appropriate stance of monetary policy, participants concurred that the labor market was very tight and that inflation was far above the Committee's 2 percent inflation objective. Participants observed that recent indicators of production and spending had pointed to modest growth, while job gains had been robust and the unemployment rate had remained low. Against this backdrop, all participants agreed that it was appropriate to raise the target range for the federal funds rate 75 basis points at this meeting and to continue the process of reducing the Federal Reserve's securities holdings, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that the Committee issued in May. Policymakers observed that the rate hike at this meeting was another step toward making the Committee's monetary policy stance sufficiently restrictive to help ease supply and demand imbalances and to bring inflation back to 2 percent. Participants reaffirmed their strong commitment to returning inflation to the Committee's 2 percent objective, with many stressing the importance of staying on this course even as the labor market slowed.

In discussing potential policy actions at upcoming meetings, participants continued to anticipate that ongoing increases in the target range for the federal funds rate would be appropriate to achieve the Committee's objectives. Participants judged that the Committee needed to move to, and then maintain, a more restrictive policy stance in

order to meet the Committee's legislative mandate to promote maximum employment and price stability. Many participants noted that, with inflation well above the Committee's 2 percent objective and showing little sign so far of abating, and with supply and demand imbalances in the economy continuing, they had raised their assessment of the path of the federal funds rate that would likely be needed to achieve the Committee's goals. Participants judged that the pace and extent of policy rate increases would continue to depend on the implications of incoming information for the outlook for economic activity and inflation and on risks to the outlook. Several participants noted that, particularly in the current highly uncertain global economic and financial environment, it would be important to calibrate the pace of further policy tightening with the aim of mitigating the risk of significant adverse effects on the economic outlook. Participants observed that, as the stance of monetary policy tightened further, it would become appropriate at some point to slow the pace of policy rate increases while assessing the effects of cumulative policy adjustments on economic activity and inflation. Many participants indicated that, once the policy rate had reached a sufficiently restrictive level, it likely would be appropriate to maintain that level for some time until there was compelling evidence that inflation was on course to return to the 2 percent objective. Participants noted that, in keeping with the Committee's Plans for Reducing the Size of the Federal Reserve's Balance Sheet, balance sheet runoff had moved up to its maximum planned pace in September and would continue at that pace. They further observed that a significant reduction in the Committee's holdings of securities was in progress and that this process was contributing to the move to a restrictive policy stance. A couple of participants remarked that, after the process of balance sheet reduction was well under way, it would be appropriate for the Committee to consider sales of agency MBS in order to enable suitable progress toward a longer-run SOMA portfolio composed primarily of Treasury securities.

In their assessment of the effects of policy actions and communications to date, participants concurred that the Committee's actions to raise expeditiously the target range for the federal funds rate demonstrated its resolve to lower inflation to 2 percent and to keep inflation expectations anchored at levels consistent with that longer-run goal. Participants noted that the Committee's commitment to restoring price stability, together with its purposeful policy actions and communications, had

contributed to a notable tightening of financial conditions over the past year that would likely help reduce inflation pressures by restraining aggregate demand. Participants observed that this tightening had led to substantial increases in real interest rates across the maturity spectrum. Most participants remarked that, although some interest-sensitive categories of spending—such as housing and business fixed investment—had already started to respond to the tightening of financial conditions, a sizable portion of economic activity had yet to display much response. They noted also that inflation had not yet responded appreciably to policy tightening and that a significant reduction in inflation would likely lag that of aggregate demand. Participants observed that a period of real GDP growth below its trend rate, very likely accompanied by some softening in labor market conditions, was required. They agreed that, by moving its policy purposefully toward an appropriately restrictive stance, the Committee would help ensure that elevated inflation did not become entrenched and that inflation expectations did not become unanchored. These policy moves would therefore prevent the far greater economic pain associated with entrenched high inflation, including the even tighter policy and more severe restraint on economic activity that would then be needed to restore price stability.

In light of the broad-based and unacceptably high level of inflation, the intermeeting news of higher-than-expected inflation, and upside risks to the inflation outlook, participants remarked that purposefully moving to a restrictive policy stance in the near term was consistent with risk-management considerations. Many participants emphasized that the cost of taking too little action to bring down inflation likely outweighed the cost of taking too much action. Several participants underlined the need to maintain a restrictive stance for as long as necessary, with a couple of these participants stressing that historical experience demonstrated the danger of prematurely ending periods of tight monetary policy designed to bring down inflation. Several participants observed that as policy moved into restrictive territory, risks would become more two-sided, reflecting the emergence of the downside risk that the cumulative restraint in aggregate demand would exceed what was required to bring inflation back to 2 percent. A few of these participants noted that this possibility was heightened by factors beyond the Committee's actions, including the tightening of monetary policy stances abroad and the weakening global economic

outlook, that were also likely to restrain domestic economic activity in the period ahead.

Source: Federal Reserve Board