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Data Insights: FOMC Minutes

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December minutes: key signaling language Featured Important Very important

…In their discussion of current economic conditions, participants noted that recent indicators pointed to modest growth of spending and production. Nonetheless, 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. The war and related events were contributing to upward pressure on inflation and were weighing on global economic activity. Against this background, participants continued to be highly attentive to inflation risks.

Participants observed that the growth of economic activity had slowed significantly in 2022 from the previous year's robust pace, partly in response to the Committee's policy actions. The effects of those actions were especially notable in interest-sensitive sectors, particularly housing. Participants remarked that, although real GDP appeared to have rebounded moderately in the second half of 2022 after declining somewhat in the first half, economic activity appeared likely to expand in 2023 at a pace well below its trend growth rate. With inflation remaining unacceptably high, participants expected that a sustained period of below-trend real GDP growth would be needed to bring aggregate supply and aggregate demand into better balance and thereby reduce inflationary pressures.

In their discussion of the household sector, participants noted that growth in consumer spending in September and October had been stronger than they had previously expected, likely supported by a strong labor market and households running down excess savings accumulated during the pandemic. A couple of participants remarked that excess savings likely would continue to support consumption spending for a while. A couple of other participants, however, commented that excess savings, particularly among low-income households, appeared to be lower and declining more rapidly than previously thought or that the savings, the majority of which appeared to be held by higher-income households, might continue to be largely unspent. Several participants remarked that budgets were stretched for low-to-moderate-income households and that many consumers were shifting their spending to less expensive alternatives. They also observed that many households were increasingly using credit to finance spending. Overall, participants assessed that there was considerable uncertainty around the consumer spending outlook. Participants commented that higher mortgage interest rates had notably restrained housing activity and that they expected housing activity to remain weak. A couple of participants remarked on anecdotes or concerns from builder contacts about contract cancellations by purchasers no longer able to qualify for loans at higher interest rates.

With regard to the business sector, participants noted that growth in investment spending appeared modest and was being restrained by high borrowing costs and an outlook for slow growth of final demand, although views on investment prospects varied across businesses and Districts. Based on discussions with District contacts as well as a survey of firms' chief financial officers, some participants commented that while businesses were generally optimistic about their own prospects, they expressed increasing concern about the general economic outlook for 2023. Participants noted signs of continued easing in supply bottlenecks, with a couple citing District contacts' reports of declines in shipping costs and delivery times. Even so, participants remarked that the improvements in supply chains had not been uniform and supply shortages remained for some types of goods. Participants also discussed the developments in energy and agricultural sectors. Several participants commented that they saw diminished risks of severe disruption from the European Union's embargo and the Group of Seven's price cap on Russian oil exports. A couple of participants noted that high costs for inputs like diesel, feed, and fertilizer were creating challenges for the agricultural sector.

Participants observed that the labor market had remained very tight, with the unemployment rate near a historically low level, robust payroll gains, a high level of job vacancies, and elevated nominal wage growth. Several participants commented that there were tentative signs of labor market imbalances improving, including declines in job openings and quits over the second half of 2022 as well as reports from District contacts that they were seeing more qualified job applicants for open positions than earlier in the year. Some participants pointed out that payroll gains had remained robust even as they slowed in recent months. Nevertheless, they noted that some other measures of employment—such as those based on the Bureau of Labor Statistics' household survey and the Quarterly Census of Employment and Wages—suggested that job growth in 2022 may have been weaker than indicated by payroll employment. Participants generally concluded that there remained a large imbalance between labor supply and labor demand, as indicated by the still-large number of job openings and elevated nominal wage growth. Participants commented that labor demand had remained strong to date despite the slowdown in economic growth, with a few remarking that some business contacts reported that they would be keen to retain workers even in the face of slowing demand for output because of their recent experiences of labor shortages and hiring challenges. With the labor force participation rate little changed since the beginning of 2022, some participants commented that labor supply appeared to be constrained by structural factors such as early retirements, reduced availability or increased cost of childcare, more costly transportation, and reduced immigration. Under an appropriately restrictive path of monetary policy, participants expected labor market supply and demand to come into better balance over time, easing upward pressures on nominal wages and prices. In the context of achieving the Committee's broad-based and inclusive maximum-employment goal, a number of participants commented that as the labor market moved into better balance, the unemployment rate for some demographic groups—particularly African Americans and Hispanics—would likely increase by more than the national average.

With inflation still well above the Committee's longer-run goal of 2 percent, participants agreed that inflation was unacceptably high. Participants concurred that the inflation data received for October and November showed welcome reductions in the monthly pace of price increases, but they stressed that it would take substantially more evidence of progress to be confident that inflation was on a sustained downward path. Participants noted that core goods prices declined in the October and November CPI data, consistent with easing supply bottlenecks. Some participants also noted that, by some measures, firms' markups were still elevated and that a continued subdued expansion in aggregate demand would likely be needed to reduce remaining upward pressure on inflation. Regarding housing services inflation, many participants observed that measures of rent based on new leases were indicating a deceleration, which would be reflected in the measures of shelter inflation with some lag. Participants noted that, in the latest inflation data, the pace of increase for prices of core services excluding shelter—which represents the largest component of core PCE price inflation—was high. They also remarked that this component of inflation has tended to be closely linked to nominal wage growth and therefore would likely remain persistently elevated if the labor market remained very tight. Consequently, while there were few signs of adverse wage-price dynamics at present, they assessed that bringing down this component of inflation to mandate-consistent levels would require some softening in the growth of labor demand to bring the labor market back into better balance.

Participants observed that measures from surveys of households and businesses as well as from financial markets generally indicated that longer-term inflation expectations remained well anchored, while short-term inflation expectations had come down. However, participants stressed that the Committee's ongoing monetary policy tightening to achieve a stance that will be sufficiently restrictive to return inflation to 2 percent is essential for ensuring that longer-term expectations remain well anchored. Several participants commented that the longer inflation remained well above the 2 percent goal, the greater the risk that longer-term inflation expectations could become unanchored. Such a development, if it materialized, would make it much more costly to bring inflation down to achieve the Committee's statutory objectives of maximum employment and price stability.

Participants noted that since the November meeting, financial conditions had eased, with the market-implied path for the federal funds rate beyond 2023 and longer-term yields coming down noticeably. A few participants remarked that the current configuration of nominal yields, with longer-term yields lower than shorter-term yields, had historically preceded recessions and hence bore watching. However, a couple of them also noted that the current inversion of the yield curve could reflect, in part, that investors expect the nominal policy rate to decline because of a fall in inflation over time.

Participants generally noted that the uncertainty associated with their economic outlooks was high and that the risks to the inflation outlook remained tilted to the upside. Participants cited the possibility that price pressures could prove to be more persistent than anticipated, due to, for example, the labor market staying tight for longer than anticipated. Participants saw a number of uncertainties surrounding the outlook for inflation stemming from factors abroad, such as China's relaxation of its zero-COVID policies, Russia's continuing war against Ukraine, and effects of synchronous policy firming by major central banks. A number of participants judged that the risks to the outlook for economic activity were weighted to the downside. They noted that sources of such risks included the potential for more persistent inflation inducing more restrictive policy responses, the prospect of unexpected negative shocks tipping the economy into a recession in an environment of subdued growth, and the possibility of households' and businesses' concerns about the outlook restraining their spending sufficiently to reduce aggregate output.

In their consideration of appropriate monetary policy actions at this meeting, participants concurred that the Committee had made significant progress over the past year in moving toward a sufficiently restrictive stance of monetary policy. Even so, participants agreed that inflation remained well above the Committee's longer-run goal of 2 percent, while the labor market remained very tight, contributing to upward pressures on wages and prices. 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 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. Participants observed that a slowing in the pace of rate increases at this meeting would better allow the Committee to assess the economy's progress toward the Committee's goals of maximum employment and price stability, as monetary policy approached a stance that was sufficiently restrictive to achieve these goals.

In discussing the policy outlook, 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. In determining the pace of future increases in the target range, participants judged that it would be appropriate to take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. With inflation staying persistently above the Committee's 2 percent goal and the labor market remaining very tight, all participants had raised their assessment of the appropriate path of the federal funds rate relative to their assessment at the time of the September meeting. No participants anticipated that it would be appropriate to begin reducing the federal funds rate target in 2023. Participants generally observed that a restrictive policy stance would need to be maintained until the incoming data provided confidence that inflation was on a sustained downward path to 2 percent, which was likely to take some time. In view of the persistent and unacceptably high level of inflation, several participants commented that historical experience cautioned against prematurely loosening monetary policy.

In light of the heightened uncertainty regarding the outlooks for both inflation and real economic activity, most participants emphasized the need to retain flexibility and optionality when moving policy to a more restrictive stance. Participants generally noted that the Committee's future decisions regarding policy would continue to be informed by the incoming data and their implications for the outlook for economic activity and inflation, and that the Committee would continue to make decisions meeting by meeting.

Participants reaffirmed their strong commitment to returning inflation to the Committee's 2 percent objective. A number of participants emphasized that it would be important to clearly communicate that a slowing in the pace of rate increases was not an indication of any weakening of the Committee's resolve to achieve its price-stability goal or a judgment that inflation was already on a persistent downward path. Participants noted that, because monetary policy worked importantly through financial markets, an unwarranted easing in financial conditions, especially if driven by a misperception by the public of the Committee's reaction function, would complicate the Committee's effort to restore price stability. Several participants commented that the medians of participants' assessments for the appropriate path of the federal funds rate in the Summary of Economic Projections, which tracked notably above market-based measures of policy rate expectations, underscored the Committee's strong commitment to returning inflation to its 2 percent goal.

Participants discussed a number of risk-management considerations related to the conduct of monetary policy. Many participants highlighted that the Committee needed to continue to balance two risks. One risk was that an insufficiently restrictive monetary policy could cause inflation to remain above the Committee's target for longer than anticipated, leading to unanchored inflation expectations and eroding the purchasing power of households, especially for those already facing difficulty making ends meet. The other risk was that the lagged cumulative effect of policy tightening could end up being more restrictive than is necessary to bring down inflation to 2 percent and lead to an unnecessary reduction in economic activity, potentially placing the largest burdens on the most vulnerable groups of the population. Participants generally indicated that upside risks to the inflation outlook remained a key factor shaping the outlook for policy. A couple of participants noted that risks to the inflation outlook were becoming more balanced. Participants generally observed that maintaining a restrictive policy stance for a sustained period until inflation is clearly on a path toward 2 percent is appropriate from a risk-management perspective.

Source: Federal Reserve Board