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Data Insights: FOMC Minutes

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February minutes: key signaling language Featured Important Very important

…Participants agreed that cumulative policy firming to date had reduced demand in the most interest-rate-sensitive sectors of the economy, particularly housing. Participants observed that growth in economic activity in 2022 had been below its longer-run trend and expected that real GDP growth would slow further in 2023. While real GDP growth had rebounded in the second half of 2022, several participants noted that growth in PDFP [real private domestic final purchases] had nearly stalled in the fourth quarter. With inflation remaining unacceptably high, participants expected that a period of below-trend growth in real GDP would be needed to bring aggregate demand into better balance with aggregate supply and thereby reduce inflationary pressures. Some participants judged that recent economic data signaled a somewhat higher chance of continued subdued economic growth, with inflation falling over time to the Committee's longer-run goal of 2 percent, although some participants noted that the probability of the economy entering a recession in 2023 remained elevated.

In their discussion of the household sector, participants observed that real consumer spending had declined in November and December—in part reflecting the tightening in financial conditions over the past year—and anticipated that consumption would likely grow at a subdued rate in 2023. Participants noted that excess savings accumulated during the pandemic had continued to support consumption, although several participants remarked that the importance of this factor would likely wane over time as excess savings continued to be drawn down or eroded by inflation. A couple of participants observed that some consumers were shifting their spending to less expensive alternatives. A few participants noted the effects of higher interest costs in restraining consumption or inhibiting the ability of some households to repay their loans, while a couple of participants noted that inflation was eroding households' purchasing power. However, a couple of participants noted that some

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states could return part of their sizable budget surpluses to households through tax cuts or rebates, which would provide support to consumption. Participants agreed that activity in the housing market had continued to weaken, largely reflecting the increase in mortgage rates over the past year.

Regarding the business sector, participants observed that growth in business fixed investment spending had been subdued in the fourth quarter and was being restrained by past interest rate increases. A number of participants commented that supply bottlenecks continued to ease, although supply chain issues remained a challenge in some sectors. Several participants remarked that the recent strong growth in inventory investment will likely slow; a couple of those participants noted that businesses appeared more confident that significant supply bottlenecks would not reemerge and might therefore choose to hold smaller inventories. Some participants commented that the easing of COVID-related lockdown restrictions in China or stronger-than-expected growth in economic activity in the euro area could provide support to final demand in the United States.

Participants agreed that the labor market remained very tight and assessed that labor demand substantially exceeded the supply of available workers. Participants noted that the unemployment rate had returned to a historically low level in December, job vacancies remained high, and wage growth remained elevated. Several participants noted that recent reductions in the workforces of some large technology businesses followed much larger increases over the previous few years and judged that these reductions did not appear to reflect widespread weakness in the demand for labor. A few participants remarked that some business contacts appeared keen to retain workers even in the face of slowing demand for output because of their recent experiences of labor shortages and hiring challenges. Participants agreed that labor supply remained constrained by structural factors such as the effects from the pandemic, including those on early retirements, and the reduced availability and increased cost of childcare. Nevertheless, participants noted tentative signs that imbalances between demand and supply in the labor market were improving, with job vacancies and payroll gains declining somewhat from high levels, the average number of hours worked falling, and growth in wages and employment costs slowing. Some participants commented on the recent reduction in temporary employment, which previously had often preceded more widespread reductions in labor demand.

Under appropriate monetary policy, participants expected labor market demand and supply to come into better balance over time, easing upward pressure on nominal wages and prices. A number of participants commented on the importance of recognizing that, to the extent national unemployment increases, historical evidence indicates that even larger increases in the unemployment rate for some demographic groups—particularly African Americans and Hispanics—would be likely to occur.

With inflation still well above the Committee's longer-run goal of 2 percent, participants agreed that inflation was unacceptably high. A number of participants commented that the costs of elevated inflation are particularly high for lower-income households. Participants noted that inflation data received over the past three months showed a welcome reduction in the monthly pace of price increases but stressed that substantially more evidence of progress across a broader range of prices would be required to be confident that inflation was on a sustained downward path. Participants noted that core goods prices had declined notably over the previous few months as supply bottlenecks had eased but anticipated that price declines for this component would dissipate as the downward pressure on goods prices from resolving supply bottlenecks fades. Participants judged that housing services inflation would likely begin to fall later this year, reflecting continued smaller increases, or potentially declines, in rents on new leases. Participants agreed that they had observed less evidence of a slowdown in the rate of increase of prices for core services excluding housing, a category that accounts for more than half of the core PCE price index. Participants judged that as long as the labor market remained very tight, wage growth in excess of 2 percent inflation and trend productivity growth would likely continue to put upward pressure on some prices in this component. A couple of participants observed that changes in wages tend to lag changes in prices, which can complicate the assessment of inflation pressures. A couple of participants remarked that the poor performance of labor productivity growth last year was restraining aggregate supply, which was contributing to imbalances between aggregate demand and aggregate supply and therefore to upward pressure on inflation. Several participants noted the possibility that as consumers become more price sensitive, businesses might accept lower profit margins in an effort to maintain market share, which could reduce inflation temporarily. Participants observed that indicators of short-term inflation expectations from surveys of households and

businesses as well as from financial markets had come down and that longer-term inflation expectations remained well anchored. A number of participants noted the importance of longer-term inflation expectations remaining anchored and remarked that the longer inflation remained elevated, the greater the risk of inflation expectations becoming unanchored. In that adverse scenario, it would be more costly to bring inflation down to achieve the Committee's statutory objectives of maximum employment and price stability.

Participants observed that financial conditions remained much tighter than in early 2022. However, several participants observed that some measures of financial conditions had eased over the past few months. A few participants noted that increased confidence among market participants that inflation would fall quickly appeared to contribute to declines in market expectations of the federal funds rate path beyond the near term. Participants noted that it was important that overall financial conditions be consistent with the degree of policy restraint that the Committee is putting into place in order to bring inflation back to the 2 percent goal.

Participants observed that the uncertainty associated with their outlooks for economic activity, the labor market, and inflation was high. Regarding upside risks to inflation, participants cited a variety of factors, including 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 also saw a number of upside risks surrounding the outlook for inflation stemming from factors abroad, such as China's relaxation of its zero-COVID policies and Russia's continuing war against Ukraine. However, a few participants remarked that the risks to their inflation outlook had become more balanced. Participants agreed that the risks to the outlook for economic activity were weighted to the downside. Participants noted that sources of such risks included the prospect of unexpected negative shocks tipping the economy into a recession in an environment of subdued growth, the effects of synchronous policy firming by major central banks, and disruptions in the financial system and broader economy associated with concerns that the statutory debt limit might not be raised in a timely manner.

In their discussion of issues related to financial stability, several participants discussed vulnerabilities in the financial system associated with higher interest rates,

including the elevated valuations for some categories of assets, particularly in the CRE sector; the susceptibility of some nonbank financial institutions to runs; and the effect of large, unrealized losses on some banks' securities portfolios. A few participants commented that international stresses had the potential to transmit to the U.S. financial system. A number of participants noted the importance of orderly functioning of the market for U.S. Treasury securities and stressed the importance of the appropriate authorities continuing to address issues related to the resilience of the market. Al-though several participants noted that the Federal Reserve's standing liquidity facilities could be helpful in addressing significant pressures in funding markets, should they arise, several participants also noted the challenges of addressing potential disruptions in U.S. core market functioning. A few participants remarked that recent failures of companies involved in crypto finance have had a limited effect on the broader financial system. These participants indicated that this limited effect reflected the minimal extent of the crypto market's connections to the banking system thus far, consistent with the risks associated with many of these activities. Several participants discussed the value of the Federal Reserve taking additional steps to understand the potential risks associated with climate change or to assess the materiality of such risks in the context of carrying out its responsibilities to evaluate risks in the banking system and broader financial system. A number of participants stressed that a drawn-out period of negotiations to raise the federal debt limit could pose significant risks to the financial system and the broader economy.

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, while there were recent signs that the cumulative effect of the Committee's tightening of the stance of monetary policy had begun to moderate inflationary pressures, inflation remained well above the Committee's longer-run goal of 2 percent and the labor market remained very tight, contributing to continuing upward pressures on wages and prices. Against this backdrop, and in consideration of the lags with which monetary policy affects economic activity and inflation, almost all participants agreed that it was appropriate to raise the target range for the federal funds rate 25 basis points at this meeting. Many of these participants observed that a further slowing in the pace of rate increases would

better allow them to assess the economy's progress toward the Committee's goals of maximum employment and price stability as they determine the extent of future policy tightening that will be required to attain a stance that is sufficiently restrictive to achieve these goals. A few participants stated that they favored raising the target range for the federal funds rate 50 basis points at this meeting or that they could have supported raising the target by that amount. The participants favoring a 50-basis point increase noted that a larger increase would more quickly bring the target range close to the levels they believed would achieve a sufficiently restrictive stance, taking into account their views of the risks to achieving price stability in a timely way. All participants agreed that it was appropriate to continue the process of reducing the Federal Reserve's securities holdings, as described in its previously announced Plans for Reducing the Size of the Federal Reserve's Balance Sheet.

In discussing the policy outlook, with inflation still well above the Committee's 2 percent goal and the labor market remaining very tight, all 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 affirmed their strong commitment to returning inflation to the Committee's 2 percent objective. In determining the extent 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. Participants 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.

Participants discussed the heightened uncertainty regarding the economic outlook and a number of factors that could affect inflation and real economic activity. 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. A number of participants observed that financial conditions had eased in recent months, which some noted could necessitate a tighter stance of monetary policy.

Participants also discussed a number of risk-management considerations related to the conduct of monetary policy. Almost all participants observed that slowing the pace of rate increases at the current juncture would allow for appropriate risk management as the Committee assessed the extent of further tightening needed to meet the Committee's goals. Several of those participants observed that risks to the economic outlook were becoming more balanced. With inflation still well above the Committee's longer-run goal, participants generally noted that upside risks to the inflation outlook remained a key factor shaping the policy outlook, and that maintaining a restrictive policy stance until inflation is clearly on a path toward 2 percent is appropriate from a risk-management perspective. A number of participants observed that a policy stance that proved to be insufficiently restrictive could halt recent progress in moderating inflationary pressures, leading inflation to remain above the Committee's 2 percent objective for a longer period, and pose a risk of inflation expectations becoming unanchored.

Participants noted that the runoff of the balance sheet had been proceeding smoothly. A few participants observed that money markets could experience some temporary pressures as reserves declined if use of the Federal Reserve's ON RRP facility continued to remain high. They noted, however, that such pressures, should they occur, would likely cause an upward re-pricing of private money-market rates that could encourage market participants to reduce their use of the facility.

Source: Federal Reserve Board