Trend Macro

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

Data Insights: FOMC Minutes

Wednesday, November 22, 2023

November minutes Key signaling language: Featured Important Very important

…The rise since July in yields on longer-dated nominal Treasury securities was mostly attributable to increases in real yields. There were small increases in inflation compensation, but the levels of spot and forward rates were within historical ranges. The manager also noted that survey measures pointed to generally stable inflation

Copyright 2023 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.

expectations, especially at longer horizons, and that inflation expectations remained well anchored.

Staff analysis and responses from the Open Market Desk's Survey of Primary Dealers and Survey of Market Participants suggested that the bulk of the increase since July in the 10-year nominal Treasury yield could be attributed to a higher term premium, though higher policy expectations at longer horizons could also have played a role. The manager also noted that liquidity conditions in the Treasury market had not changed materially since July, suggesting that Treasury market liquidity had not been an important driver of the increase in yields.

…The economic forecast prepared by the staff for the October–November meeting was similar to the September projection. The staff expected fourth-quarter GDP growth to slow markedly from its third-quarter rate. All told, however, average GDP growth over the second half of the year was projected to be a little faster than the first half's pace…

Participants noted that real GDP had expanded at an unexpectedly strong pace in the third quarter, boosted by a surge in consumer spending. Nevertheless, participants judged that aggregate demand and aggregate supply continued to come into better balance, as a result of the current restrictive stance of monetary policy and the continued normalization of aggregate supply conditions. Participants assessed that while labor market conditions remained tight, they had eased since earlier in the year, partly as a result of recent increases in labor supply. Participants judged that the current stance of monetary policy was restrictive and was putting downward pressure on economic activity and inflation. In addition, they noted that financial conditions had tightened significantly in recent months. Participants noted that inflation had moderated over the past year but stressed that current inflation remained unacceptably high and well above the Committee's longer-run goal of 2 percent. They also stressed that further evidence would be required for them to be confident that inflation was clearly on a path to the Committee's 2 percent objective. Participants continued to view a period of below-potential growth in real GDP and some further softening in labor market conditions as likely to be needed to reduce inflation pressures sufficiently to return inflation to 2 percent over time.

In their discussion of the household sector, participants observed that the incoming data on consumer spending had again surprised to the upside, likely supported by a strong labor market and by generally solid household balance sheets. Nevertheless, some participants remarked that the finances of some households—especially those in the low- and moderate-income categories—were increasingly coming under pressure amid high prices for food and other essentials as well as tight credit conditions. Several participants added that delinquencies on auto loans and credit cards had risen for these households. Some participants commented that their District contacts reported a somewhat weaker picture of consumer demand than indicated by the incoming aggregate data. Several participants, however, noted that repeated upside surprises in the aggregate spending data could indicate that considerable momentum could be sustained. A couple of these participants commented that the aggregate household sector may have more financial resources than previously thought, which could help account for the strength in spending. A few participants observed that activity in the housing sector had flattened out in recent months, likely reflecting the effects of further increases in mortgage rates from already elevated levels.

Business fixed investment was flat in the third quarter, and participants observed that conditions reported by their business contacts varied across industries and Districts. Some participants noted that businesses were benefiting from an increased ability to hire and retain workers, better-functioning supply chains, or reduced input cost pressures. A few participants commented that their business contacts had reported that cost increases could not be easily passed on to customers. Several participants commented that the apparent resolution of the United Auto Workers strike would reduce business-sector uncertainty. Several participants noted that an increasing number of District businesses were reporting that higher interest rates were affecting their businesses or that firms were increasingly cutting or delaying their investment plans because of higher borrowing costs and tighter bank lending conditions. A few participants noted that the tighter financial and credit conditions could be particularly challenging for small businesses. A few participants observed that higher interest rates were also affecting the agricultural sector, with their contacts noting that high financing costs were likely weighing on purchases of heavy agricultural equipment. Regarding the energy sector, a few participants observed that energy markets had

calmed after significant volatility at the start of the current armed conflict between Israel and Hamas.

Participants observed that the labor market remained tight. Payroll growth was unexpectedly strong in September, and the unemployment rate remained low. Nevertheless, participants assessed that labor supply and labor demand were continuing to come into better balance. Measures of labor supply had moved up, with the labor force participation rate for prime-age workers rising this year, especially for women, and immigration also boosting labor supply. A few participants expressed concern that the recent pace of increases in labor supply might not be sustainable in light of challenges regarding the availability of childcare and the uncertainty regarding the extent to which immigration would continue to boost the growth of labor supply. Regarding labor demand, various measures appeared to indicate some easing, including a downward trend in job openings, a lower quits rate, and reduced wage premiums offered to job switchers. Consistent with the gradual rebalancing of labor market conditions, participants commented that the pace of nominal wage increases had continued to moderate. A few participants noted, however, that nominal wages were still rising at rates above levels generally assessed to be consistent with the sustained achievement of the Committee's 2 percent inflation objective, given current estimates of trend productivity growth.

Participants observed that inflation had continued to moderate since the middle of last year. Both the 6- and 12-month change measures of core PCE price inflation had come down somewhat in recent months, despite a less favorable monthly reading in September. Participants pointed to the softening of core goods prices in recent months, as well as the continued gradual decline in housing services inflation. However, participants also noted that there had been only limited progress in bringing down inflation in core services excluding housing. Participants noted that longer-term inflation expectations remained well anchored. Participants observed that, notwithstanding the moderation of inflation so far, inflation remained well above the Committee's 2 percent longer-run objective and that elevated inflation was continuing to harm businesses and households, particularly low-income households. Participants stressed that they would need to see more data indicating that inflation pressures were abating to be more confident that inflation was on course to return to 2 percent over time.

Participants noted that in recent months, financial conditions had tightened significantly because of a substantial run-up in longer-term Treasury yields, among other factors. Higher Treasury yields contributed to an increase in 30-year mortgage rates to levels not seen in many years and led to higher corporate borrowing rates. Many participants observed that a range of measures suggested that the rise in longer-term yields had been driven primarily or substantially by a rise in the term premiums on Treasury securities. Participants generally viewed factors such as a fiscal outlook that suggested greater future supply of Treasury securities than previously thought and increased uncertainty about the economic and policy outlooks as likely having contributed to the rise in the term premiums. Some participants noted that the rise in longer-term yields may also have been driven by expectations for a higher path of the federal funds rate in light of the surprising resilience of the economy or a possible rise in the neutral policy rate. Participants highlighted that longer-term yields could be volatile and that the factors behind the recent increase, as well as their persistence, were uncertain. However, they also noted that, whatever the source of the rise in longer-term yields, persistent changes in financial conditions could have implications for the path of monetary policy and that it would therefore be important to continue to monitor market developments closely.

Participants generally noted a high degree of uncertainty surrounding the economic outlook. As upside risks to economic activity, participants noted that the factors behind the resilience in spending could persist longer than expected. As downside risks, participants cited the possibility that the effects on households and businesses of the cumulative policy tightening and tighter financial conditions could be larger than expected, disruptions from a potential government shutdown, and the possibility that the resumption of student loan repayments could weigh on household spending by more than was expected. As upside risks to inflation, participants cited the possibility that progress on disinflation stalls or inflation reaccelerates because of continued momentum in economic activity. A potential for a broadening of the armed conflict in the Middle East was seen as presenting upside risk to inflation through its potential effect on oil prices as well as downside risk to economic activity.

In their discussion of financial stability, participants observed that the banking system was sound and resilient and that banking stresses had subsided. However, many participants commented that unrealized losses on assets resulting from the rise in

longer-term interest rates, significant reliance by some banks on uninsured deposits, and increased funding costs at banks warranted monitoring. Many participants also commented on risks associated with a potential sharp decline in CRE valuations, which could adversely affect some banks and other financial institutions. Several participants noted potential cyber risks and emphasized the importance of firms, particularly providers of critical infrastructure, being prepared to recover from such threats. A few participants also discussed the importance of monitoring Treasury market functioning and potential vulnerabilities posed by the amount of leverage being used by hedge funds in this market. In addition, several participants emphasized the need for banks to establish readiness to use Federal Reserve liquidity facilities and for the Federal Reserve to ensure its own readiness to provide liquidity during periods of stress.

In their consideration of appropriate monetary policy actions at this meeting, participants noted that economic activity expanded at a strong pace in the third quarter and had been resilient. While the labor market remained tight, job gains had moderated, on balance, since earlier in the year, and there were continuing signs that supply and demand in the labor market were coming into better balance. While inflation had moderated since the middle of last year, it remained well above the Committee's longer-run goal of 2 percent, and participants remained resolute in their commitment to bring inflation down to the Committee's 2 percent objective. Participants also noted that tighter financial and credit conditions facing households and businesses would likely weigh on economic activity, hiring, and inflation, although the extent of these effects remained uncertain. Participants commented on the significant tightening in financial conditions in recent months, driven by higher longer-term yields, with many noting that it was uncertain whether this tightening of financial conditions would persist and to what extent it reflected expectations for tighter policy or other factors. Amid these economic conditions, all participants judged it appropriate to maintain the target range for the federal funds rate at 5¼ to 5½ percent at this meeting. Participants judged that maintaining this restrictive stance of policy at this meeting would support further progress toward the Committee's goals while allowing more time to gather additional information to evaluate this progress. All participants agreed that it was appropriate to continue the process of reducing the Federal Reserve's securities holdings, as described in the

previously announced Plans for Reducing the Size of the Federal Reserve's Balance Sheet.

In discussing the policy outlook, participants continued to judge that it was critical that the stance of monetary policy be kept sufficiently restrictive to return inflation to the Committee's 2 percent objective over time. All participants agreed that the Committee was in a position to proceed carefully and that policy decisions at every meeting would continue to be based on the totality of incoming information and its implications for the economic outlook as well as the balance of risks. Participants noted that further tightening of monetary policy would be appropriate if incoming information indicated that progress toward the Committee's inflation objective was insufficient. Participants expected that the data arriving in coming months would help clarify the extent to which the disinflation process was continuing, aggregate demand was moderating in the face of tighter financial and credit conditions, and labor markets were reaching a better balance between demand and supply. Participants noted the importance of continuing to communicate clearly about the Committee's data-dependent approach and its firm commitment to bring inflation down to 2 percent.

All participants judged that it would be appropriate for policy to remain at a restrictive stance for some time until inflation is clearly moving down sustainably toward the Committee's objective. Participants also observed that the continuing process of reducing the size of the Federal Reserve's balance sheet was an important part of the overall approach to achieving their macroeconomic objectives. A few participants noted that the process of balance sheet runoff could continue for some time, even after the Committee begins to reduce the target range for the federal funds rate. Several participants commented on the recent decline in the use of the ON RRP facility, noting that the use of the facility had been responsive to market conditions.

Participants discussed several risk-management considerations that could bear on future policy decisions. Participants generally judged that, with the stance of monetary policy in restrictive territory, risks to the achievement of the Committee's goals had become more two sided. But with inflation still well above the Committee's longer-run goal and the labor market remaining tight, most participants continued to

see upside risks to inflation. These risks included the possibility that the imbalance of aggregate demand and supply could persist longer than expected and slow the progress on inflation, geopolitical tensions and risks emanating from global oil markets, the effects of a tight housing market on shelter inflation, and the potential for more limited declines in goods prices. Many participants commented that even though economic activity had been resilient and the labor market had continued to be strong, downside risks to economic activity remained. Such risks included potentially larger-than-expected effects of the tightening in financial and credit conditions on aggregate demand and on bank, business, and household balance sheets; continued weakness in the CRE sector; and potential disruptions to global oil markets...

Source: Federal Reserve Board