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Data Insights: FOMC Minutes

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January minutes   Key signaling language: Featured   Important   Very important

... The manager turned next to expectations for monetary policy. Market participants broadly viewed recent inflation data and the December Summary of Economic Projections (SEP) as increasing the odds that rate cuts might start sooner than previously thought. The modal path of the federal funds rate from the Open Market Desk's Survey of Primary Dealers and Survey of Market Participants was little changed from December but showed an increased likelihood of earlier rate cuts. The modal path implied by options prices declined some over the intermeeting period.

Both modal paths were closer to the December median SEP projection than the average path for the policy rate implied by futures prices, which had declined more substantially over the period. The futures-based path likely reflected the effect of investors' perceived probability of more substantial rate cuts rather than their baseline expectations.

Communications over the period heightened market attention around a potential slowing of balance sheet runoff. Most Desk survey respondents expected a slowing of the pace to start by July, although there was considerable uncertainty about the exact start date. The average expected timing for the end of runoff shifted slightly earlier, and the portfolio size at the end of runoff was slightly higher than in the December surveys.

…In their discussion of current economic conditions, participants noted that recent indicators suggested that economic activity had been expanding at a solid pace. Real GDP growth in the fourth quarter of last year came in above 3 percent at an annual rate, below the strong growth posted in the third quarter but still above most forecasters' expectations. Participants observed that the unexpected strength in real GDP growth in the fourth quarter reflected stronger-than-expected net exports and inventory investment, which tend to be volatile and may carry little signal for future growth. Still, consumption continued to grow at a solid pace. In addition to strong demand, many participants attributed the recent expansion in economic activity to favorable supply developments. Participants noted that the pace of job gains had moderated since early last year but remained strong and that the unemployment rate had remained low. Inflation had eased over the past year but remained elevated.

Regarding the economic outlook, participants judged that the current stance of monetary policy was restrictive and would continue to put downward pressure on economic activity and inflation. Accordingly, they expected that supply and demand in product and labor markets would continue to move into better balance. In light of the policy restraint in place, along with more favorable inflation data amid ongoing improvements in supply conditions, participants viewed the risks to achieving the Committee's employment and inflation goals as moving into better balance. However, participants noted that the economic outlook was uncertain and that they remained highly attentive to inflation risks.

In their discussion of inflation, participants observed that inflation had eased over the past year but remained above the Committee's 2 percent inflation objective. They remained concerned that elevated inflation continued to harm households, especially those with limited means to absorb higher prices. While the inflation data had indicated significant disinflation in the second half of last year, participants observed that they would be carefully assessing incoming data in judging whether inflation was moving down sustainably toward 2 percent.

Participants noted improvements in both headline and core inflation and discussed the underlying components of these series. Although total PCE inflation in December remained above the Committee's 2 percent objective on a 12-month basis, on a 6-month basis, total PCE inflation was near 2 percent at an annual rate, and core PCE inflation was just below 2 percent. Participants judged that some of the recent improvement in inflation reflected idiosyncratic movements in a few series. Nevertheless, they viewed that there had been significant progress recently on inflation returning to the Committee's longer-run goal. Many participants indicated that they expected core nonhousing services inflation to gradually decline further as the labor market continued to move into better balance and wage growth moderated further. Various participants noted that housing services inflation was likely to fall further as the deceleration in rents on new leases continued to pass through to measures of such inflation. While many participants pointed to disinflationary pressures associated with improvements in aggregate supply—such as increases in the labor force or better productivity growth—a couple of participants judged that the downward pressure on core goods prices from the normalization of supply chains was likely to moderate.

Participants observed that longer-term inflation expectations had remained well anchored at a level consistent with the Committee's 2 percent inflation objective. Measures of near-term inflation expectations had also declined recently, in some cases to within their ranges in the years before the pandemic. Some participants pointed to reports from contacts that firms could not as easily pass on price increases to consumers or were making less frequent price adjustments than they had in recent years.

In their discussion of the household sector, participants observed that consumer spending had been stronger than expected, supported by low unemployment and solid income growth. A number of participants judged that consumption growth was likely to moderate this year, as growth in labor income was expected to slow and pandemic-related excess savings were expected to diminish. In addition, some participants noted signs that the finances of some households—especially those in the low- and moderate-income categories—were increasingly coming under pressure, which these participants saw as a downside risk to the outlook for consumption. In particular, they pointed to increased usage of credit card revolving balances and buy-now-pay-later services, as well as increased delinquency rates for some types of consumer loans.

The reports of business contacts cited by participants varied across industries and Districts. In a few Districts, contacts reported that the pace of economic activity was steady or solid, while in several others, contacts expressed increased optimism about the economic outlook and prospects for investment. District reports from manufacturers were mixed, as some contacts saw increased activity, whereas others saw subdued or weakening activity. A couple of participants noted that al-though soft commodity prices and elevated borrowing costs had contributed to a decline in farm incomes recently, agricultural land values remained resilient, and delinquencies on farm loans continued to be low. A few participants remarked that financing and credit conditions were particularly challenging for small businesses.

Participants noted that the labor market remained tight, but demand and supply in that market had continued to come into better balance. Payroll growth had remained strong in the last few months of 2023 but had slowed from its pace seen a year ago, while the unemployment rate remained low. Participants also observed that the ratio of job openings to unemployed workers had declined over the past year but still remained somewhat above its pre-pandemic level. Consistent with a reduction in labor market tightness, business contacts in several Districts reported an easing in wage pressures or an increased ability to hire and retain workers. Participants mentioned several developments that had boosted labor supply last year, including higher labor force participation, immigration, and an improved job-matching process; however, a few participants judged that further increases in labor supply may be limited, pointing, for instance, to the decline in labor force participation in December.

While labor market conditions were generally seen as strong, several participants noted that recent job gains were concentrated in a few sectors, which, in their view, pointed to downside risks to the outlook for employment.

Participants discussed the uncertainty surrounding the economic outlook. As an upside risk to both inflation and economic activity, participants noted that momentum in aggregate demand may be stronger than currently assessed, especially in light of surprisingly resilient consumer spending last year. Furthermore, several participants mentioned the risk that financial conditions were or could become less restrictive than appropriate, which could add undue momentum to aggregate demand and cause progress on inflation to stall. Participants also noted some other sources of upside risks to inflation, including possible disruptions to supply chains from geopolitical developments, a potential rebound in core goods prices as the effects of supply-side improvements dissipate, or the possibility that wage growth remains elevated. Downside risks to inflation and economic activity noted by participants included geopolitical risks that could result in a material pullback in demand, possible negative spillovers from lower growth in some foreign economies, the risk that financial conditions could remain restrictive for too long, or the possibility that a weakening of household balance sheets could contribute to a greater-than-expected deceleration in consumption. A few participants mentioned the possibility that economic activity could surprise to the upside and inflation to the downside because of more-favorable-than-expected supply-side developments.

In the discussion of financial stability, participants observed that risks to the banking system had receded notably since last spring, though they noted vulnerabilities at some banks that they assessed warranted monitoring. These participants noted potential risks for some banks associated with increased funding costs, significant reliance on uninsured deposits, unrealized losses on assets resulting from the rise in longer-term interest rates, or high CRE exposures. Participants judged that liquidity in the financial system remained more than ample and discussed the importance of considering liquidity conditions as the Federal Reserve's balance sheet continues to normalize. While participants noted that they were not seeing any signs of liquidity pressures at banks, several participants noted that, as a matter of prudent contingency planning, banks should continue to improve their readiness to use the Federal Reserve's discount window, and that the Federal Reserve should continue to improve the operational efficiency of the window. In addition, some participants commented on the difficulties associated with banks relying on some forms of private wholesale funding during times of stress. A few participants remarked on the importance of measures aimed at increasing the resilience of the Treasury market. A few participants noted cyber risks and the importance of firms being able to recover from cyber events. A few participants also commented on the financial condition of low- and moderate-income households who have exhausted their savings, as well as the importance of monitoring data on rising delinquencies on credit cards and autos.

In their consideration of appropriate monetary policy actions at this meeting, participants noted that recent indicators suggested that economic activity had been expanding at a solid pace. Job gains had moderated since early last year but remained strong, and the unemployment rate had remained low. Inflation had eased over the past year but remained elevated. Participants also noted that the risks to achieving the Committee's employment and inflation goals were moving into better balance and that the Committee remained highly attentive to inflation risks. Participants continued to be resolute in their commitment to bring inflation down to the Committee's 2 percent objective.

In light of current economic conditions and their implications for the outlook for economic activity and inflation, as well as the balance of risks, all participants judged it appropriate to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent at this meeting. All participants also judged it 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.

Participants viewed maintaining the current stance of policy as appropriate given the incoming data, which indicated that inflation had continued to move toward the Committee's 2 percent objective and that demand and supply in the labor market had continued to move into better balance. Participants commented that maintaining the target range for the federal funds rate at this meeting would promote further progress toward the Committee's goals and allow participants to gather additional information to evaluate this progress.

In discussing the policy outlook, participants judged that the policy rate was likely at its peak for this tightening cycle. They pointed to the decline in inflation seen during 2023 and to growing signs of demand and supply coming into better balance in product and labor markets as informing that view. Participants generally noted that they did not expect it would be appropriate to reduce the target range for the federal funds rate until they had gained greater confidence that inflation was moving sustainably toward 2 percent. Many participants remarked that the Committee's past policy actions and ongoing improvements in supply conditions were working together to move supply and demand into better balance. Participants noted that the future path of the policy rate would depend on incoming data, the evolving outlook, and the balance of risks. Several participants emphasized the importance of continuing to communicate clearly about the Committee's data-dependent approach.

In discussing risk-management considerations that could bear on the policy outlook, participants remarked that while the risks to achieving the Committee's employment and inflation goals were moving into better balance, they remained highly attentive to inflation risks. In particular, they saw upside risks to inflation as having diminished but noted that inflation was still above the Committee's longer-run goal. Some participants noted the risk that progress toward price stability could stall, particularly if aggregate demand strengthened or supply-side healing slowed more than expected. Participants highlighted the uncertainty associated with how long a restrictive monetary policy stance would need to be maintained. Most participants noted the risks of moving too quickly to ease the stance of policy and emphasized the importance of carefully assessing incoming data in judging whether inflation is moving down sustainably to 2 percent. A couple of participants, however, pointed to downside risks to the economy associated with maintaining an overly restrictive stance for too long.

Participants observed that the continuing process of reducing the size of the Federal Reserve's balance sheet was an important part of the Committee's overall approach to achieving its macroeconomic objectives and that balance sheet runoff had so far proceeded smoothly. In light of ongoing reductions in usage of the ON RRP facility, many participants suggested that it would be appropriate to begin in-depth discussions of balance sheet issues at the Committee's next meeting to guide an eventual decision to slow the pace of runoff. Some participants remarked that, given the uncertainty surrounding estimates of the ample level of reserves, slowing the pace of runoff could help smooth the transition to that level of reserves or could allow the Committee to continue balance sheet runoff for longer. In addition, 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.

Source: Federal Reserve Board