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

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The economic forecast prepared by the staff for the April–May meeting was similar to the March projection. …Total and core PCE price inflation were both projected to move lower this year relative to last year, though the expected pace of disinflation was slower than in the March projection, as incoming data pointed to more

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persistence in inflation in coming months. Inflation was expected to decline further beyond this year as demand and supply in product and labor markets continued to move into better balance; by 2026, total and core PCE price inflation were expected to be close to 2 percent.

…Participants observed that while inflation had eased over the past year, in recent months there had been a lack of further progress toward the Committee's 2 percent objective. The recent monthly data had showed significant increases in components of both goods and services price inflation. In particular, inflation for core services excluding housing had moved up in the first quarter compared with the fourth quarter of last year, and prices of core goods posted their first three-month increase in several months. In addition, housing services inflation had slowed less than had been anticipated based on the smaller increases in measures of market rents over the past year. A few participants remarked that unusually large seasonal patterns could have contributed to January's large increase in PCE inflation, and several participants noted that some components that typically display volatile price changes had boosted recent readings. However, some participants emphasized that the recent increases in inflation had been relatively broad based and therefore should not be overly discounted.

Participants generally commented that they remained highly attentive to inflation risks. They also remained concerned that elevated inflation continued to harm the purchasing power of households, especially those least able to meet the higher costs of essentials like food, housing, and transportation.

Participants noted that they continued to expect that inflation would return to 2 percent over the medium term. However, recent data had not increased their confidence in progress toward 2 percent and, accordingly, had suggested that the disinflation process would likely take longer than previously thought. Participants discussed several factors that, in conjunction with appropriately restrictive monetary policy, could support the return of inflation to the Committee's goal over time. One was a further reduction in housing services price inflation as lower readings for rent growth on new leases continued to pass through to this category of inflation. However, many participants commented that the pass-through would likely take place only gradually or noted that a reacceleration of market rents could reduce the effect.

Several participants stated that core nonhousing services price inflation could resume its decline as wage growth slows further with labor demand and supply moving into better balance, aided by higher labor force participation and strong immigration flows. In addition, many participants commented that ongoing increases in productivity growth would support disinflation if sustained, though the outlook for productivity growth was regarded as uncertain. Several participants said that business contacts in their Districts reported increased difficulty in raising their output prices, while a few participants reported a continued ability of firms in their Districts to pass on higher costs to consumers. Although some measures of short-term inflation expectations from surveys of consumers had increased in recent months, medium- and longer-term measures of expected inflation had remained well anchored, which was seen as crucial for meeting the Committee's inflation goal on a sustained basis. While supply chain improvements had supported disinflation for goods prices over the previous year, participants commented that an expected more gradual pace of such improvements could slow progress on inflation. Several participants commented that growth of aggregate demand would likely have to slow from its strong pace in recent quarters for inflation to move sustainably toward the Committee's goal.

Participants assessed that demand and supply in the labor market, on net, were continuing to come into better balance, though at a slower rate. Nevertheless, they saw conditions as having generally remained tight amid recent strong payroll growth and a still-low unemployment rate. Participants cited a variety of indicators that suggested some easing in labor market tightness, including declining job vacancies, a lower quits rate, and a reduced ratio of job openings to unemployed workers. Some participants indicated that business contacts had reported less difficulty in hiring or retaining workers, although contacts in several Districts continued to report tight labor conditions, especially in the health care and construction sectors. Many participants commented that the better balance between labor demand and supply had contributed to an easing of nominal wage pressures. Even so, a number of participants noted that some measures of labor cost growth, including the ECI, had not eased in recent months, and a couple of participants remarked that negotiated compensation agreements had added to wage pressures in their Districts. Many participants noted that, during the past year, labor supply had been boosted by

increased labor force participation rates as well as by immigration. Participants further commented that recent estimates of greater immigration in the past few years and an overall increase in labor supply could help explain the strength in employment gains even as the unemployment rate had remained roughly flat and wage pressures had eased.

Participants noted that recent indicators suggested that economic activity had continued to expand at a solid pace. Real GDP growth in the first quarter had moderated relative to the second half of last year, but PDFP growth maintained a strong pace. High interest rates appeared to weigh on consumer durables purchases in the first quarter, and growth of business fixed investment remained modest. Despite the high interest rates, residential investment grew more strongly in the first quarter than its modest pace in the second half of last year.

Although recent PDFP data suggested continued strong economic momentum, participants generally did not interpret the data as indicating a further acceleration of activity and expected that GDP growth would slow from last year's strong pace. A number of participants commented that high rates of immigration could support economic activity by boosting labor supply and contributing to aggregate demand. Participants noted the important influence of productivity growth for the economic outlook. Some participants suggested that the recent increase in productivity growth might not persist because it reflected one-time adjustments to the level of productivity or reflected continued elevated volatility in the data over the past several years. A few participants commented that higher productivity growth might be sustained by the incorporation of technologies such as artificial intelligence into existing business operations or by high rates of new business formation in the technology sector.

In their discussion of the outlook for the household sector, participants observed that consumer spending remained firm in the first quarter, 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 the financial positions of many households were expected to weaken. Many participants noted signs that the finances of low- and moderate-income households were increasingly coming under pressure, which these

participants saw as a downside risk to the outlook for consumption. They pointed to increased usage of credit cards and buy-now-pay-later services, as well as increased delinquency rates for some types of consumer loans. In addition, elevated housing costs were adding to financial strains for lower-income households. A couple of participants noted that financial conditions appeared favorable for wealthier households, which account for a large portion of aggregate consumption, with hefty wealth gains resulting from recent equity and house price increases.

…Participants discussed the risks and uncertainties around the economic outlook. They generally noted their uncertainty about the persistence of inflation and agreed that recent data had not increased their confidence that inflation was moving sustainably toward 2 percent. Some participants pointed to geopolitical events or other factors resulting in more severe supply bottlenecks or higher shipping costs, which could put upward pressure on prices and weigh on economic growth. The possibility that geopolitical events could generate commodity price increases was also seen as an upside risk to inflation. A number of participants noted uncertainty regarding the degree of restrictiveness of current financial conditions and the associated risk that such conditions were insufficiently restrictive on aggregate demand and inflation. Several participants commented that increased efficiencies and technological innovations could raise productivity growth on a sustained basis, which might allow the economy to grow faster without raising inflation. Participants also noted downside risks to economic activity, including slowing economic growth in China, a deterioration in conditions in domestic CRE markets, or a sharp tightening in financial conditions.

In their discussion of financial stability, participants who commented noted vulnerabilities to the financial system that they assessed warranted monitoring. Participants discussed a range of risks emanating from the banking sector, including unrealized losses on assets resulting from the rise in longer-term yields, high CRE exposure, significant reliance by some banks on uninsured deposits, cyber threats, or increased financial interconnections among banks. Several participants commented on the rapid growth of private credit markets, noting that such developments should be monitored because the sector was becoming more interconnected with other parts of the financial system and that some associated risks may not yet be apparent. A few participants also commented on the importance of measures aimed at increasing

resilience in the Treasury market, such as central clearing, or on potential vulnerabilities posed by leveraged investors in the Treasury market. A couple of participants commented that the Federal Reserve should continue to improve the operational efficiency of the discount window. Participants generally noted that high interest rates could contribute to vulnerabilities in the financial system. In that context, a number of participants emphasized that monetary policy should be guided by the outlook for employment and inflation and that other tools should be the primary means to address financial stability risks.

…Participants also discussed the process of reducing the Federal Reserve's securities holdings. Participants judged that balance sheet reduction had proceeded smoothly. Almost all participants expressed support for the decision to begin to slow the pace of decline of the Federal Reserve's securities holdings in June by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion, maintaining the monthly redemption cap on agency debt and agency mortgage backed securities (MBS) at $35 billion, and reinvesting any principal payments in excess of the $35 billion cap into Treasury securities. A few participants indicated that they could have supported a continuation of the current pace of balance sheet runoff at this time or a slightly higher redemption cap on Treasury securities than was decided upon. Various participants emphasized that the decision to slow the pace of runoff does not have implications for the stance of monetary policy. Several participants also emphasized that slowing the pace of balance sheet runoff did not mean that the balance sheet would ultimately shrink by less than it would otherwise. Some participants commented that slowing the pace of balance sheet runoff would help facilitate a smooth transition from abundant to ample reserve balances by reducing the likelihood that money markets experience undue stress that could require an early end to runoff. Participants generally assessed that it would be important to continue to monitor indicators of reserve conditions as balance sheet runoff continued. In addition, a few participants commented that the existing redemption cap on agency debt and agency MBS was unlikely to bind at any point over the coming years, but the decision to reinvest any principal payments above that cap into Treasury securities was consistent with the Committee's longer-run intention to hold a portfolio that consists primarily of Treasury securities. A couple of

participants commented that it would be useful to begin discussions regarding the appropriate longer-run maturity composition of the SOMA portfolio.

…In discussing risk-management considerations that could bear on the policy outlook, participants generally assessed that risks to the achievement of the Committee's employment and inflation goals had moved toward better balance over the past year. Participants remained highly attentive to inflation risks and noted the uncertainty associated with the economic outlook. Although monetary policy was seen as restrictive, many participants commented on their uncertainty about the degree of restrictiveness. These participants saw this uncertainty as coming from the possibility that high interest rates may be having smaller effects than in the past, that longer-run equilibrium interest rates may be higher than previously thought, or that the level of potential output may be lower than estimated. Participants assessed, however, that monetary policy remained well positioned to respond to evolving economic conditions and risks to the outlook. Participants discussed maintaining the current restrictive policy stance for longer should inflation not show signs of moving sustainably toward 2 percent or reducing policy restraint in the event of an unexpected weakening in labor market conditions. Various participants mentioned a willingness to tighten policy further should risks to inflation materialize in a way that such an action became appropriate.

Source: Federal Reserve Board