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Data Insights: FOMC Minutes

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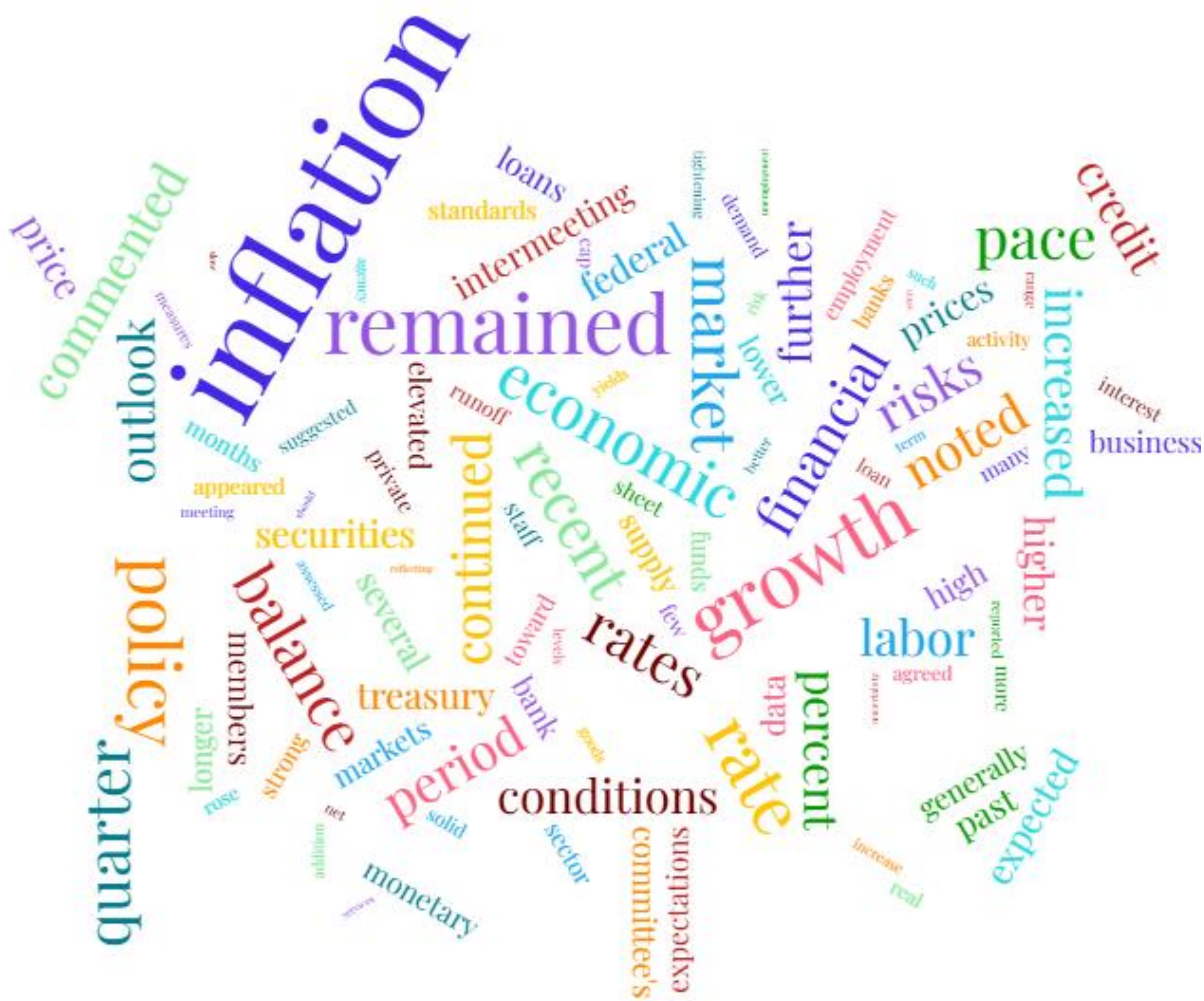
January minutes   Key signaling language: Featured   Important   Very important



Committee participants began discussions related to their review of the Federal Reserve's monetary policy framework. This review is focused on two specific areas: the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy, which presents the Committee's approach to the conduct of monetary policy, and the Committee's policy communication practices. The Committee's 2 percent longer-run inflation goal will be retained and is not a focus of the review.

In support of these discussions, staff briefings provided a retrospective on the Committee's 2019–20 framework review and summarized the experience abroad in conducting reviews of monetary policy frameworks. The staff presentation began by recapping the creation and evolution of the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy and the context of the Committee's 2019–20 review. The adoption of the statement in 2012 introduced the Committee's 2 percent inflation target and codified long-standing practices followed by the Committee and, as such, was an important step in improving the transparency, accountability, and predictability of U.S. monetary policymaking. The launch of the 2019–20 review was motivated in part by a desire to evaluate the experience of the Global Financial Crisis and its aftermath. During this period, inflation had run persistently below the Committee's 2 percent objective, even as the unemployment rate and interest rates remained low. These developments indicated a greater risk that the federal funds rate would be constrained by its effective lower bound (ELB) more often in the future, posing challenges to the achievement of the Committee's dual-mandate goals over the medium term. The staff summarized the scope and components of the 2019–20 review, including its outreach to a broad range of individuals and groups, and the rationale behind the changes made to the statement at the end of the review.

In summarizing the international experience, the staff noted that occasional reviews of monetary policy frameworks were seen as useful in adapting to evolving economic environments, promoting transparency, and fostering public understanding and, therefore, were becoming the norm in advanced economies. Reviews abroad had covered various aspects related to monetary policy goals, strategies, tools, communications, forecasting, and governance, with some of the recent reviews giving particular attention to topics such as the experience of the COVID–19 pandemic, the ensuing global inflation episode, and the conduct and communication of monetary policy in times of unusual uncertainty.

Participants viewed the statement as having played an important role in building a common understanding among policymakers of the congressionally mandated monetary policy goals and of their monetary policy strategy. The statement and other means of policy communication also figured importantly in conveying that understanding to the public and helping to anchor inflation expectations, thereby supporting the effective transmission of monetary policy. Participants indicated that they were looking forward to their discussions at upcoming meetings and to hearing a range of perspectives at various Fed Listens events as well as at a planned research conference, and that they were approaching the review with open minds.

Participants noted that the economic consequences of the COVID–19 pandemic were largely unforeseen at the time of the 2019–20 review and that the current economic environment differed greatly from the period leading up to that review, which was characterized in part by persistently low inflation and interest rates. In light of the experience of the past five years, participants assessed that it was important to consider potential revisions to the statement, with particular attention to some of the elements introduced in 2020. Participants highlighted as areas of consideration the statement's focus on the risks to the economy posed by the ELB, the approach of mitigating shortfalls from maximum employment, and the approach of aiming to achieve inflation moderately above 2 percent following periods of persistently below-target inflation. Participants emphasized the need for the FOMC's monetary policy framework to be robust to a wide range of economic circumstances. They noted that economic uncertainty—including about the values of the longer-run neutral policy rate, the economy's potential growth rate, and the level of maximum employment—would remain an important factor affecting their decisionmaking. Participants also mentioned aspects of the statement that they thought should continue to be emphasized—including the Committee's firm commitment to achieving maximum employment and 2 percent inflation, as well as the importance of keeping longer-term inflation expectations well anchored.

Participants expected that their discussions related to the framework review would continue at upcoming meetings. They expected the review to wrap up by late summer and intended to report the outcomes of the review to the public.

…Participants' Views on Current Conditions and the Economic Outlook

In their discussion of inflation developments, participants observed that inflation had eased significantly over the past two years. Inflation remained somewhat elevated, however, relative to the Committee's 2 percent longer-run goal, and progress toward that goal had slowed over the past year. Available data suggested that total PCE prices had risen about 2.6 percent over the 12 months ending in December and that, excluding the volatile consumer food and energy categories, core PCE prices rose 2.8 percent. A number of participants remarked that current readings of 12-month inflation were boosted by relatively high inflation readings in the first quarter of last year, and several participants noted that cumulative inflation over the past 3, 6, or 9 months showed greater progress than 12 month measures. Most participants commented that month-over-month inflation readings in November and December had exhibited notable progress toward the Committee's goal of price stability, including in some key subcategories. Many participants, however, emphasized that additional evidence of continued disinflation would be needed to support the view that inflation was returning sustainably to 2 percent. Regarding the subcategories, housing services inflation, which had remained elevated for much of the previous year, had shown a decline, as had market-based measures of core nonhousing services inflation. Several participants noted that some nonmarket-based services price categories, such as financial and insurance services, had shown less improvement, but a few also observed that price movements in such categories typically have not provided reliable signals about resource pressures or the future trajectory of inflation. Several participants observed that core goods prices had not declined as much on net in recent months compared with earlier in 2024.

With regard to the outlook for inflation, participants expected that, under appropriate monetary policy, inflation would continue to move toward 2 percent, although progress could remain uneven. Participants cited various factors as likely to put continuing downward pressure on inflation, including an easing in nominal wage growth, well-anchored longer-term inflation expectations, waning business pricing power, and the Committee's still-restrictive monetary policy stance. A few noted, however, that the current target range for the federal funds rate may not be far above its neutral level. Furthermore, some participants commented that with supply and demand in the labor market roughly in balance and in light of recent productivity gains, labor market conditions were unlikely to be a source of inflationary pressure in the near future. However, other factors were cited as having the potential to hinder the disinflation process, including the effects of potential changes in trade and immigration policy as well as strong consumer demand. Business contacts in a number of Districts had indicated that firms would attempt to pass on to consumers higher input costs arising from potential tariffs. In addition, some participants noted that some market- or survey-based measures of expected inflation had increased recently, although many participants emphasized that longer-term measures of expected inflation had remained well anchored. Some participants remarked that reported inflation at the beginning of the year was harder than usual to interpret because of the difficulties in fully removing seasonal effects, and a couple of participants commented that any increase in reported inflation in the first quarter due to such difficulties would imply a corresponding decrease in reported inflation in other quarters of the year.

Participants judged that labor market conditions had remained solid and that those conditions were broadly consistent with the Committee's goal of maximum employment. Payroll gains had averaged 170,000 per month over the last three months of 2024 and the unemployment rate had stabilized at a relatively low level. Participants also noted that recent readings of indicators such as job vacancies, the quits rate, and labor turnover were generally consistent with stable labor market conditions. Participants anticipated that under appropriate monetary policy, conditions in the labor market would likely remain solid. Nonetheless, participants generally noted that labor market indicators merited close monitoring. Business contacts in a few Districts noted that they were expecting stable employment levels and moderate wage growth at their firms. A couple of participants noted that the upcoming benchmark revision to the payroll growth estimates by the Bureau of Labor Statistics could provide more clarity regarding labor market conditions.

Participants observed that the economy had continued to expand at a solid pace and that recent data on economic activity, and consumer spending in particular were, on balance, stronger than anticipated. Participants remarked that consumption had been supported by a solid labor market, elevated household net worth, and rising real wages, which had been associated in part with productivity gains. Several participants cautioned that low- and moderate-income households continued to experience financial strains, which could damp their spending. A few participants cited continued increases in rates of delinquencies on credit card borrowing and automobile loans as signs of such strains.

With regard to the business sector, participants observed that investment in equipment and intangibles was strong over the past year, though it appeared to have slowed in the fourth quarter. Some participants noted that favorable aggregate supply developments—including increases in labor supply, business investment, and productivity—continued to support a solid expansion of business activity. Many participants remarked that District contacts or surveys of businesses reported substantial optimism about the economic outlook, stemming in part from an expectation of an easing in government regulations or changes in tax policies. In contrast, some participants noted that contacts reported increased uncertainty regarding potential changes in federal government policies. A couple of participants remarked that the agricultural sector continued to face significant strains stemming from low crop prices and high input costs.

A number of participants commented on the financial conditions bearing on spending by households and businesses. Participants generally saw it as important to continue to keep a close watch on such conditions and their potential effects on economic activity and inflation. Many participants noted that certain financial conditions had tightened over the past several months. For example, longer-term Treasury and corporate bond yields and mortgage rates had risen notably. A couple of participants commented that high equity valuations or low credit spreads were providing some support to economic activity.

In their evaluation of the risks and uncertainties associated with the economic outlook, the vast majority of participants judged that the risks to the achievement of the Committee's dual-mandate objectives of maximum employment and price stability were roughly in balance, though a couple commented that the risks to achieving the price stability mandate currently appeared to be greater than the risks to achieving the maximum employment mandate. Participants generally pointed to upside risks to the inflation outlook. In particular, participants cited the possible effects of potential changes in trade and immigration policy, the potential for geopolitical developments to disrupt supply chains, or stronger-than-expected household spending. A couple of participants remarked that, in the period ahead, it might be especially difficult to distinguish between relatively persistent changes in inflation and more temporary changes that might be associated with the introduction of new government policies. Participants pointed to various risks to economic activity and employment, including downside risks associated with an unexpected weakening of the labor market, a weakening of consumers' financial positions, or a tightening of financial conditions, as well as upside risks associated with a potentially more favorable regulatory environment for businesses and continued strength in domestic spending.

In their discussion of financial stability, participants who commented noted a range of factors that warranted monitoring. Several participants mentioned issues related to the banking system. A few commented that bank funding risks had lessened and that many banks had improved their ability to access the discount window; however, a couple observed that some banks had increased their reliance on reciprocal deposits, and that the stability of these deposits had not been tested in a time of stress. Several participants noted that some banks remained vulnerable to a rise in longer-term yields and the associated unrealized losses on bank assets. Several participants also mentioned potential vulnerabilities at nonbank financial institutions or nonfinancial corporations to a rise in longer-term yields or to leverage in these sectors. A few participants noted concerns about asset valuation pressures in equity and corporate debt markets. A few participants discussed vulnerabilities associated with CRE exposures, noting that risks remained, although there were some signs that the deterioration of conditions in the CRE sector was lessening. Several participants commented on cyber risks that could impair the operation of financial institutions, financial infrastructure, and, potentially, the overall economy. Several participants commented on vulnerabilities in the Treasury market, including concerns about dealer intermediation capacity and the degree of leveraged positions in the market. The migration to central clearing was noted by a few as an important development to track in this regard.

In their consideration of monetary policy at this meeting, participants noted that inflation remained somewhat elevated. Participants also observed that recent indicators suggested that economic activity had continued to expand at a solid pace, that the unemployment rate had stabilized at a low level, and that labor market conditions had remained solid in recent months. With the stance of policy significantly less restrictive than it had been before the Committee's policy easing over its previous three meetings, all participants viewed it as appropriate to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. Participants judged that it was appropriate to continue the process of reducing the Federal Reserve's securities holdings.

In discussing the outlook for monetary policy, participants observed that the Committee was well positioned to take time to assess the evolving outlook for economic activity, the labor market, and inflation, with the vast majority pointing to a still-restrictive policy stance. Participants indicated that, provided the economy remained near maximum employment, they would want to see further progress on inflation before making additional adjustments to the target range for the federal funds rate. Participants noted that policy decisions were not on a preset course and were conditional on the evolution of the economy, the economic outlook, and the balance of risks.

In discussing risk-management considerations that could bear on the outlook for monetary policy, a majority of participants observed that the current high degree of uncertainty made it appropriate for the Committee to take a careful approach in considering additional adjustments to the stance of monetary policy. Factors mentioned by participants as supporting such an approach included the reduced downside risks to the outlook for the labor market and economic activity, increased upside risks to the outlook for inflation, and uncertainties concerning the neutral rate of interest, the degree of restraint from higher longer-term interest rates, or the economic effects of potential government policies. Many participants noted that the Committee could hold the policy rate at a restrictive level if the economy remained strong and inflation remained elevated, while several remarked that policy could be eased if labor market conditions deteriorated, economic activity faltered, or inflation returned to 2 percent more quickly than anticipated.

A number of participants also discussed some issues related to the balance sheet. Regarding the composition of secondary-market purchases of Treasury securities that would occur once the process of reducing the size of the Federal Reserve's holdings of securities had come to an end, many participants expressed the view that it would be appropriate to structure purchases in a way that moved the maturity composition of the SOMA portfolio closer to that of the outstanding stock of Treasury debt while also minimizing the risk of disruptions to the market. Regarding the potential for significant swings in reserves over coming months related to debt ceiling dynamics, various participants noted that it may be appropriate to consider pausing or slowing balance sheet runoff until the resolution of this event. Several participants also expressed support for the Desk's future consideration of possible ways to improve the efficacy of the SRF.

Source: Federal Reserve Board