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Data Insights: FOMC Minutes

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January minutes   Key signaling language: Featured   Important   Very important

Committee participants continued their discussions related to their review of the Federal Reserve's monetary policy framework, with a focus on labor market dynamics and the FOMC's maximum employment goal. The staff briefed policymakers on the concept of maximum employment and related labor market indicators. They discussed conceptual benchmarks used in evaluating the position of the labor market relative to maximum employment and in ascertaining the interaction of maximum employment and price stability. They discussed a set of core labor market indicators used to help assess maximum employment, including the unemployment rate, job vacancies, the employment-to-population (EPOP) ratio, and the labor force participation rate (LFPR), and described the use of these indicators in assessing maximum employment during the pandemic-related recession and subsequent economic recovery. The staff also presented model-based analysis of simple monetary policy rules that respond to deviations of inflation from 2 percent but differ on whether they respond to shortfalls or deviations from maximum employment.

Participants generally supported the current description of maximum employment in the Statement on Longer-Run Goals and Monetary Policy Strategy as being not directly measurable and changing over time for reasons owing largely to nonmonetary factors. Participants acknowledged that it is difficult to assess maximum employment and that they have been well served by monitoring a wide range of indicators that can vary depending on labor market and economic conditions. They also reflected on how both the Committee and the public have interpreted the current description of maximum employment as a broad-based and inclusive goal.

Participants reviewed the relationship between the dual-mandate goals and noted that those goals are not necessarily in conflict when both unemployment and inflation are low. Participants also discussed the implications of pursuing a strategy that seeks to mitigate shortfalls of employment from its maximum level, as described in the statement, and the ways the public has interpreted that approach since it was introduced into the statement. Participants indicated that they thought it would be appropriate to reconsider the shortfalls language. They judged that any strategy conveyed in the statement should be robust to a wide range of economic circumstances. They also considered the extent to which the current statement had effectively communicated the Committee's approach to achieving its longer-run goals, including the Committee's assessment of the appropriate policy responses in a period of a tight labor market…

In conjunction with this FOMC meeting, participants submitted their projections of the most likely outcomes for real GDP growth, the unemployment rate, and inflation for each year from 2025 through 2027 and over the longer run. The projections were based on participants' individual assessments of appropriate monetary policy, including their projections of the federal funds rate. The longer-run projections represented each participant's assessment of the rate to which each variable would tend to converge under appropriate monetary policy and in the absence of further shocks to the economy. Participants also provided their individual assessments of the level of uncertainty and the balance of risks associated with their projections. The Summary of Economic Projections was released to the public after the meeting.

Participants observed that available data pointed to an economy that continued to grow at a solid pace and labor market conditions that remained broadly balanced, but that inflation stayed somewhat elevated. Participants generally noted the high degree of uncertainty facing the economy. Information from participants' business contacts and from many surveys indicated some deterioration in household and business sentiment amid heightened uncertainty about government policies. Various participants commented that high uncertainty had the potential to damp consumer spending as well as business hiring and investment activities or that inflation was likely to be boosted by increased tariffs. As a result, participants generally saw increased downside risks to employment and economic growth and upside risks to inflation while indicating that high uncertainty surrounded their economic outlooks.

In their discussion of inflation developments, participants noted that inflation had eased significantly over the past two years but remained somewhat elevated relative to the Committee's 2 percent longer-run goal. Some participants observed that inflation data over the first two months of this year were higher than they had expected. Among the major subcategories of prices, housing services inflation had continued to moderate, consistent with the past slowing in market rents, but inflation in core nonhousing services remained high, especially in nonmarket services. Some participants highlighted that core goods inflation had increased, and most of them noted that these increases might reflect the effects of the anticipation of higher tariffs.

With regard to the outlook for inflation, participants judged that inflation was likely to be boosted this year by the effects of higher tariffs, although significant uncertainty surrounded the magnitude and persistence of such effects. Several participants noted that the announced or planned tariff increases were larger and broader than many of their business contacts had expected. Several participants also noted that their contacts were already reporting increases in costs, possibly in anticipation of rising tariffs, or that their contacts had indicated willingness to pass on to consumers higher input costs that would arise from potential tariff increases. A couple of participants highlighted factors that might limit the inflationary effects of tariffs, noting that many households had depleted the excess savings they had accumulated during the pandemic and were less likely to accept additional price increases, or that stricter immigration policies might reduce demand for rental and affordable housing and alleviate upward pressures on housing inflation. A couple of participants noted that the continued balance in the labor market suggested that labor market conditions were unlikely to be a source of inflationary pressure. A couple of participants noted that, in the period ahead, it could be especially difficult to distinguish between relatively persistent changes in inflation and more temporary changes that might be associated with the introduction of tariffs. Participants commented on a range of factors that could influence the persistence of tariff effects, including the extent to which tariffs are imposed on intermediate goods and thus affect input costs at various stages of production, the extent to which complex supply chains need to be restructured, the actions of trading partners in responding with retaliatory increases in tariffs, and the stability of longer-term inflation expectations.

Almost all participants pointed out that many market- or survey-based measures of near-term expected inflation had increased recently. Participants generally noted that most measures of longer-term expected inflation remained well anchored, a factor likely to put downward pressure on inflation. Several participants emphasized that ensuring that longer-term inflation expectations remained anchored would enhance the Committee's ability to achieve its price-stability goal.

Participants judged that labor market conditions remained broadly in balance. The unemployment rate had stabilized at a relatively low level, and nominal wage growth continued to moderate. Average payroll employment growth, while slowing some recently, remained solid. Several participants highlighted recent increases in businesses' layoff announcements and in people working part time for economic reasons. A majority of participants commented that the recent cuts in federal government jobs and to federal funding had begun to affect employment at federal contractors, universities, hospitals, municipalities, and nonprofit organizations, with many organizations that rely on government contracts having reported layoffs or pauses in their hiring plans. In addition, many participants noted that their contacts and business survey respondents reported pausing hiring decisions because of elevated policy uncertainty. Several participants relayed reports from contacts who were concerned that restrictive immigration policies would reduce labor supply and put upward pressure on wages in certain sectors.

…With regard to the business sector, most participants commented that contacts or surveys reported increased uncertainty about potential changes in federal government policies and a deterioration in business sentiment, which had led many firms to pause their capital spending plans. Several participants highlighted that the auto industry faced significant risks associated with tariffs because of its interconnected and cross-border supply chains. By contrast, several participants noted that their contacts expressed optimism about future firm profitability driven by more business-friendly regulatory or fiscal policy changes or expected productivity gains from artificial intelligence and related technologies. A few participants highlighted the strains faced by the agricultural sector, as tariffs threatened to further compress its profit margins by lowering farm export prices and raising input costs.

Some participants noted that financial conditions had tightened since the January meeting, reflecting lower equity prices and higher risk spreads on corporate bonds, but most of them commented that risk premiums in bond and equity markets remained low by historical standards or that businesses and consumers with higher credit scores continued to be able to obtain financing. A few participants cautioned that an abrupt repricing of risk in financial markets could exacerbate the effects of any negative shocks to the economy.

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. In this context, and amid elevated uncertainty around the economic outlook, 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.

In discussing the outlook for monetary policy, participants remarked that uncertainty about the net effect of an array of government policies on the economic outlook was high, making it appropriate to take a cautious approach. Emphasizing that uncertainty, a majority of participants noted the potential for inflationary effects arising from various factors to be more persistent than they projected. With economic growth and the labor market still solid and current monetary policy restrictive, participants assessed that the Committee was well positioned to wait for more clarity on the outlook for inflation and economic activity. Participants noted that policy decisions were not on a preset course and would be informed by 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, participants assessed that uncertainty around the economic outlook had increased, with almost all participants viewing risks to inflation as tilted to the upside and risks to employment as tilted to the downside. Participants remarked that monetary policy was well positioned to address future developments; a restrictive policy could be maintained for longer if inflation were to remain elevated, and policy could be eased if labor market conditions were to deteriorate or economic activity were to weaken. Some participants observed, however, that the Committee may face difficult tradeoffs if inflation proved to be more persistent while the outlook for growth and employment weakened. Several participants emphasized that elevated inflation could prove to be more persistent than expected.

Participants assessed that balance sheet reduction had gone well thus far. All participants judged it appropriate to continue the process of reducing the Federal Reserve's securities holdings. Almost all participants supported a slowing of the pace of runoff at this meeting. Most participants noted the importance of clearly communicating that slowing the runoff pace had no implications for the stance of monetary policy, would not affect the long-term path of the balance sheet, was a natural progression of the slowing decided at the May 2024 meeting, and was in line with the Committee's principles and plans for balance sheet reduction announced in 2022. Some participants noted that a slower pace of runoff would also help guard against reserve scarcity emerging with little advance notice during a period of potentially rapid increase in the TGA. Several participants did not see a compelling case for slowing the pace of runoff at this meeting. A number of participants commented that the Committee's existing tools could also be used to help address potential disruptions to the market for reserves. Some participants highlighted the importance of the Federal Reserve's ceiling tools and encouraged the ongoing efforts of the Desk to improve the efficacy of the standing repo facility. Several participants observed that the Federal Reserve's traditional tool of open market operations could also be used should signs of reserve scarcity unexpectedly emerge. Many participants expressed interest in continued discussion of technical aspects of balance sheet policy and tools after the framework review is completed.

…Voting for this action: Jerome H. Powell, John C. Williams, Michael S. Barr, Michelle W. Bowman, Susan M. Collins, Lisa D. Cook, Austan D. Goolsbee, Philip N. Jefferson, Adriana D. Kugler, Alberto G. Musalem, and Jeffrey R. Schmid.

Voting against this action: Christopher J. Waller.

Governor Waller preferred no change in the federal funds target range and continuing the pace of decline in securities holdings in place at the time of the vote. This view was based on reserve balances being over $3 trillion as well as no evidence from money market indicators or his outreach conversations that the banking system is getting close to an ample level of reserves. In addition, rather than changing the pace of balance sheet reduction, he thought the Federal Reserve should rely on its existing tools and develop a plan for how to respond to short-run strains if they emerge.

Source: Federal Reserve Board