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Data Insights: FOMC Minutes

Wednesday, August 16, 2017

July 26 minutes: key signaling language

FOMC communications over the intermeeting period were viewed as broadly in line with investors' expectations that the Committee would continue to remove policy accommodation at a gradual pace. Market participants generally interpreted the information on reinvestment policy provided in June in the Committee's postmeeting statement and its Addendum to the Policy Normalization Principles and Plans as consistent with their expectation that a change to reinvestment policy was likely to occur this year....

... Reflecting in part continued tightening of lending standards, consumer loan growth at banks moderated further in the second quarter; however, that weakness was partially offset by more robust lending by credit unions.

... the staff continued to view vulnerabilities stemming from financial leverage as well as maturity and liquidity transformation as low, and vulnerabilities from leverage in the nonfinancial sector appeared to remain moderate.

...meeting participants agreed that information received over the intermeeting period indicated that the labor market had continued to strengthen and that economic activity had been rising moderately so far this year.

...In light of continued low recent readings on inflation, participants expected that inflation on a 12-month basis would remain somewhat below 2 percent in the near term.

... several participants noted that uncertainty about the course of federal government policy, including in the areas of fiscal policy, trade, and health care, was tending to weigh down firms' spending and hiring plans. In addition, a few participants suggested that the likelihood of near-term enactment of a fiscal stimulus program had declined further or that the fiscal stimulus likely would be smaller than they previously expected.

… A few participants expressed concerns about the possibility of substantially overshooting full employment, with one citing past difficulties in achieving a soft landing. District contacts confirmed tightness in the labor market but relayed little evidence of wage pressures, although some firms were reportedly attempting to attract workers with a variety of nonwage benefits.

… Many participants, however, saw some likelihood that inflation might remain below 2 percent for longer than they currently expected, and several indicated that the risks to the inflation outlook could be tilted to the downside. Participants agreed that a fall in longer-term inflation expectations would be undesirable, but they differed in their assessments of whether inflation expectations were well anchored. One participant pointed to the stability of a number of measures of inflation expectations in recent months, but a few others suggested that continuing low inflation expectations may have been a factor putting downward pressure on inflation or that inflation expectations might need to be bolstered in order to ensure their consistency with the Committee's longer-term inflation objective.

A number of participants noted that much of the analysis of inflation used in policymaking rested on a framework in which, for a given rate of expected inflation, the degree of upward pressures on prices and wages rose as aggregate demand for goods and services and employment of resources increased above long-run sustainable levels. A few participants cited evidence suggesting that this framework was not particularly useful in forecasting inflation. However, most participants thought that the framework remained valid, notwithstanding the recent absence of a pickup in inflation in the face of a tightening labor market and real GDP growth in excess of their estimates of its potential rate. Participants discussed possible reasons for the coexistence of low inflation and low unemployment. These included a diminished responsiveness of prices to resource pressures, a lower natural rate of unemployment, the possibility that slack may be better measured by labor market indicators other than unemployment, lags in the reaction of nominal wage growth and inflation to labor market tightening, and restraints on pricing power from global developments and from innovations to business models spurred by advances in technology. A couple of participants argued that the response of inflation to resource utilization could become stronger if output and employment appreciably overshot their full employment levels, although other participants pointed out that this hypothesized nonlinear response had little empirical support.

…Several participants noted that the further increases in equity prices, together with continued low longer-term interest rates, had led to an easing of financial conditions. However, different assessments were expressed about the implications of this development for the outlook for aggregate demand and, consequently, appropriate monetary policy. According to one view, the easing of financial conditions meant that the economic effects of the Committee's actions in gradually removing policy accommodation had been largely offset by other factors influencing financial markets, and that a tighter monetary policy than otherwise was warranted. According to another view, recent rises in equity prices might be part of a broad-based adjustment of asset prices to changes in longer-term financial conditions, importantly including a lower neutral real interest rate, and, therefore, the recent equity price increases might not provide much additional impetus to aggregate spending on goods and services.

Participants also considered equity valuations in their discussion of financial stability. A couple of participants noted that favorable macroeconomic factors provided backing for current equity valuations; in addition, as recent equity price increases did not seem to stem importantly from greater use of leverage by investors, these increases might not pose appreciable risks to financial stability.

…Participants agreed that it would not be desirable for the current regulatory framework to be changed in ways that allowed a reemergence of the types of risky practices that contributed to the crisis.

In their discussion of monetary policy, participants reaffirmed their view that a gradual approach to removing policy accommodation was likely to remain appropriate to promote the Committee's objectives of maximum employment and 2 percent inflation. Participants commented on a number of factors that would influence their ongoing assessments of the appropriate path for the federal funds rate. Most saw the outlook for economic activity and the labor market as little changed from their earlier projections and continued to anticipate that inflation would stabilize around the Committee's 2 percent objective over the medium term. However, some participants expressed concern about the recent decline in inflation, which had occurred even as resource utilization had tightened, and noted their increased uncertainty about the outlook for inflation. They observed that the Committee could afford to be patient under current circumstances in deciding when to increase the federal funds rate further and argued against additional adjustments until incoming information confirmed that the recent low readings on inflation were not likely to persist and that inflation was more clearly on a path toward the Committee's symmetric 2 percent objective over the medium term. In contrast, some other participants were more worried about risks arising from a labor market that had already reached full employment and was projected to tighten further or from the easing in financial conditions that had developed since the Committee's policy normalization process was initiated in December 2015. They cautioned that a delay in gradually removing policy accommodation could result in an overshooting of the Committee's inflation objective that would likely be costly to reverse, or that a delay could lead to an intensification of financial stability risks or to other imbalances that might prove difficult to unwind.

…A number of participants also commented that the appropriate pace of normalization of the federal funds rate would depend on how financial conditions evolved and on the implications of those developments for the pace of economic activity. Among the considerations mentioned were the extent of current downward pressure on longer-term yields arising from the Federal Reserve's asset holdings and how this pressure would diminish over time as balance sheet normalization proceeded, the strength and degree of persistence of other domestic and global factors that had contributed to the easing of financial conditions and elevated asset prices, and whether and how much the neutral rate of interest would rise as the economy continued to expand.

Participants also discussed the appropriate time to implement the plan for reducing the Federal Reserve's securities holdings that was announced in June in the Committee's postmeeting statement and its Addendum to the Policy Normalization Principles and Plans. Participants generally agreed that, in light of their current assessment of economic conditions and the outlook, it was appropriate to signal that implementation of the program likely would begin relatively soon, absent significant adverse developments in the economy or in financial markets. Many noted that the program was expected to contribute only modestly to the reduction in policy accommodation. Several reiterated that, once the program was under way, further adjustments to the stance of monetary policy in response to economic developments would be centered on changes in the target range for the federal funds rate. Although several participants were prepared to announce a starting date for the program at the current meeting, most preferred to defer that decision until an upcoming meeting while accumulating additional information on the economic outlook and developments potentially affecting financial markets.

Source: FOMC, TrendMacro analysis