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Data Insights: FOMC Minutes

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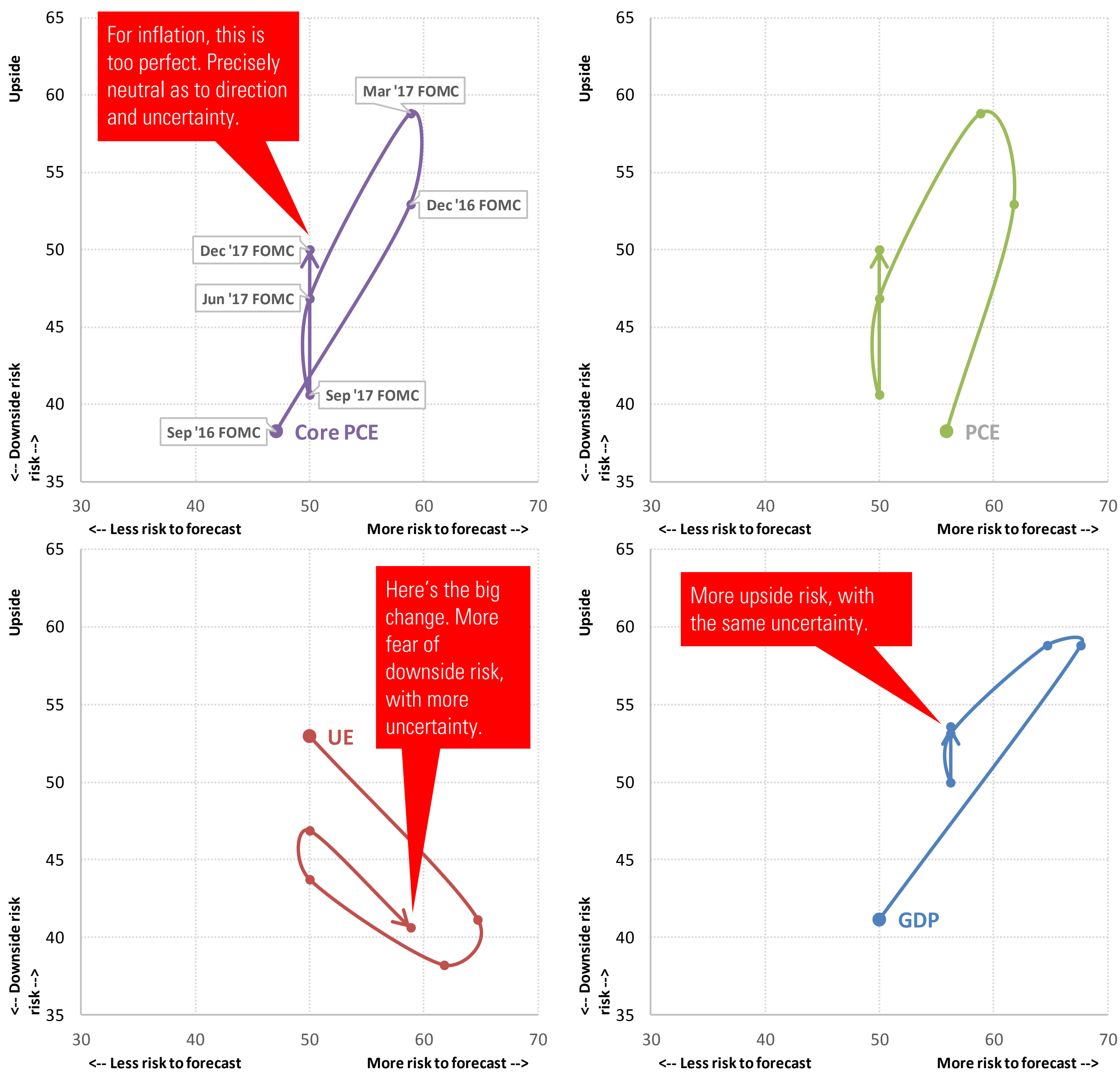
Evolving "uncertainty" Diffusion indices of forecast risks in Summary of Economic Projections
From ● September 16 FOMC to → December 17 FOMC



Source: FOMC, TrendMacro calculations

December minutes: key signaling language

...The U.S. economic projection prepared by the staff…Beyond 2017, the forecast for real GDP growth was revised up modestly, reflecting the staff's updated assumption that the reduction in federal income taxes expected to begin next year would be larger than assumed in the previous projection... The unemployment rate was projected to decline further over the next few years and to continue running below the staff's slightly downward-revised estimate of the longer-run natural rate over this period.

… participants continued to expect that, with gradual adjustments in the stance of monetary policy, economic activity would expand at a moderate pace and labor market conditions would remain strong. Inflation on a 12-month basis was expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term. Near-term risks to the economic outlook appeared to be roughly balanced…, but participants agreed that it would be important to continue to monitor inflation developments closely.

… A few participants noted that expectations of tax reform may have already raised consumer spending somewhat to the extent that those expectations had spurred increases in asset valuations and household net worth. A number of participants expressed uncertainty about the magnitude of the effects of tax reform on consumer spending.

…Many participants judged that the proposed changes in business taxes, if enacted, would likely provide a modest boost to capital spending, although the magnitude of the effects was uncertain. The resulting increase in the capital stock could contribute to positive supply-side effects, including an expansion of potential output over the next few years. However, some business contacts and respondents to business surveys suggested that firms were cautious about expanding capital spending in response to the proposed tax changes or noted that the increase in cash flow that would result from corporate tax cuts was more likely to be used for mergers and acquisitions or for debt reduction and stock buybacks.

…A few participants noted that a reduction in personal tax rates could potentially increase labor supply, but the magnitude of such effects was quite uncertain.

Against the backdrop of the continued strengthening in labor market conditions, participants discussed recent wage developments. Overall, the pace of wage increases had generally been modest and in line with inflation and productivity growth. In some Districts, reports from business contacts or evidence from surveys pointed to a pickup in wage gains, particularly for unskilled or entry-level workers. In a couple of regions, businesses facing tight labor market conditions were said to be offering more flexible work arrangements or taking advantage of technology to use employees more efficiently, rather than raising wages. A few participants judged that the tightness in labor markets was likely to translate into an acceleration in wages; however, another observed that the absence of broad-based upward wage pressures suggested that there might be scope for further improvement in labor market conditions.

…Several of them expressed concern that persistently weak inflation may have led to a decline in longer-term inflation expectations; they pointed to low market-based measures of inflation compensation, declines in some survey measures of inflation expectations, or evidence from statistical models suggesting that the underlying trend in inflation had fallen in recent years...

…Meeting participants also discussed the recent narrowing of the gap between the yields on long- and short-maturity nominal Treasury securities, which had resulted in a flatter profile of the term structure of interest rates. Among the factors contributing to the flattening, participants pointed to recent increases in the target range for the federal funds rate, reductions in investors' estimates of the longer-run neutral real interest rate, lower longer-term inflation expectations, and lower term premiums. They generally agreed that the current degree of flatness of the yield curve was not unusual by historical standards…

…A couple of participants did not believe it was appropriate to raise the target range for the federal funds rate at this meeting; these participants suggested that the Committee should maintain the target range at 1 to 1-1/4 percent until the actual rate of inflation had moved further toward the Committee's 2 percent longer-run objective or inflation expectations had increased. They judged that leaving the target range at its current level would better support an increase in inflation expectations and thereby increase the likelihood that inflation will rise to 2 percent.

…A few participants indicated that they were not comfortable with the degree of additional policy tightening through the end of 2018 implied by the median projections for the federal funds rate in the December SEP. They expressed concern that such a path of increases in the policy rate, while gradual, might prove inconsistent with a sustained return of inflation to 2 percent, or that the level of the federal funds rate might already be near its current neutral value...

Due to the persistent shortfall of inflation from the Committee's 2 percent objective, or the risk that monetary policy could again become constrained by the zero lower bound, a few participants suggested that further study of potential alternative frameworks for the conduct of monetary policy such as price-level targeting or nominal GDP targeting could be useful.

…In Mr. Evans's view, with inflation continuing to run substantially below 2 percent and measures of inflation expectations lower than he believed to be consistent with a symmetric 2 percent inflation objective, it was important to pause in the process of policy normalization. Leaving the target range at 1 to 1-1/4 percent for a time would better support an increase in inflation expectations, increase the likelihood that inflation will rise to 2 percent and perhaps modestly beyond, and thus provide more support for the symmetry of the Committee's inflation objective. Such a pause also would better allow the Committee time to assess the degree to which earlier soft readings on inflation were transitory or more persistent.

In Mr. Kashkari's view, while employment growth remained strong, wage growth had not picked up and inflation remained notably below the Committee's 2 percent target. In addition, the yield curve had flattened as long-term rates had not moved higher even though the Committee raised the federal funds rate target range. He was concerned that the flattening yield curve was partly due to falling longer-term inflation expectations or a lower neutral real rate of interest. He preferred to wait for inflation to move closer to 2 percent on a sustained basis or for inflation expectations to move up before further raising the target range for the federal funds rate.

Source: Federal Reserve Board