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Data Insights: FOMC Minutes

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January minutes: key signaling language

…staff presentations considered two key channels by which monetary policy influences inflation--the response of inflation to changes in resource utilization and the role of inflation expectations, or trend inflation, in the price-setting process. In part because inflation was importantly influenced by a number of short-lived factors, the effects of current and expected resource utilization gaps on inflation were not easy to discern empirically. Estimates of the strength of those effects had diminished noticeably in recent years. The briefings highlighted a number of other challenges associated with estimating the strength and timing of the linkage between resource utilization and inflation, including the reliability of and changes over time in estimates of the natural rate of unemployment and potential output and the ability to adequately account for supply shocks. …Almost all participants who commented agreed that a Phillips curve-type of inflation framework remained useful as one of their tools for understanding inflation dynamics and informing their decisions on monetary policy. Policymakers pointed to a number of possible reasons for the difficulty in estimating the link between resource utilization and inflation in recent years. These reasons included an extended period of low and stable inflation in the United States and other advanced economies during which the effects of resource utilization on inflation became harder to identify, the shortcomings of commonly used measures of resource gaps, the effects of transitory changes in relative prices, and structural factors that had made business pricing more competitive or prices more flexible over time. … A couple of participants questioned the usefulness of a Phillips curve-type framework for policymaking, citing the limited ability of such frameworks to capture the relationship between economic activity and inflation.

…The U.S. economic projection prepared by the staff for the January FOMC meeting was stronger than the staff forecast at the time of the December meeting. Real GDP was estimated to have risen in the fourth quarter of last year by somewhat more than the staff had previously expected, as gains in both household and business spending were larger than anticipated. Beyond 2017, the forecast for real GDP growth was revised up, reflecting a reassessment of the recently enacted tax cuts, along with higher projected paths for equity prices and foreign economic growth and a lower assumed path for the foreign exchange value of the dollar.

…Estimates of total and core PCE price inflation for 2017 were in line with the staff's previous forecast. The projection for inflation over the medium term was revised up slightly, primarily reflecting tighter resource utilization in the January forecast. Total PCE price inflation in 2018 was projected to be somewhat faster than in 2017 despite a slower projected pace of increases in consumer energy prices; core PCE prices were forecast to rise notably faster in 2018, importantly reflecting both the expected waning of transitory factors that held down 12-month measures of inflation in 2017 as well as the projected further tightening in resource utilization. The staff projected that core inflation would reach 2 percent in 2019 and that total inflation would be at the Committee's 2 percent objective in 2020.

…The staff saw the risks to the forecasts for real GDP growth and the unemployment rate as balanced. The risks to the projection for inflation also were seen as balanced. Downside risks included the possibilities that longer-term inflation expectations may have edged lower or that the run of soft core inflation readings this year could prove to be more persistent than the staff expected. These downside risks were seen as essentially counterbalanced by the upside risk that inflation could increase more than expected in an economy that was projected to move further above its potential.

…Participants generally saw incoming information on economic activity and the labor market as consistent with continued above-trend economic growth and a further strengthening in labor market conditions, with the recent solid gains in household and business spending indicating substantial underlying economic momentum. They pointed to accommodative financial conditions, the recently enacted tax legislation, and an improved global economic outlook as factors likely to support economic growth over coming quarters. Participants expected that with further gradual adjustments in the stance of monetary policy, economic activity would expand at a moderate pace and labor market conditions would remain strong. Near-term risks to the economic outlook appeared roughly balanced. Inflation on a 12-month basis was expected to move up this year and to stabilize around the Committee's 2 percent objective over the medium term. However, participants judged that it was important to continue to monitor inflation developments closely.

…During their discussion of labor market conditions…With regard to how firms might use part of their tax savings to boost compensation, a few participants suggested that such a boost could be in the form of onetime bonuses or variable pay rather than a permanent increase in wage structures. It was noted that the pace of wage gains might not increase appreciably if productivity growth remains low. That said, a number of participants judged that the continued tightening in labor markets was likely to translate into faster wage increases at some point.

In their discussion of inflation developments, many participants noted that inflation data in recent months had generally pointed to a gradual rise in inflation, as the 12-month core PCE price inflation rose to 1.5 percent in December, up 0.2 percentage point from the low recorded in the summer. Meanwhile, total PCE price inflation was 1.7 percent over the same 12-month period. Participants anticipated that inflation would continue to gradually rise as resource utilization tightened further and as wage pressures became more apparent; several expected that declines in the foreign exchange value of the dollar in recent months would also likely help return inflation to 2 percent over the medium term. Business contacts in a few Districts reported that they had begun to have some more ability to raise prices to cover higher input costs. That said, a few participants posited that the recently enacted corporate tax cuts might lead firms to cut prices in order to remain competitive or to gain market share, which could result in a transitory drag on inflation.

…In their consideration of monetary policy, participants discussed the implications of recent economic and financial developments for the outlook for economic growth, labor market conditions, and inflation and, in turn, for the appropriate path of the federal funds rate. Participants agreed that a gradual approach to raising the target range for the federal funds rate remained appropriate and reaffirmed that adjustments to the policy path would depend on their assessments of how the economic outlook and risks to the outlook were evolving relative to the Committee's policy objectives. While participants continued to expect economic activity to expand at a moderate pace over the medium term, they anticipated that the rate of economic growth in 2018 would exceed their estimates of its sustainable longer-run pace and that labor market conditions would strengthen further. A number of participants indicated that they had marked up their forecasts for economic growth in the near term relative to those made for the December meeting in light of the strength of recent data on economic activity in the United States and abroad, continued accommodative financial conditions, and information suggesting that the effects of recently enacted tax changes--while still uncertain--might be somewhat larger in the near term than previously thought. Several others suggested that the upside risks to the near-term outlook for economic activity may have increased. A majority of participants noted that a stronger outlook for economic growth raised the likelihood that further gradual policy firming would be appropriate.

…Some participants also commented on the likely evolution of the neutral federal funds rate. By most estimates, the neutral level of the federal funds rate had been very low in recent years, but it was expected to rise slowly over time toward its longer-run level. However, the outlook for the neutral rate was uncertain and would depend on the interplay of a number of forces. For example, the neutral rate, which appeared to have fallen sharply during the Global Financial Crisis when financial headwinds had restrained demand, might move up more than anticipated as the global economy strengthened. Alternatively, the longer-run level of the neutral rate might remain low in the absence of fundamental shifts in trends in productivity, demographics, or the demand for safe assets.

… a couple of members expressed concern about the outlook for inflation, seeing little evidence of a meaningful improvement in the underlying trend in inflation, measures of inflation expectations, or wage growth. Several members commented that they saw both upside and downside risks to the inflation outlook, and members agreed to continue to monitor inflation developments closely.

Members agreed …to carefully monitor actual and expected inflation developments relative to the Committee's symmetric inflation goal. Members expected that economic conditions would evolve in a manner that would warrant further gradual increases in the federal funds rate. They judged that a gradual approach to raising the target range would sustain the economic expansion and balance the risks to the outlook for inflation and unemployment. Members agreed that the strengthening in the near-term economic outlook increased the likelihood that a gradual upward trajectory of the federal funds rate would be appropriate. They therefore agreed to update the characterization of their expectation for the evolution of the federal funds rate in the postmeeting statement to point to "further gradual increases" while maintaining the target range at the current meeting. Members continued to anticipate that the federal funds rate would likely remain, for some time, below levels that were expected to prevail in the longer run. Nonetheless, they again stated that the actual path for the federal funds rate would depend on the economic outlook as informed by the incoming data.

Source: Federal Reserve Board