Five Takeaways From The FOMC Minutes

- There are five broad takeaways from this batch of minutes (here) to the November 7th–8th meeting.
- **First, the minutes flagged a rate hike as appropriate 'fairly soon.'** Recall that when they used 'fairly soon' in the August minutes in reference to when to remove 'accommodative' from the statement, they did so right away in the next statement in September. That may imply that the Fed is on track for another hike at its December meeting but it leaves enough wiggle room for a hold if developments between now and then seriously disappoint. Here's the direct quote:

  "Consistent with their judgment that a gradual approach to policy normalization remained appropriate, almost all participants expressed the view that another increase in the target range for the federal funds rate was likely to be warranted fairly soon if incoming information on the labor market and inflation was in line with or stronger than their current expectations."

- **Regarding the conditionality of the "fairly soon" rate hike reference that is data dependent, here is what I think will be the main developments to monitor between now and the decision on Dec 19th:**
  - G20 this weekend: US-China truce albeit temporary?
  - OPEC Dec 6th: production cuts that may lift oil and with it inflation expectations?
  - Possible Brexit developments especially risk of a hard Brexit
  - Powell again in JEC testimony next Wednesday
  - next Friday's nonfarm payrolls report with another possible up-tick in wage growth
  - CPI on the 12th
  - holiday shopping: retail sales for November on Dec 14th
- **Second, the committee also signalled a potential language shift on future rate hikes at some upcoming meeting** that could be December or later and the exact quote is below. In some respects this is new and may be taken as a signal of a less mechanical approach than the 25bps hikes per calendar quarter that have defined the pattern to date. In other respects, however, it is not new at all in that the Fed has always positioned its moves as data dependent (see this morning's Daily Points for more on that). It's therefore ambiguous whether the Fed is signalling a pause here compared to prior language. As long as the economy performs in keeping with dual mandate goals, the Fed will keep hiking.

  "Participants also commented on how the Committee's communications in its postmeeting statement might need to be revised at coming meetings, particularly the language referring to the Committee's expectations for "further gradual increases" in the target range for the federal funds rate. Many participants indicated that it might be appropriate at some upcoming meetings to begin to transition to statement language that placed greater emphasis on the evaluation of

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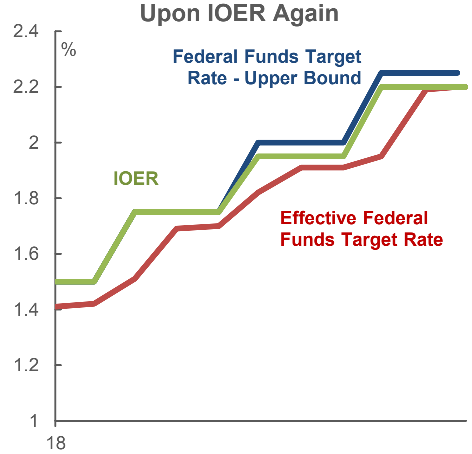
EFF Has Converged Upon IOER Again



Sources: Scotiabank Economics, Bloomberg.

> incoming data in assessing the economic and policy outlook; such a change would help to convey the Committee's flexible approach in responding to changing economic circumstances. "

- **Third, the minutes noted a possible change in the IOER rate before the next meeting in December.** As our fixed income strategist Roger Quick notes, the minutes are likely stale in this regard because the pressure on the relative short-term rates in question has not been as feared in the minutes. The quote is below, but also see the accompanying chart that depicts how the effective fed funds rate and the IOER rate are essentially now on top of each other and not meeting the criteria for a further upward drift in EFF as flagged in the quote below that captures the state of the discussion on November 7th–8th:

> "Following the Desk briefings, the Chairman noted the upward trend in the EFFR relative to the IOER rate over the intermeeting period and suggested that it might be appropriate to implement another technical adjustment in the IOER rate relative to the top of the target range for the federal funds rate fairly soon. While the funds rate seemed to have stabilized recently, there remained some risk that it could continue to drift higher before the Committee's next meeting. As a contingency plan, participants agreed that it would be appropriate for the Board to implement such a technical adjustment in the IOER rate before the December meeting if necessary to keep the federal funds rate well within the target range established by the FOMC."

- **In any event, while this matters to short-term rates traders, it's a discussion over a technical adjustment that is of little consequence to broader markets and the broader economy.**
- **Fourth—and notably—there was no hint at changing estimates of the neutral policy rate in the discussion. Indeed, note that it was just a minority view in the quote below.** The December projections may alter neutral rate forecasts by the FOMC consensus but there is no signal with respect to appetite to doing so in today's minutes.

> "A couple of participants noted that the federal funds rate might currently be near its neutral level and that further increases in the federal funds rate could unduly slow the expansion of economic activity and put downward pressure on inflation and inflation expectations."

- **If it's only a couple of participants then that implies the majority see a fair gap between the current fed funds target range (upper limit of 2.25%) and the neutral rate.**
- **Fifth, there was no balance sheet discussion and so that is sensibly to be expected at the December FOMC** given that Chair Powell said it would occur sometime in the Fall which now only leaves the December 18–19 FOMC meeting. That should be a lively one with a likely hike, possible change in language on "further gradual" hikes, revised forecasts and a balance sheet management dialogue but in the context of a general sense—including the NY Fed's Simon Potter's speech—that the Fed is content with its balance sheet management strategy.
- Please see below for the categorization of remarks by the Fed's usual language that indicates frequency of citation. As an interesting aside, there are very few entries in the categories that signal widespread agreement among FOMC participants.

All

- none

Generally Agreed

- none

In General

"In general, participants viewed recent price developments as consistent with their expectation that inflation would remain near the Committee's symmetric 2 percent objective on a sustained basis."

Nearly All

- none

Almost all

"Almost all participants reaffirmed the view that further gradual increases in the target range for the federal funds rate would likely be consistent with sustaining the Committee's objectives of maximum employment and price stability."

All but one

- none

Majority

- none

Most

"Although household spending overall was seen as strong, most participants noted weakness in residential investment. This weakness was attributed to a variety of factors, including increased mortgage rates, building cost increases, and supply constraints."

More than half

- none

Fewer than half

- none

Several

"Several participants observed that the stimulative effects of fiscal policy would likely diminish over time, while the lagged effects of reductions in monetary policy accommodation would show through more fully, with both factors contributing to their expectation that economic growth would slow to a pace closer to trend."

"Several participants were concerned that the high level of debt in the nonfinancial business sector, and especially the high level of leveraged loans, made the economy more vulnerable to a sharp pullback in credit availability, which could exacerbate the effects of a negative shock on economic activity."

Many

"Many participants noted that the recent pace of aggregate wage gains was broadly consistent with trends in productivity growth and inflation."

Some

On the discussion regarding IOER, "Some participants saw it as desirable to explore the possibility of targeting a secured interest rate. Some also expressed interest in studying, over the longer term, approaches in which the Committee would target a mixture of secured and unsecured rates."

"The renminbi continued to depreciate, moving closer to 7.0 renminbi per dollar—a level that some market participants viewed as a possible trigger for intensifying depreciation pressures."

"Participants observed that growth in business fixed investment slowed in the third quarter following several quarters of rapid growth. Some participants pointed to anecdotal evidence regarding higher tariffs and uncertainty about trade policy, slowing global demand, rising input costs, or higher interest rates as possible factors contributing to the slowdown. A couple of others noted that business investment growth can be volatile on a quarterly basis and factors such as the recent cuts in corporate taxes and high levels of business sentiment were expected to support investment going forward."

“Some participants viewed economic and financial developments abroad, including the possibility of further appreciation of the U.S. dollar, as posing downside risks for domestic economic growth and inflation.”

“Some participants raised the concern that tightening resource utilization in conjunction with an increase in the ability of firms to pass through increases in tariffs or in other input costs to consumer prices could generate undesirable upward pressure on inflation.”

A number

“Despite these developments, a number of participants judged that financial conditions remained accommodative relative to historical norms.”

A few

“A few participants indicated that uncertainty had increased recently, pointing to the high levels of uncertainty regarding the effects of fiscal and trade policies on economic activity and inflation.”

“A few participants suggested that some of these financial vulnerabilities might not currently represent risks to financial stability so much as they represent downside risks to the economic outlook”

“However, a few participants, while viewing further gradual increases in the target range of the federal funds rate as likely to be appropriate, expressed uncertainty about the timing of such increases.”

A couple

“A couple of participants noted that the federal funds rate might currently be near its neutral level and that further increases in the federal funds rate could unduly slow the expansion of economic activity and put downward pressure on inflation and inflation expectations.”

“A couple of participants saw scope for further increases in the labor force participation rate as the strong economy pulled more workers into the labor market, while a couple of other participants judged that there was little scope for significant further increases.”

“A couple of participants saw scope for further increases in the labor force participation rate as the strong economy pulled more workers into the labor market, while a couple of other participants judged that there was little scope for significant further increases.”

“A couple of participants expressed the concern that measures of inflation expectations would remain low, particularly if economic growth slowed more than expected.”

“a couple of participants suggested that financial stability risks and risks to the outlook are interconnected. A couple of participants also commented on the upcoming release of the Board’s first public Financial Stability Report and noted that the report would increase the transparency of the Federal Reserve’s financial stability work as well as enhance communications on this topic.”

“A couple of participants noted that the federal funds rate might currently be near its neutral level and that further increases in the federal funds rate could unduly slow the expansion of economic activity and put downward pressure on inflation and inflation expectations.”

One

- none