Economic Update

November 21, 2023

FOMC Minutes Say Monetary Policy Needs to Remain Restrictive, With Bias Toward Higher Fed Funds Rate

- **According to the minutes from the FOMC meeting on October 31 and November 1, FOMC participants maintained a tightening bias, even as they kept the fed funds rate unchanged for a third straight meeting.**

- **Participants noted that monetary policy remained restrictive, and that supply and demand were coming into balance.**

- **Inflation remained elevated, however.**

- **PNC expects the FOMC to maintain the current range for the fed funds rate until the second half of 2024.**

At its meeting on October 31 and November 1, the Federal Open Market Committee maintained the fed funds rate in a range between 5.25% and 5.50%. After raising the fed funds rate to this level in late July, the FOMC has kept the rate in this range at its two subsequent meetings. Although they kept the fed funds rate unchanged, the meeting minutes say that "participants continued to judge that it was critical that the stance of monetary policy be kept sufficiently restrictive to return inflation to the Committee's 2% objective over time. All participants agreed that the Committee was in a position to proceed carefully and that policy decisions at every meeting would continue to be based on the totality of incoming information and its implications for the economic outlook as well as the balance of risks."

The minutes say that the FOMC expects to keep the fed funds rate elevated in the near term: "All participants judged that it would be appropriate for policy to remain at a restrictive stance for some time until inflation is clearly moving down sustainably toward the Committee's objective." In addition, the FOMC maintained its tightening bias: "Participants noted that further tightening of monetary policy would be appropriate if incoming information indicated that progress toward the Committee's inflation objective was insufficient." The FOMC indicated that incoming data would determine near-term monetary policy: "Participants expected that the data arriving in coming months would help clarify the extent to which the disinflation process was continuing, aggregate demand was moderating in the face of tighter financial and credit conditions, and labor markets were reaching a better balance between demand and supply."

Although third quarter GDP growth was very strong, participants believed that aggregate supply and demand were coming into balance thanks to restrictive monetary policy and the ongoing normalization on the supply side of the economy. They also noted an easing in the labor market and a tightening in financial conditions in the fall. In particular, they noted higher long-term interest rates, including higher mortgage rates.

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Participants noted that overall inflation remained well above the committee's 2% objective, and they wanted further confirmation that inflation was indeed slowing to the committee's 2% objective. They thought that GDP growth needed to slow to below potential and that further softening in the labor market was required to bring inflation back to 2%. In addition, some participants said that wage growth needed to slow further to a pace more consistent with 2% inflation. Participants noted that core goods inflation had slowed, as had housing services inflation.

One concern was continued strength in consumer spending, repeatedly coming in stronger than expected. However, consumer spending growth was expected to slow due to high interest rates.

Risks remained elevated. There were risks to both the upside and downside for growth. In addition, there were upside and downside risks for inflation. Participants were particularly concerned about the potential for continued elevated inflation.

PNC expects that the FOMC will keep the fed funds rate in its current range of 5.25% to 5.50% until the second half of 2024, when a slowing economy will support rate cuts. Monetary policy is currently restrictive, weighing on economic growth; inflation continues to gradually ease to the 2% objective; and job growth is softening to a more sustainable pace. That being said, risks to the fed funds rate are to the upside. These include continued strength in the labor market and consumer spending, stubbornly high inflation, and a war in the Middle East that would drive up oil prices.

There was little market response to the release of the minutes. The fed funds futures market is currently pricing in a 95% probability of no change in the fed funds rate at the FOMC's next meeting, on December 13.

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