The Daily Dish

Inside the Fed's Thinking

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Washington is currently a two-ring circus: the debt ceiling and the Fed. Unfortunately, AAF does not have a mole in debt-limit negotiations, but yesterday the Fed released the minutes of its most recent meeting. It is a peek into its thinking.

Recall that the Fed's preferred measure of inflation is the core personal consumption expenditure price index. This stood at 5.0 percent in April 2022 and had only fallen to 4.6 percent by March 2023. (Measured using market-based prices, the corresponding readings are 4.9 percent and 4.7 percent.) In short, there has been very little progress over the past year in bringing down inflation. The next reading – data for May – arrives Friday at 8:30 a.m.

As for the present, inflation remains well above the 2 percent target, but growth in demand is clearly softening. First quarter growth in gross domestic product checked in at a weak 1.1 percent and recent reports on retail sales, capital goods orders, and other indicators show slow but steady weakening. The staff forecast in the May meeting indicated a recession for the second straight time: "The economic forecast prepared by the staff for the May FOMC meeting continued to assume that the effects of the expected further tightening in bank credit conditions, amid already tight financial conditions, would lead to a mild recession starting later this year, followed by a moderately paced recovery. Real GDP was projected to decelerate over the next two quarters before declining modestly in both the fourth quarter of this year and the first quarter of next year." Inflation was forecast to drop off substantially in 2024 and return to 2 percent in 2025.

Nevertheless, the Federal Open Market Committee (FOMC) voted unanimously to raise rates by 25 basis points. Yet it may be difficult to generate unanimity in future the voting. Views are now widening regarding the best path forward. Here's the key paragraph:

> *Taking into account these various considerations, participants discussed their views on the extent to which further policy firming after the current meeting may be appropriate. Participants generally expressed uncertainty about how much more policy tightening may be appropriate. Many participants focused on the need to retain optionality after this meeting. Some participants commented that, based on their expectations that progress in returning inflation to 2 percent could continue to be unacceptably slow, additional policy firming would likely be warranted at future meetings. Several participants noted that if the economy evolved along the lines of their current outlooks, then further policy firming after this meeting may not be necessary. In light of the prominent risks to the Committee's objectives with respect to both maximum employment and price stability, participants generally noted the im- portance of closely monitoring incoming information and its implications for the economic outlook.*

In short, there are some arguments to raise, some to pause, and some to halt rate hikes.

The most interesting thing about the June meeting is not whether the Fed raises or – as Eakinomics expects – pauses. It is whether the FOMC continues to remain united or the divisions break into the public eye.