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MARKET SIGHT*LINES*

The Federal Reserve's January Meeting Minutes Highlight Strengths and Vulnerabilities

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In our report **Outlook 2024: Embracing Change** (report, video), we included our view that the Federal Reserve (Fed) would keep its benchmark rate elevated for some time, only cutting the rate 0.50%-0.75% later in the year after evidence of sustained cooler inflation. Our view has been more muted than the consensus view, which recently called for a quarter-point rate cut in March, and six more through the year.

The Fed recently released its minutes for the January 2024 meeting, offering more detail on the discussion, debate, and policy decision. In this week's Sight|Lines, we review and summarize some key takeaways from these minutes, which highlight some strengths and potential vulnerabilities in the current environment.

THE TAKEAWAY: THE ECONOMY IS STRONG, INFLATION HAS COOLED, BUT THE FED SEES POTENTIAL VULNERABILITIES

Fed minutes usually provide insight into the discussion and debate among Fed officials and staff as they weigh policy decisions, and this was the case for the January minutes. In summary:

- *Economic Growth*: There was a consensus that fourth quarter GDP grew at a solid pace.
- *Labor Market Conditions*: Officials noted labor market tightness, but signs of easing.
- *Inflation Trends*: Officials observed a welcome deceleration of consumer price inflation.
- *Policy Decisions*: Voting officials were unanimous in maintaining the current policy.
- *Future Policy Adjustments*: The consensus view is to take a data-driven approach, with a greater focus on not cutting rates too soon.
- *Economic Risks*: Both upside and downside economic risks were discussed, including the potential for excess demand and geopolitical risks.
- *Financial Stability*: The Fed is appropriately focused on financial stability and banking system resilience, and the January minutes removed a statement for a good reason.

IN-DEPTH: THE ECONOMY IS STRONG, INFLATION HAS COOLED, BUT VULNERABILITIES INCLUDE THE POTENTIAL FOR POLICY ERROR AND WEAKENING FINANCIAL STABILITY

The January Fed minutes provide insight into the Fed officials' focus leading to its policy decisions. Going deeper:

- *Economic Growth*: With a consensus that fourth quarter GDP grew at a solid pace, officials:
    - Are observing a deceleration in the rate of growth, and
    - Note the contributions of net exports and inventory investments, two volatile categories.
- *Labor Market Conditions*: Officials observe that the labor market remains tight but is easing, discussing:
    - The better alignment of labor supply and demand, and
    - The moderated pace of job gains and the decline in labor participation.
- *Inflation Trends*: The Fed is monitoring for cooling inflation, and recent data shows such cooling:
    - Meeting participants observed a deceleration in total and core consumer price inflation.
    - Officials discussed inflation expectations and some alignment with pre-pandemic levels.
- *Policy Decisions*: Voting officials were unanimous in maintaining the two key policy components:
    - The fed funds rate target range will remain at 5.25%-5.50%.
    - The balance sheet reduction program will continue.
- *Future Policy Adjustments*: The consensus view continues to be to take a data-driven approach:
    - There's a sense that officials worry more about cutting rates too soon and reigniting inflation.
- *Economic Risks*: Both upside and downside economic risks were discussed during the January meeting:
    - 2023 economic growth was stronger than expected, and solid aggregate demand may continue.
    - Participants also discussed "possible disruptions to supply chains from geopolitical developments," with such risks possibly resulting in a "material pullback in demand."
- *Financial Stability*: The Fed meeting included a discussion on banking system resilience, and there was a subtle, but positive, change between the December and January meetings' minutes:
    - December: "Members concurred that the U.S. banking system was sound and resilient."
    - January: "Given that the stresses that emerged … early last year have subsided, members agreed to remove from the statement the reference to the resilience of the U.S. banking system…"

CONCLUSION

The Fed's January minutes detailed its discussion, debate, and policy decisions. We see the Fed waiting until the fourth quarter to cut its funds rate. The details of the Fed minutes reinforce our view. The Fed wants sustained, lower inflation to avoid policy error, with particular focus on preventing inflation from reheating. And, notably, officials removed a reference to the banking system resilience as the crisis of 2023 appears to have subsided. Despite this action, we see this as a topic that warrants greater focus going forward.

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