Take 5 Five
WITH THE ST. LOUIS FED

November 3, 2023

Fed Maintains Pause in November, Proceeds Carefully Moving Forward

Transcript

Kathleen Navin: Welcome to this installment of *Take Five with the St. Louis Fed*. I'm Kathleen Navin, senior business economist in Supervision, and today I will be discussing the latest FOMC meeting that took place on October 31 and November 1. At this meeting, the FOMC unanimously decided to maintain the current target for the federal funds rate at a range of 5.25 to 5.50%. Additionally, there were no changes to current balance sheet policy, where the reduction in securities continues as originally announced last year.

Overall, the Federal Reserve's balance sheet has declined by a little over $1 trillion since quantitative tightening began last year. While there was no update to the summary of economic projections at this FOMC meeting, we did get some insights into current views on economic activity through both the FOMC statement as well as the chair's press briefing that occurred after the release of the statement. In particular, the statement referenced the strong economic growth that occurred in the third quarter and, as we see here, real GDP growth was 4.9% in the third quarter, well above trend and driven by a strong reading on consumer spending. In addition, there was reference to continued job gains. And while those job gains have been moderating, they remain strong, and the unemployment rate as of September remains low. It's worth noting that the October jobs report was released after the November FOMC meeting, as well as this discussion, and will be an important piece of data as the Federal Reserve looks to determine monetary policy going forward for the December meeting.

But sticking with the November meeting, what we also saw was a continued emphasis on inflation and, in particular, the view that inflation remains elevated. Here we see on the next chart headline, PCE inflation measured on a year-over-year basis was 3.4% as of September and core PCE inflation, which removes the volatile components of food and energy, was 3.7% as of September, both still above the Fed's objective of 2%. And indeed, while the Federal Reserve weighs the recent strength in economic activity and the potential for that to reaccelerate inflation at the same time, it's considering whether or not the recent tightening in financial conditions could potentially slow economic activity, working in the other direction. And indeed, there was reference to the recent tightening in financial conditions in both the FOMC statement as well as Chair Powell's press briefing. In particular,

looking ahead, the statement noted tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation.

Let's review some of the tightening and financial conditions that have occurred since this summer. First, let's look at interest rates. Here we see the 10-year Treasury yield in the maroon color has risen by roughly a percentage point since mid-July to the timing of the November FOMC meeting; and an increase in the 10-year Treasury yield has important implications for other borrowing costs, such as corporate yields, as well as the mortgage rate. And here, in particular, we see that the mortgage rate in the gray line has risen to around 8% at the time of the November FOMC meeting and this is over 20-year highs, so higher borrowing costs has the effect of putting downward pressure on interest-sensitive sectors of the economy, such as housing and business-fixed investment.

In addition, we've seen that equity prices have retreated in recent months. In particular, here we have the S&P 500, and we see the decline that has occurred since the end of July. Equity valuations have important implications for household balance sheets as this is a component of household net worth and could have effects for consumer spending. And thirdly, looking at the recent changes in the broad dollar, we see an additional appreciation in the dollar since July, an additional source of the tightening that's referenced in financial conditions, and this has important implications for trade balances. An appreciation in the dollar would make exports more expensive and would put downward pressure on that part of the economy.

So overall, the Federal Reserve is weighing all of the different implications from these different data—both the economic data and the financial data—and as a result, the Committee is committed to proceeding carefully in determining the appropriate path of policy going forward. And indeed, Chair Powell noted during the press briefing, "In light of the uncertainties and risks and how far we have come, the Committee is proceeding carefully. We will continue to make our decisions meeting by meeting based on the totality of incoming data and their implications for the outlook, for economic activity and inflation, as well as the balance of risks."

Now, while we didn't get an updated dots plot at this FOMC meeting, it is interesting to see how market expectations have changed. Here we see market expectations from the FedWatch Tool by the Chicago Mercantile Exchange. We see that they have not really changed in terms of 2023 expectations that there will be no additional rate hikes. And what we see here is that markets continue to expect no additional tightening in this cycle and that

rate cuts will begin in June of next year, and that's an earlier start to cuts than markets expected at the time of the September FOMC meeting.

Now, we'll get a new set of these projections in December so that will give some insight into the 2024 path, but Chair Powell emphasized during the press briefing that the Committee is not thinking about rate cuts at this time. Instead, it is focused on determining whether or not monetary policy has reached a sufficiently restrictive level to bring inflation sustainably down to 2% over time. In addition, the Federal Reserve will continue to be data-dependent between now and the December meeting in determining that appropriate path for policy moving forward. And in the November FOMC statement, the Committee said, "In determining the extent of additional policy firming that may be appropriate to return inflation to 2% over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." So we'll be watching the data come in—both the economic data and the financial data—between now and the December meeting.

And until that time, that wraps up our November summary. And I'll see you in December. Thanks so much.

(END OF RECORDING)