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FOMC Minutes: Two-Way Risks

The minutes showed a split Committee on how much more policy tightening is needed. A June pause will be hotly debated. We see a path to consensus on a pause that underscores additional tightening could be needed should the data be uncooperative. A softer May core CPI will be the final data in hand.

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May FOMC Minutes

Bottom line: *The minutes of the May meeting revealed there was a split on the support for further rate hikes, however, "respondents still assigned a substantial probability that the peak rate may turn out to be above 5.25%." Respondents also expected the peak rate to be maintained through January 2024, consistent with prior projections. We continue to expect no further hike at the June FOMC meeting and the peak rate of 5.1% to hold before the Fed makes its first 25bp cut in 1Q24.*

Since the May FOMC meeting, communication from policymakers has shown a clear division on the path forward for rates. **The FOMC minutes revealed that the FOMC is indeed divided on whether to hike rates further, but participants "generally expressed uncertainty about how much more policy tightening may be appropriate."** What was agreed upon is the need to retain flexibility and be data dependent. The minutes provided more color on when participants expect the first rate cut, which is in January 2024, in line with the March SEP.

There continued to be little conversation on the balance sheet. The minutes noted that balance sheet runoff was continuing to run smoothly and "all participants agreed that it was also appropriate to continue the process of reducing the Federal Reserve's securities holdings, as described in its previously announced Plans for Reducing the Size of the Federal Reserve's Balance Sheet."

A substantial portion of the minutes were once again dedicated to monitoring the impact of tighter lending standards on economic activity, but there seemed to be **less concern of banking instability than in the prior minutes**. The minutes revealed that "overall, the credit quality of most businesses and households remained solid but deteriorated somewhat for businesses with lower credit ratings and for households with lower credit scores." Further, some participants mentioned that "developments in the banking sector appeared to have had only a modest effect so far on credit availability for firms." **A notable comment was that several participants do not think tighter credit availability will necessarily lead to lower inflation**, given that both supply and demand for credit are moderating. Participants still gauged risks to inflation to the upside, though less so compared with March.

Ultimately, **we think it won't be difficult to get consensus on a June pause if it is coupled with the promise that further hikes could be needed if the data do not cooperate**. A similar tactic was taken in December 2015 when then Chair Yellen looked to gain consensus around lifting from the zero lower bound if the statement promised rate hikes thereafter would be carefully considered and it was not necessarily the start of a rate hike cycle - memorialized by including the word "gradual" in the statement twice.

The June decision for many FOMC participants may come down to the May CPI data, in hand on the cusp of the meeting. **Our preliminary forecast for May core CPI is an increase of 0.30%M, slowing from the pace in April**. We believe the May CPI print will show a slowdown in core services, which includes our expectation that the downward trend in housing (rents & OER) resumes. Policymakers in particular will be focused on non-housing services inflation so as usual, the devil will be in the details.

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