

NEXUS338

The following summary represents direct quotes (with minor immaterial changes to make reading easier) from the press conference – Prepared remarks and Q&A session.

<https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20251210.pdf>

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- **Dual Mandate Affirmation**

Squarely focused on achieving dual mandate goals of maximum employment and stable prices. In the near term, risks to inflation are tilted to the upside and risks to employment to the downside - a challenging situation.

- **The Economy**

Important federal government data have been delayed due to the shutdown. Available indicators suggest that economic activity has been expanding at a moderate pace. GDP rose at a 1.6 percent pace in the first half of the year, down from 2.4 percent last year. The shutdown of the federal government will weigh on economic activity while it persists, but these effects should reverse after the shutdown ends.

- **The Labor Market**

The unemployment rate remained relatively low through August. Job gains have slowed significantly since earlier in the year. A good part of the slowing likely reflects a decline in the growth of the labor force, due to lower immigration and labor force participation, though labor demand has clearly softened as well. Available evidence suggests that both layoffs and hiring remain low, and that both households' perceptions of job availability and firms' perceptions of hiring difficulty continue to decline. In this less dynamic and somewhat softer labor market, the downside risks to employment appear to have risen in recent months.

There are primarily two reasons for the weakening labor market and on the supply side. First is the declining labor force participation, which is a cyclical phenomenon. Second is declining immigration, which is just a big policy change that actually began in the last administration and accelerating. In addition, labor demand has declined and so the labor -- the unemployment rate has gone down, meaning that demand for workers has gone down a little more than supply.

- **Inflation**

Inflation has eased significantly from its highs in mid-2022 but remains somewhat elevated relative to our 2 percent longer-run goal. September's Consumer Price Index suggests that total PCE prices rose 2.8 percent over the 12 months and core PCE prices rose 2.8 percent as well. These readings are higher than earlier in the year as inflation for goods has picked up. In contrast, disinflation appears to be continuing for services. Near-term measures of inflation expectations have moved up, on balance, over the course of this year on news about tariffs, as reflected in both market- and survey-based measures. Beyond the next year or so, however, most measures of longer-term expectations remain consistent with the 2 percent inflation goal. Higher tariffs are pushing up prices in some categories of goods,

resulting in higher overall inflation. A reasonable base case is that the effects on inflation will be relatively short-lived - a one-time shift in the price level. But it is also possible that the inflationary effects could instead be more persistent, and that is a risk to be assessed and managed.

The Committee always breaks inflation down into three components.

1. Goods prices are increasing, and that's really due to the tariffs and is moving inflation up.
2. Housing services' inflation has been coming down and is expected to continue to come down.
3. Services other than housing services and that's kind of been moving sideways over the last few months, but a significant part of that is non-market services (it largely reflects higher stock prices and financial services that are imputed rather than actually paid). A modestly restrictive policy should lead to a gradually cooling economy. That's one of the reasons for a gradually cooling labor market

In total, there are two conditions:

- First, inflation away from tariffs is actually not so far from the 2 percent goal. The base case for tariff inflation is that it will come, and it probably will increase further. But it will be a one-time increase. One pathway through which it could become inflationary is a really tight labor market; and that is not the case now.
- Second, inflation expectations are moving up, and that is not the case.

- **Tariff & Inflation**

The basic expectation is that there will be some additional increased inflation to come because it takes a while for tariffs to work their way through the production chain and finally get to consumers. And consumers see those effects now from the tariffs that were put in place now many months ago. This phenomenon will continue to happen for some time, probably into the spring. These are not big increases though. These are a tenth or so on inflation. There may be big increases on a particular product that's been tariffed, but overall, these are fairly modest. Once all the tariffs are in, they stop generating inflation, this becomes a one-time price increase. This is the theory. Once the last tariff is put on something, at that point it becomes a higher price level, but prices stop going up and just be at that level. And then measured inflation will come back down to non-tariff inflation,

- **Balance of Risks**

In the near term, risks to inflation are tilted to the upside and risks to employment to the downside. There is no risk-free path for policy as the Fed navigates this tension between the employment and inflation goals. The Fed's framework calls for a balanced approach in promoting both sides of the dual mandate. Today's situation is where the risks are to the upside for inflation and to the downside for employment. The Fed has one tool; it can't do both of those and address both of those at once.

- **Interest Rate Policy**

With downside risks to employment having increased in recent months, the balance of risks has shifted. Accordingly, the Committee judged it appropriate at this meeting to take another step

toward a more neutral policy stance. The Fed remains well positioned to respond in a timely way to potential economic developments. The Committee will continue to determine the appropriate stance of monetary policy based on the incoming data, the evolving outlook, and the balance of risks. The economy continues to face two-sided risks. In the Committee's discussions there were strongly differing views about how to proceed in December. A further reduction in the policy rate at the December meeting is not a forgone conclusion - far from it. Policy is not on a preset course. Rates are looser, they're accommodative right now, and they are meaningfully less tight than they were'

- **End of Quantitative Tightening**

The Committee decided to conclude the reduction of aggregate securities holdings as of December 1. The long-stated plan has been to stop balance sheet runoff when reserves are somewhat above the level the Committee judges consistent with ample reserve conditions. Signs have clearly emerged that this standard has been reached. (1) In money markets, repo rates have moved up relative to the Fed's administered rates, and (2) observing more notable pressures on selected dates along with more use of the standing repo facility. In addition, (3) the effective federal funds rate has begun to move up relative to the rate of interest on reserve balances. These developments are what is expected as the size of the Fed balance sheet declined and warrant the decision to cease runoff. Over the 3-1/2 years the Fed balance sheet has fallen from 35 percent to about 21 percent. In December, the Fed will enter the next phase of its normalization plans by holding the size of its balance sheet steady for a time while reserve balances continue to move gradually lower as other non-reserve liabilities such as currency keep growing. The Fed will continue to allow agency securities to run off its balance sheet and will reinvest the proceeds from those securities in Treasury bills, furthering progress toward a portfolio consisting primarily of Treasury securities. Right now, the balance sheet has a lot more duration than the outstanding universe of treasury securities. This reinvestment strategy will also help move the weighted average maturity of the Fed's portfolio closer to that of the outstanding stock of Treasury securities, thus furthering the normalization of the composition of its balance sheet.