Dinesh Bakshi
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Analysis of Federal Reserve Meeting Minutes

Article

Waning inflation, a slump in the US job market, and a cooling economy are likely to prompt a rate cut in the coming months, the minutes of the Federal Reserve's meeting held between June 11-June 12 indicate.
Here are the other key highlights from the Federal Reserve meeting:
With the continuing downward trends in inflation and employment, the Fed will likely cut its benchmark interest rate in the coming months from 5.3%, a 23-year peak. The current interest rate is unchanged at 5.25% to 5.50%.
Several factors could ease inflation in the coming months, including the slower growth in wages, which will reduce pressure on companies to raise prices to cover their labour costs.
The Fed highlighted several cases of retail chains and other businesses lowering prices and offering discounts, a sign that customers increasingly resist higher prices.
However, more evidence was needed to show that inflation was returning sustainably to the Fed's 2% target. The Fed signalled it is in no rush to reduce borrowing costs.
Consumers, particularly lower-income households, are spending less, companies are advertising fewer job openings and economic growth weakened in the first three months of 2024.
Unlike the previous Fed meetings, the officials cited concerns that a further cooling in the job market might lead to increased layoffs. So far, slowing demand for workers is seen in the form of fewer job postings.
The minutes also showed signs of a slowdown. “The vast majority of participants assessed that growth in economic activity appeared to be gradually cooling, and most participants remarked that they viewed” the central bank’s benchmark rate as high enough to slow growth and inflation,” the minutes of the Fed meeting showed.
Lower- and moderate-income households are “encountering increasing strains as they attempt to meet higher living costs.”
Strains on lower- and moderate-income households prompted increasing use of credit cards and delinquency rates, which has become a concern, according to the minutes.

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Questions:

1. Define inflation and explain how it affects an economy. *(2 marks)*
2. Identify two factors mentioned in the article that are contributing to easing inflation in the US. *(2 marks)*
3. Discuss how a rate cut by the Federal Reserve can impact consumer spending, particularly for lower-income households. *(6 marks)*
4. Examine the potential consequences of a cooling job market on the US economy. *(6 marks)*
5. Analyze how lowering the benchmark interest rate could influence borrowing costs and stock prices. Provide specific examples. *(8 marks)*
6. Evaluate the trade-offs the Federal Reserve faces between achieving stable prices and maximum employment. How might these conflicting goals influence their decision on interest rates? *(10 marks)*

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Suggested Answers

1. **Define inflation and explain how it affects an economy.**
   Definition: Inflation is the rate at which the general level of prices for goods and services rises, eroding purchasing power. Inflation decreases the value of money, leading to higher costs of living. It can reduce consumer spending, increase interest rates, and lead to uncertainty in the economy.

2. **Identify two factors mentioned in the article that are contributing to easing inflation in the US.**
   - Slower growth in wages, reducing the need for companies to raise prices to cover labor costs.
   - Retail chains and other businesses lowering prices and offering discounts, indicating resistance to higher prices from customers.

3. **Discuss how a rate cut by the Federal Reserve can impact consumer spending, particularly for lower-income households.**
   A rate cut reduces borrowing costs, making loans and credit cheaper. This can increase disposable income for consumers, encouraging higher spending. Lower-income households may benefit as they rely more on credit for purchases, helping to alleviate some financial strains and potentially boosting overall consumer demand.

4. **Examine the potential consequences of a cooling job market on the US economy.**
   A cooling job market can lead to increased unemployment and reduced income, which decreases consumer spending. Lower demand for goods and services can slow economic growth. Businesses may experience reduced profits, leading to further layoffs and a negative feedback loop that can deepen economic downturns.

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5. **Analyze how lowering the benchmark interest rate could influence borrowing costs and stock prices. Provide specific examples.**
   Lowering the benchmark interest rate reduces the cost of borrowing for mortgages, auto loans, and business loans. For example, homeowners may refinance at lower rates, reducing monthly payments and increasing disposable income. Lower rates also make stocks more attractive as investments compared to bonds, potentially boosting stock prices. Businesses may borrow more to invest in expansion, driving economic growth.

6. **Evaluate the trade-offs the Federal Reserve faces between achieving stable prices and maximum employment. How might these conflicting goals influence their decision on interest rates?**
   Stable Prices: Keeping inflation low ensures the purchasing power of money remains stable, which is crucial for long-term economic planning and saving.
   Maximum Employment: Lowering interest rates can stimulate job creation by encouraging borrowing and investment.
   Trade-Offs: Reducing interest rates to boost employment can lead to higher inflation if demand outstrips supply. Conversely, raising rates to control inflation can increase unemployment. The Fed must balance these goals, often prioritizing one over the other based on current economic conditions. For example, with inflation under control but unemployment rising, the Fed might lower rates to support job growth.

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