Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

TrendMacro

Data Insights: FOMC Minutes

Wednesday, November 20, 2019

October minutes: key signaling language Featured Important Very important

Committee participants continued their discussions related to the ongoing review of the Federal Reserve's monetary policy strategy, tools, and communication practices. Staff briefings provided an assessment of a range of monetary policy tools that the Committee could employ to provide additional economic stimulus and bolster inflation outcomes, particularly in future episodes in which the policy rate would be constrained by the effective lower bound (ELB). The staff first discussed policy rate tools, focusing on three forms of forward guidance—qualitative, which provides a nonspecific indication of the expected duration of accommodation; date-based, which specifies a date beyond which accommodation could start to be reduced; and outcome-based, which ties the possible start of a reduction of accommodation to the achievement of certain macroeconomic outcomes. The briefing addressed communications challenges associated with each form of forward guidance, including the need to avoid conveying a more negative economic outlook than the FOMC expects. Nonetheless, the staff suggested that forward guidance generally had been effective in easing financial conditions and stimulating economic activity in circumstances when the policy rate was above the ELB and when it was at the ELB. The briefing also discussed negative interest rates, a policy option implemented by several foreign central banks. The staff noted that although the evidence so far suggested that this tool had provided accommodation in jurisdictions where it had been employed, there were also indications of possible adverse side effects. Moreover, differences between the U.S. financial system and the financial systems of those jurisdictions suggested that the foreign experience may not provide a useful guide in assessing whether negative rates would be effective in the United States.

The second part of the staff briefing focused on balance sheet policy tools. The staff discussed the benefits and costs associated with the large-scale asset purchase programs implemented by the Federal Reserve after the financial crisis. In general,

Copyright 2019 Trend Macrolytics LLC. All rights reserved. This document is not to be forwarded to individuals or organizations not authorized by Trend Macrolytics LLC to receive it. For information purposes only; not to be deemed to be recommendations for buying or selling specific securities or to constitute personalized investment advice. Derived from sources deemed to be reliable, but no warranty is made as to accuracy.

the staff's review of the historical experience suggested that the benefits of large-scale asset purchase programs were significant and that many of the potential costs of such programs identified at the time either did not materialize or materialized to a smaller degree than initially feared. In addition, the staff presentation noted that—taking account of investor expectations ahead of the announcement of each new program—the effects of asset purchases did not appear to have diminished materially across consecutive programs. However, going forward, such policies might not be as effective because longer-term interest rates would likely be much lower at the onset of a future asset purchase program than they were before the financial crisis. The staff also compared the benefits and costs associated with asset purchase programs that are of a fixed cumulative size and those that are flow-based—where purchases continue at a specific pace until certain macroeconomic outcomes are achieved—and examined the potential effectiveness of using asset purchases to place ceilings on interest rates. The briefing also discussed lending programs that could facilitate the flow of credit to households or businesses…

All participants judged that negative interest rates currently did not appear to be an attractive monetary policy tool in the United States. Participants commented that there was limited scope to bring the policy rate into negative territory, that the evidence on the beneficial effects of negative interest rates abroad was mixed, and that it was unclear what effects negative rates might have on the willingness of financial intermediaries to lend and on the spending plans of households and businesses. Participants noted that negative interest rates would entail risks of introducing significant complexity or distortions to the financial system. In particular, some participants cautioned that the financial system in the United States is considerably different from those in countries that implemented negative interest rate policies, and that negative rates could have more significant adverse effects on market functioning and financial stability here than abroad…

Review of Options for Repo Operations to Support Control of the Federal Funds Rate

The staff briefed participants on the recent experience with using repo operations to support control of the federal funds rate and on possibly maintaining a role for repo operations in the monetary policy implementation framework over the longer run. Ongoing capacity for repo operations could be viewed as useful in an ample-reserves

regime as a way of providing insurance against unexpected stresses in money markets that could drive the federal funds rate outside the Committee's target range over a sustained period. The staff presented two potential approaches for conducting repo operations if the Committee decided to maintain an ongoing role for such operations. Under the first approach, the Desk would conduct modestly sized, relatively frequent repo operations designed to provide a high degree of readiness should the need for larger operations arise; under the second approach, the FOMC would establish a standing fixed-rate facility that could serve as an automatic money market stabilizer. Assessing these two approaches involved several considerations, including the degree of assurance of control over the federal funds rate, the likelihood that participation in the Federal Reserve's repo operations could become stigmatized, the possibility that the operations could encourage the Federal Reserve's counterparties to take on excessive liquidity risks in their portfolios, and the potential disintermediation of financial transactions currently undertaken by private counterparties. Regular, modestly sized repo operations likely would pose relatively little risk of stigma or moral hazard, but they may provide less assurance of control over the federal funds rate because it might be difficult for the Federal Reserve to anticipate money market pressures and scale up its repo operations accordingly. A standing fixed-rate repo facility would likely provide substantial assurance of control over the federal funds rate, but use of the facility could become stigmatized, particularly if the rate was set at a relatively high level. Conversely, a standing facility with a rate set at a relatively low level could result in larger and more frequent repo operations than would be appropriate. And by effectively standing ready to provide a form of liquidity on an as-needed basis, such a facility could increase the risk that some institutions may take on an undesirably high amount of liquidity risk.

In their comments following the staff presentation, participants emphasized the importance of maintaining reserves at a level consistent with the Committee's choice of an ample-reserves monetary policy implementation framework, in which control over the level of the federal funds rate is exercised primarily through the setting of the Federal Reserve's administered rates and in which active management of the supply of reserves is not required. Some participants indicated that, in such an environment, they would have some tolerance for allowing the federal funds rate to vary from day to day and to move occasionally outside its target range, especially in

those instances associated with easily identifiable technical events; a couple of participants expressed discomfort with such misses.

Participants expressed a range of views on the relative merits of the two approaches described by the staff for conducting repo operations. Many participants noted that, once an ample supply of reserves is firmly established, there might be little need for a standing repo facility or for frequent repo operations. Some of these participants indicated that a basic principle in implementing an ample-reserves framework is to maintain reserves on an ongoing basis at levels that would obviate the need for open market operations to address pressures in funding markets in all but exceptional circumstances. Many participants remarked, however, that even in an environment with ample reserves, a standing facility could serve as a useful backstop to support control of the federal funds rate in the event of outsized shocks to the system. Several of these participants also suggested that, if a standing facility were created that allowed banks to monetize a portion of their securities holdings at times of market stress, banks could possibly reduce their demand for reserves in normal times, which could make it feasible for the monetary policy implementation framework to operate with a significantly smaller quantity of reserves than would otherwise be needed. A couple of participants pointed out that establishing a standing facility would be similar to the practice of some other major central banks. A number of participants noted that, before deciding whether to implement a standing repo facility, additional work would be necessary to assess the likely implications of different design choices for a standing repo facility, such as pricing, eligible counterparties, and the set of acceptable collateral. Echoing issues raised at the Committee's June 2019 meeting, various participants commented on the need to carefully evaluate these design choices to guard against the potential for moral hazard, stigma, disintermediation risk, or excessive volatility in the Federal Reserve's balance sheet. A couple of other participants suggested that an approach based on modestly sized, frequent repo operations that could be quickly and substantially ramped up in response to emerging market pressures would mitigate the moral hazard, disintermediation, and stigmatization risks associated with a standing repo facility.

Participants made no decisions at this meeting on the longer-run role of repo operations in the ample-reserves regime or on an approach for conducting repo

operations over the longer run. They generally agreed that they should continue to monitor the market effects of the Federal Reserve's ongoing repo operations and Treasury bill purchases and that additional analysis of the recent period of money market dislocations or of fluctuations in the Federal Reserve's non-reserve liabilities was warranted. Some participants called for further research on the role that the financial regulatory environment or other factors may have played in the recent dislocations…

Participants' Views on Current Conditions and the Economic Outlook

…Participants generally viewed the economic outlook as positive. Participants judged that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective were the most likely outcomes, and they indicated that their views on these outcomes had changed little since the September meeting. Uncertainties associated with trade tensions as well as geopolitical risks had eased somewhat, though they remained elevated. In addition, inflation pressures remained muted. The risk that a global growth slowdown would further weigh on the domestic economy remained prominent.

In their discussion of the household sector, participants agreed that consumer spending was increasing at a strong pace. They also generally expected that, in the period ahead, household spending would likely remain on a firm footing, supported by strong labor market conditions, rising incomes, and favorable financial conditions. In addition, survey measures of consumer confidence remained high, and a couple of participants commented that business contacts in consumer-facing industries reported strong demand. Many participants noted that components of household spending that are thought to be particularly sensitive to interest rates had improved, including purchases of consumer durables. In addition, residential investment had turned up. Most participants who reported on spending by households in their Districts also cited favorable conditions for consumer spending, athough several participants reported mixed data on spending or an increase in precautionary savings in their Districts.

In their discussions of the business sector, participants saw trade tensions and concerns about the global growth outlook as the main factors contributing to weak

business investment and exports and the associated restraint on domestic economic growth. Moreover, participants generally expected that trade uncertainty and sluggish global growth would continue to damp investment spending and exports. A number of participants judged that tight labor market conditions were also causing firms to forego investment expenditures, or invest in automation systems to reduce the need for additional hiring. However, business sentiment appeared to remain strong for some industries, particularly those most closely connected with consumer goods.

Participants discussed developments in the manufacturing, energy, and agricultural sectors of the U.S. economy. Manufacturing production remained weak, and continuing concerns about global growth and trade uncertainty suggested that conditions were unlikely to improve materially over the near term. In addition, the labor strike at General Motors had disrupted motor vehicle output, and ongoing issues at Boeing were slowing manufacturing in the commercial aircraft industry. A couple of participants noted that activity was particularly weak for the energy industry, in part because of low petroleum prices. In addition, a few participants noted ongoing challenges in the agricultural sector, including those associated with lower crop yields, tariffs, weak export demand, and difficult financial positions for many farmers. One bright spot for the agricultural sector was that some commodity prices had firmed recently.

Participants judged that conditions in the labor market remained strong, with the unemployment rate near historical lows and continued solid job gains, on average. In addition, some participants commented on the strength or improvement in labor force participation nationally or in their Districts. However, the pace of increases in employment had slowed some, on net, in recent months. On the one hand, the slowing could be interpreted as a natural consequence of the economy being near full employment. On the other hand, slowing job gains might also be indicative of some cooling in labor demand, which may be consistent with an observed decline in the rate of job openings and decreases in other measures of labor market tightness. Several participants commented that the preliminary benchmark revision released in August by the Bureau of Labor Statistics had indicated that payroll employment gains would likely show less momentum coming into this year once those revisions are incorporated in published data early next year. Growth of wages had also slowed this

year by some measures. Consistent with strong national data on the labor market, business contacts in many Districts indicated continued strong labor demand, with firms still reporting difficulties finding qualified workers, or broadening their recruiting to include traditionally marginalized groups.

In their discussion of inflation developments, participants noted that readings on overall and core PCE inflation, measured on a 12-month change basis, had continued to run below the Committee's symmetric 2 percent objective. While survey-based measures of longer-term inflation expectations were generally little changed, some measures of households' inflation expectations had moved down to historically low levels. Market-based measures of inflation compensation remained low, with some longer-term measures being at or near multi-year lows. Weakness in the global economy, perceptions of downside risks to growth, and subdued global inflation pressures were cited as factors tilting inflation risk to the downside, and a few participants commented that they expected inflation to run below 2 percent for some time. Some other participants, however, saw the recent inflation data as consistent with their previous assessment that much of the weakness seen early in the year would be transitory, or that some recent monthly readings seemed broadly consistent with the Committee's longer-run inflation objective of 2 percent. A couple of participants noted that some measures of inflation could temporarily move above 2 percent early next year because of the transitory effects of tariffs.

Participants also discussed risks regarding the outlook for economic activity, which remained tilted to the downside. Some risks were seen to have eased a bit, although they remained elevated. There were some tentative signs that trade tensions were easing, the probability of a no-deal Brexit was judged to have lessened, and some other geopolitical tensions had diminished. Several participants noted that statistical models designed to gauge the probability of recession, including those based on information from the yield curve, suggested that the likelihood of a recession occurring over the medium term had fallen somewhat over the intermeeting period. However, other downside risks had not diminished. In particular, some further signs of a global slowdown in economic growth emerged; weakening in the global economy could further restrain the domestic economy, and the risk that the weakness in domestic business spending, manufacturing, and exports could give rise to slower hiring and weigh on household spending remained prominent.

Among those participants who commented on financial stability, most highlighted the risks associated with high levels of corporate indebtedness and elevated valuation pressures for a variety of risky assets. Although financial stability risks overall were seen as moderate, several participants indicated that imbalances in the corporate debt market had grown over the economic expansion and raised the concern that deteriorating credit quality could lead to sharp increases in risk spreads in corporate bond markets; these developments could amplify the effects of an adverse shock to the economy. Several participants were concerned that some banks had reduced the sizes of their capital buffers at a time when they should be rising. A few participants observed that valuations in equity and bond markets were high by historical standards and that CRE valuations were also elevated. A couple of participants indicated that market participants may be overly optimistic in the pricing of risk for corporate debt. A couple of participants judged that the monitoring of financial stability vulnerabilities should also encompass risks related to climate change.

In their consideration of the monetary policy options at this meeting, most participants believed that a reduction of 25 basis points in the target range for the federal funds rate would be appropriate. In discussing the reasons for such a decision, these participants continued to point to global developments weighing on the economic outlook, the need to provide insurance against potential downside risks to the economic outlook, and the importance of returning inflation to the Committee's symmetric 2 percent objective on a sustained basis. A couple of participants who were supportive of a rate cut at this meeting indicated that the decision to reduce the federal funds rate by 25 basis points was a close call relative to the option of leaving the federal funds rate unchanged at this meeting.

Many participants judged that an additional modest easing at this meeting was appropriate in light of persistent weakness in global growth and elevated uncertainty regarding trade developments. Nonetheless, these participants noted that incoming data had continued to suggest that the economy had proven resilient in the face of continued headwinds from global developments and that previous adjustments to monetary policy would continue to help sustain economic growth. In addition, several participants suggested that a modest easing of policy at this meeting would likely better align the target range for the federal funds rate with a variety of indicators used to assess the appropriate policy stance, including estimates of the neutral

interest rate and the slope of the yield curve. A couple of participants judged that there was more room for the labor market to improve. Accordingly, they saw further accommodation as best supporting both of the Committee's dual-mandate objectives.

Many participants continued to view the downside risks surrounding the economic outlook as elevated, further underscoring the case for a rate cut at this meeting. In particular, risks to the outlook associated with global economic growth and international trade were still seen as significant despite some encouraging geopolitical and trade-related developments over the intermeeting period. In light of these risks, a number of participants were concerned that weakness in business spending, manufacturing, and exports could spill over to labor markets and consumer spending and threaten the economic expansion. A few participants observed that the considerations favoring easing at this meeting were reinforced by the proximity of the federal funds rate to the ELB. In their view, providing adequate accommodation while still away from the ELB would best mitigate the possibility of a costly return to the ELB.

Many participants also cited the level of inflation or inflation expectations as justifying a reduction of 25 basis points in the federal funds rate at this meeting. Inflation continued to run below the Committee's symmetric 2 percent objective, and inflationary pressures remained muted. Several participants raised concerns that measures of inflation expectations remained low and could decline further without a more accommodative policy stance. A couple of these participants, pointing to experiences in Japan and the euro area, were concerned that persistent inflation shortfalls could lead to a decline in longer-run inflation expectations and less room to reduce the federal funds rate in the event of a future recession. In general, the participants who justified further easing at this meeting based on considerations related to inflation viewed this action as helping to move inflation up to the Committee's 2 percent objective on a sustained basis and to anchor inflation expectations at levels consistent with that objective.

Some participants favored maintaining the existing target range for the federal funds rate at this meeting. These participants suggested that the baseline projection for the economy remained favorable, with inflation expected to move up and stay near the Committee's 2 percent objective. They also judged that policy accommodation was

already adequate and, in light of lags in the transmission of monetary policy, preferred to take some time to assess the economic effects of the Committee's previous policy actions before easing policy further. Several participants noted that downside risks had diminished over the intermeeting period and saw little indication that weakness in business sentiment was spilling over into labor markets and consumer spending. A few participants raised the concern that a further easing of monetary policy at this meeting could encourage excessive risk-taking and exacerbate imbalances in the financial sector.

With regard to monetary policy beyond this meeting, most participants judged that the stance of policy, after a 25 basis point reduction at this meeting, would be well calibrated to support the outlook of moderate growth, a strong labor market, and inflation near the Committee's symmetric 2 percent objective and likely would remain so as long as incoming information about the economy did not result in a material reassessment of the economic outlook. However, participants noted that policy was not on a preset course and that they would be monitoring the effects of the Committee's recent policy actions, as well as other information bearing on the economic outlook, in assessing the appropriate path of the target range for the federal funds rate. A couple of participants expressed the view that the Committee should reinforce its postmeeting statement with additional communications indicating that another reduction in the federal funds rate was unlikely in the near term unless incoming information was consistent with a significant slowdown in the pace of economic activity.

…President George dissented at this meeting because she believed that an unchanged setting of monetary policy was appropriate based on incoming data and the outlook for economic activity over the medium term. Recognizing risks to the outlook from the effects of trade developments and weaker global activity, President George would be prepared to adjust policy should incoming data point to a materially weaker outlook for the economy. President Rosengren dissented because he judged that monetary policy was already accommodative and that additional accommodation was not needed for an economy in which labor markets are very tight. He judged that providing additional accommodation posed risks of further inflating the prices of risky assets and encouraging households and firms to take on too much leverage.

…Videoconference meeting of October 4, 2019

The Committee met by videoconference on October 4, 2019, to review developments in money markets and to discuss steps the Committee could take to facilitate efficient and effective implementation of monetary policy.

The staff reviewed recent developments in money markets and the effect of the Desk's continued offering of overnight and term repo operations. Staff analysis and market commentary suggested that many factors contributed to the funding stresses that emerged in mid-September. In particular, financial institutions' internal risk limits and balance sheet costs may have slowed the distribution of liquidity across the system at a time when reserves had dropped sharply and Treasury issuance was elevated. Although money market conditions had since improved, market participants expressed uncertainty about how funding market conditions may evolve over coming months, especially around year-end. Further out, the April 2020 tax season, with associated reductions in reserves around that time, was viewed as another point at which money market pressures could emerge.

The manager pro tem reviewed options that the Committee could consider to boost the level of reserves in the banking system and to address temporary money market pressures that could adversely affect monetary policy implementation. These options included a program of Treasury bill purchases coupled with overnight and term repo operations to maintain reserves at or above their early September level.

During their discussion, all FOMC participants agreed that control over the federal funds rate was a priority and that recent money market developments suggested it was appropriate to consider steps at this time to maintain a level of reserves consistent with the Committee's chosen ample-reserves regime. Given the projected decline in reserves around year-end and in the spring of 2020, they judged that it was important to reach consensus soon on a near-term plan and associated communications.

All participants expressed support for a plan to purchase Treasury bills into the second quarter of 2020 and to continue conducting overnight and term repo operations at least through January of next year. Many participants supported conducting operations to maintain reserve balances around the level that prevailed in

early September. Some others suggested moving to an even higher level of reserves to provide an extra buffer and greater assurance of control over the federal funds rate. In discussing the pace of Treasury bill purchases, many participants supported a relatively rapid pace to boost reserve levels quickly, while others supported a more moderate pace of purchases. Participants generally judged that Treasury bill purchases and the associated increase in reserves would, over time, result in a gradual reduction in the need for repo operations. A few participants indicated that purchasing Treasury notes and bonds with limited remaining maturities could also be considered as a way to boost reserves, particularly if the Federal Reserve faced constraints on the pace at which it could purchase Treasury bills. Participants generally acknowledged some uncertainty over the efficient and effective level of reserves and noted it would be prudent to continue to monitor money market developments and stand ready to adjust the plan as necessary. Overall, participants agreed that the pace of purchases as well as the parameters of the repo operations were technical details of monetary policy implementation not intended to affect the stance of monetary policy and should be communicated as such.

Most participants preferred not to wait until the October 29–30 FOMC meeting to issue a public statement regarding the planned Treasury bill purchases and repo operations. They noted that releasing a statement before the October 29–30 FOMC meeting would help reinforce the point that these actions were technical and not intended to affect the stance of policy. In addition, a few participants remarked that an earlier release would allow the Desk to begin boosting the level of reserves sooner. A couple of participants, however, wanted to wait until the October 29–30 FOMC meeting to announce the plan so as not to surprise market participants or lead them to infer that the Committee regarded the situation as dire and thus requiring immediate action. The Chair proposed having the staff produce a draft statement that the Committee could comment on early in the following week. Formal approval could occur by notation vote with an anticipated release of a statement to the public on October 11, 2019.

Source: Federal Reserve Board