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Data Insights: FOMC Minutes

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January minutes: key signaling language Featured Important Very important

Participants continued their discussion related to the ongoing review of the Federal Reserve's monetary policy strategy, tools, and communication practices. At this meeting, the discussion focused on two topics: the potential interactions between monetary policy and financial stability and the potential use of inflation ranges around the Committee's 2 percent inflation objective. The staff briefing on the first topic noted that in the current environment of low neutral rates, achieving the Committee's dual-mandate goals of maximum employment and price stability would require low policy rates frequently, regardless of the monetary policy strategy and tools chosen. Consequently, policy strategies and tools that help support a stronger economy and anchor inflation expectations at a level consistent with the Committee's objective in a low-neutral-rate environment can help promote financial stability. In addition, the staff reported that the available empirical evidence suggests that the effects of changes in policy rates on asset prices and risk premiums tend to be modest relative to the historical fluctuations in those measures. However, there may be circumstances in which a persistently accommodative policy stance that is otherwise consistent with the dual-mandate goals may contribute to an increase in financial system vulnerabilities, including through increased borrowing, financial leverage, and valuation pressures...

In their discussion of the effects that alternative monetary policy strategies and tools might have on financial stability, participants noted that macroeconomic stability and the achievement of the Committee's dual mandate depended on a stable financial system. An unstable financial system may amplify shocks to the economy and exacerbate increases in unemployment or drive inflation further away from the Committee's goal. With respect to the relationship between monetary policy and financial stability, some participants noted that evidence regarding the link between the policy stance and elevated financial vulnerabilities was limited, with a couple of participants further observing that there were not many episodes of persistently low interest rates. In addition, some past episodes of heightened financial vulnerabilities were associated with excessive risk-taking behavior that did not seem to be very responsive to typical changes in interest rates. A number of participants judged that, under some circumstances, low policy rates might help foster financial stability provided they are needed to support strong economic conditions and price stability. Some participants remarked, however, that keeping policy rates low to achieve both of the Committee's dual-mandate objectives may contribute to a buildup of financial vulnerabilities, especially at times when the economy is at or above full employment, a development that could pose future risks to the economy and to the ability of the Committee to achieve its dual mandate.

Participants discussed how financial stability considerations should be incorporated in the conduct of monetary policy. They generally agreed that supervisory, regulatory, and macroprudential tools should be the primary means to address financial stability risks. A few participants commented that this is especially the case when addressing risks associated with structural features such as the current low level of neutral interest rates. A number of participants noted that countercyclical macroprudential tools, such as the countercyclical capital buffer, could be used to address cyclical financial stability risks. However, various participants noted that while these tools could be deployed proactively to lean against the buildup of financial vulnerabilities, they have some limitations in the context of the U.S. financial system, where the few available tools are, for the most part, not designed to address vulnerabilities outside the banking sector. In addition, these tools are not within the authority of the Committee, and their use requires coordination with other prudential regulators. Recognizing these limitations, many participants remarked that the Committee should not rule out the possibility of adjusting the stance of monetary policy to mitigate financial stability risks, particularly when those risks have important implications for the economic outlook and when macroprudential tools had been or were likely to be ineffective at mitigating those risks. Nevertheless, many participants noted that the current knowledge of the interactions between the stance of monetary policy and financial vulnerabilities is too imprecise to warrant systematically adjusting monetary policy in response to the evolution of financial stability risks. As a result, monetary policy should be guided primarily by the outlook for employment and inflation, and it should respond to financial stability risks only insofar as such risks significantly threaten the achievement of the Committee's mandate. Several participants observed that the monetary policy measures needed to curb financial stability risks could be quite large, and the resulting effects on employment and inflation could place a high hurdle for such measures. Some participants remarked that, because financial stability risks are a consideration for achieving the Committee's dual mandate, a clear communications strategy would be needed to convey the Committee's assessments of financial vulnerabilities and their potential implications for the monetary policy outlook. Several participants noted that a communications strategy could include the possible use of financial instability escape clauses to help explain the rationale for policy actions when a buildup of financial vulnerabilities poses risks to the achievement of the Committee's goals.

The staff's briefing on considerations regarding the use of an inflation range focused on three different concepts of an inflation range. First, an uncertainty range could communicate the magnitude of the inherent variability of inflation that would still be consistent with achieving the Committee's symmetric inflation objective. Second, an operational range could signal that, under some conditions, the Committee would prefer inflation to be away from its longer-run objective for a time; such a range could potentially be used as part of a makeup policy strategy, including one based on average inflation targeting, or in other strategies aimed at offsetting the adverse effects of a binding effective lower bound on policy rates. Third, an indifference range could communicate that monetary policy would not respond to deviations of inflation within that range. The briefing also summarized the experiences of foreign central banks that use inflation ranges; these ranges were typically put in place many years ago, often in conjunction with adopting an inflation target. The staff highlighted the communications challenges that could arise if an inflation range were introduced at a time when inflation had been running below the central bank's objective for a number of years. In this environment, the introduction of a symmetric range around the point objective could be misinterpreted as a sign that the central bank was not concerned about inflation remaining below its stated goal, a situation that could lead to inflation expectations drifting down to the lower end of the range.

Participants expressed a range of views on the potential benefits and costs of different types of inflation ranges. Most participants expressed concern that introducing a symmetric inflation range around the 2 percent objective following an extended period of inflation mostly running somewhat below 2 percent could be misperceived as a signal that the Committee was comfortable with continued misses below its symmetric inflation objective. Many participants agreed that an uncertainty range could be misinterpreted as an indifference range and hence as a lack of commitment by the Committee to its symmetric 2 percent inflation objective. Some participants suggested that it was not clear that introducing a range would help much in achieving the Committee's inflation objective; they noted that introducing a range could make that objective less clear to the public. Instead of establishing a range, the Committee could continue to communicate that its inflation objective was symmetric around 2 percent. While inflation is inherently variable, the Committee then could emphasize its intention for inflation to be centered on the 2 percent objective. Nevertheless, in view of the inherent variability of inflation, several participants judged that there could be some benefit in communicating the inflation objective with a symmetric range around the point target. In addition, a few participants suggested that an inflation range could convey the uncertainty associated with the available array of inflation measures or that the Committee's communications could more explicitly reference other measures of inflation. Several participants also stated that employing an asymmetric operational range for a time—with 2 percent being at or near the lower end of that range—while still maintaining the longer-run target of 2 percent could help communicate that the Committee intended inflation to average 2 percent over time, which in turn could help keep longer-run inflation expectations at levels consistent with its objective.

Participants expected that, at upcoming meetings, they would continue their deliberations on the Committee's review of monetary policy strategy, tools, and communication practices. Participants continued to anticipate that the review will likely be completed around the middle of this year…

…Incoming data suggested that foreign economic growth slowed further in the fourth quarter to a very subdued pace. In the advanced foreign economies (AFEs), growth appeared to have remained weak as the manufacturing slump continued and a consumption tax hike in Japan led to a sharp contraction in household spending. In the emerging economies, social unrest weighed heavily on economic activity in Hong Kong and Chile, while the labor strike at General Motors was a further drag on

Mexico's already weak economy. In contrast, early GDP releases showed a pickup in growth in China and some other Asian economies, though news of the coronavirus outbreak raised questions about the sustainability of that pickup. Foreign inflation rose in the wake of temporary factors in India and China, while it remained soft in most AFEs, in part reflecting previous declines in energy prices and muted core inflation pressures…

…Conditions in domestic short-term funding markets, including in secured financing, were stable over the intermeeting period, even over year-end. Rates declined slightly, likely reflecting increased liquidity and a higher level of reserves provided by the Desk's open market operations. The effective federal funds rate remained close to the IOER rate, and spreads for term unsecured commercial paper and negotiable certificates of deposit narrowed substantially, particularly after year-end. The Desk's open market operations proceeded smoothly.

The projection for U.S. real GDP growth prepared by the staff for the January FOMC meeting was stronger than in the previous forecast. Data pertaining to the fourth quarter of 2019, particularly on imports, suggested output rose faster at the end of the year than was previously projected, and this faster pace seemed consistent with the solid employment gains in the fourth quarter. In addition, more supportive financial conditions and the anticipated effects of the phase-one trade deal between the United States and China pushed up the staff's GDP forecast for this year and next. All told, real GDP growth was projected to be about the same in 2020 as in 2019 and then to slow modestly in the coming years, partly because of a fading boost from fiscal policy. Output was forecast to expand at a rate a little above the staff's estimate of its potential rate of growth in 2020 and 2021 and then to slow to a pace slightly below potential output growth in 2022. The unemployment rate was projected to decline a little further this year and to remain at that lower level through 2022; the unemployment rate was anticipated to be below the staff's estimate of its longer-run natural rate throughout the forecast period.

…Participants generally judged that the current stance of monetary policy was appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation returning to the Committee's symmetric 2 percent objective. They expected economic growth to continue at a moderate pace, supported by accommodative monetary and financial conditions. In addition, some trade uncertainties had diminished recently, and there were some signs of stabilization in global growth. Nonetheless, uncertainties about the outlook remained, including those posed by the outbreak of the coronavirus.

With respect to the business sector, participants observed that business investment and exports remained weak and that manufacturing output had declined over the past year. Looking ahead, participants were generally cautiously optimistic about the effects on the business sector of the recent favorable trade developments and the signs of stabilization in global growth. Many participants expressed the view that these developments might boost business confidence or raise export demand, which would help strengthen or at least stabilize business investment. A few participants remarked that contacts in their Districts had noted that business sentiment was brighter or that companies were intending to expand their capital expenditures this year. Several other participants, however, judged that the effect of the recent trade agreement with China would be relatively limited, as trade uncertainty would likely remain elevated, with the possibility remaining of the emergence of new tensions as well as the reescalation of existing tensions. They noted that the agreement would still leave a large portion of tariffs in place and that many firms had already been making production and supply chain adjustments in response to trade tensions.

Participants also commented on ongoing challenges facing the energy and agriculture sectors. A couple of participants remarked that activity in the energy sector continued to be weak, and a few noted that financial conditions in the agricultural sector would likely remain challenging for many despite farm subsidies from the federal government and recent optimism surrounding trade prospects.

…In their discussion of inflation developments, participants noted that recent readings on overall and core PCE price inflation, measured on a 12-month basis, had continued to run below 2 percent. Overall, participants described their inflation outlook as having changed little since December. Participants generally expected inflation to move closer to 2 percent in the coming months as the unusually low readings in early 2019 drop out of the 12-month calculation. Participants also expected that, as the economic expansion continues and resource utilization remains high, inflation would return to the 2 percent objective on a sustainable basis. A few participants expressed less confidence in this outlook for inflation and commented that inflation had averaged less than 2 percent over the past several years even as resource utilization had increased, or pointed to downward pressures from global or technology-related factors that could continue to suppress inflation. A couple of participants, however, noted that some alternative inflation indicators, including trimmed mean measures, suggested that there had been a modest step-up in underlying inflation during 2019 or that underlying inflation could already be at a level consistent with the Committee's goal.

Participants generally saw the distribution of risks to the outlook for economic activity as somewhat more favorable than at the previous meeting, although a number of downside risks remained prominent. The easing of trade tensions resulting from the recent agreement with China and the passage of the USMCA as well as tentative signs of stabilization in global economic growth helped reduce downside risks and appeared to buoy business sentiment. The risk of a "hard" Brexit had appeared to recede further. In addition, statistical models designed to estimate the probability of recession using financial market data suggested that the likelihood of a recession occurring over the next year had fallen notably in recent months. Still, participants generally expected trade-related uncertainty to remain somewhat elevated, and they were mindful of the possibility that the tentative signs of stabilization in global growth could fade. Geopolitical risks, especially in connection with the Middle East, remained. The threat of the coronavirus, in addition to its human toll, had emerged as a new risk to the global growth outlook, which participants agreed warranted close watching.

…In their consideration of monetary policy at this meeting, participants judged that it would be appropriate to maintain the target range for the federal funds rate at 1-1/2 to 1-3/4 percent to support sustained expansion of economic activity, strong labor market conditions, and inflation returning to the Committee's symmetric 2 percent objective. With regard to monetary policy beyond this meeting, participants viewed the current stance of policy as likely to remain appropriate for a time, provided that incoming information about the economy remained broadly consistent with this economic outlook. Of course, if developments emerged that led to a material reassessment of the outlook, an adjustment to the stance of monetary policy would be appropriate, in order to foster achievement of the Committee's dual-mandate objectives.

In commenting on the monetary policy outlook, participants concurred that maintaining the current stance of policy would give the Committee time for a fuller assessment of the ongoing effects on economic activity of last year's shift to a more accommodative policy stance and would also allow policymakers to accumulate further information bearing on the economic outlook. Participants discussed how maintaining the current policy stance for a time could be helpful in supporting U.S. economic activity and employment in the face of global developments that have been weighing on spending decisions.

With regard to the Committee's price-stability objective, participants observed that the current degree of monetary policy accommodation would be useful in facilitating a return of inflation to 2 percent. Several participants noted that inflation returning to 2 percent would help ensure that longer-term inflation expectations remained consistent with the Committee's longer-run inflation objective. A few participants stressed that the Committee should be more explicit about the need to achieve its inflation goal on a sustained basis. Several participants suggested that inflation modestly exceeding 2 percent for a period would be consistent with the achievement of the Committee's longer-run inflation objective and that such mild overshooting might underscore the symmetry of that objective. With regard to the Committee's maximum employment objective, a few participants observed that the actual level of employment might still be below maximum employment and that maintaining the present monetary policy stance would allow the economy to achieve that maximum level. A couple of other participants expressed concern that tight labor markets have in the past been associated with economic and financial imbalances and that the emergence of such imbalances might jeopardize the longer-run attainment of the Committee's dual-mandate goals.

Participants discussed the open market operations that the Federal Reserve had undertaken since September to implement monetary policy, as well as forthcoming operational measures. Participants agreed that the operations undertaken by the Desk since mid-September had been effective in helping to stabilize conditions in money markets and that implementation of the plan that the Committee announced in

October to purchase Treasury bills and conduct repo operations had proceeded smoothly. Participants observed that enactment of this plan had succeeded in replenishing reserve balances to levels at or above those prevailing in early September 2019 and in ensuring continued control of the federal funds rate. Many participants stressed that, as reserves approached durably ample levels, the need for sizable Treasury bill purchases and repo operations would diminish and that such operations could be gradually scaled back or phased out. Beyond that point, regular open market operations would be required over time in order to accommodate the trend growth in the Federal Reserve's liabilities and maintain an ample level of reserves. Participants who commented on the Desk's proposal for the transition to the ample-reserves regime indicated that they were comfortable with that proposal. They remarked that the details of the Committee's plans would be adjusted as appropriate to support effective implementation of monetary policy. Participants noted that it would be important to continue to communicate to the public that open market operations now and in the period ahead were technical operations aimed at achieving and maintaining ample reserves and that any adjustments to those operations were not intended to represent a change in the stance of monetary policy. Several participants suggested that the Committee should resume before long its discussion of the role that repo operations might play in an ample-reserves regime, including the possible creation of a standing repo facility. A couple of these participants cited the potential for such a facility to reduce the banking system's demand for reserves over the longer term.

Source: Federal Reserve Board