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Data Insights: FOMC Minutes

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September minutes: key signaling language Featured Important Very important

Participants discussed the FOMC's asset purchases, including the role they are playing in supporting the Committee's maximum-employment and price-stability goals. In their discussions, participants focused on the objectives of these purchases; considerations for assessing the appropriate pace and composition of asset purchases over time; communications regarding the future path of asset purchases; and the potential effects of higher levels of reserves, associated with the ongoing expansion in Federal Reserve asset holdings, on banks' balance sheets and money market rates. Participants agreed that this discussion would be helpful for future assessments of the appropriate structure of the Committee's asset purchases. While participants judged that immediate adjustments to the pace and composition of asset purchases were not necessary, they recognized that circumstances could shift to warrant such adjustments. Accordingly, participants saw the ongoing careful consideration of potential next steps for enhancing the Committee's guidance for its asset purchases as appropriate.

The participants' discussion was preceded by staff presentations. The staff reviewed some key considerations relevant for conducting asset purchases in the current environment. The staff judged that the Committee's forward guidance on the federal funds rate, the expansion of the Federal Reserve's securities holdings since March, and expectations for a further expansion all had contributed to a very low level of longer-term yields despite substantial Treasury debt issuance. The staff noted that financial market participants generally expected the Committee to continue its net asset purchases at the current pace through next year and at a reduced pace in subsequent years. The staff discussed various changes the Committee could make to the structure of its purchases, including to their pace and composition as well as to the guidance the Committee has been providing to the public about its future asset purchases. The staff discussed the structure of asset purchase programs of several foreign central banks and how they have evolved during the pandemic. Finally, the staff evaluated how higher levels of reserves associated with the ongoing expansion in the Federal Reserve's asset holdings might influence banks' balance sheets and money market rates and discussed the various tools that the Federal Reserve has for managing money market rates in an environment with very high levels of reserves.

In their discussion regarding the role of the Committee's asset purchases, participants noted that these purchases have supported and sustained smooth market functioning and helped foster accommodative financial conditions. With market functioning seen as having largely recovered, many participants indicated that the role of asset purchases had shifted more toward fostering accommodative financial conditions for households and businesses to support the Committee's employment and inflation goals. Still, participants generally judged that asset purchases would continue to support smooth market functioning, and many judged that asset purchases helped provide insurance against risks that might reemerge in financial markets in an environment of high uncertainty. A few participants indicated that asset purchases could also help guard against undesirable upward pressure on longer-term rates that could arise, for example, from higher-than-expected Treasury debt issuance. Several participants noted the possibility that there may be limits to the amount of additional accommodation that could be provided through increases in the Federal Reserve's asset holdings in light of the low level of longer-term yields, and they expressed concerns that a significant expansion in asset holdings could have unintended consequences.

Participants commented on considerations related to the appropriate pace and composition of asset purchases. Participants generally saw the current pace and composition as effective in fostering accommodative financial conditions. Participants noted that the Committee could provide more accommodation, if appropriate, by increasing the pace of purchases or by shifting its Treasury purchases to those with a longer maturity without increasing the size of its purchases. Alternatively, the Committee could provide more accommodation, if appropriate, by conducting purchases of the same pace and composition over a longer horizon. Pointing to the recently announced change in the Bank of Canada's asset purchase program, several participants judged that the Committee could maintain its current degree of accommodation by lengthening the maturity of the Committee's Treasury purchases while reducing the pace of purchases somewhat. In their view, such a change in the Committee's purchase structure would have to be carefully communicated to the public to avoid the misperception that the reduced pace of purchases represented a decline in the degree of accommodation. A few participants expressed concern that maintaining the current pace of agency MBS purchases could contribute to potential valuation pressures in housing markets.

The September FOMC statement indicated that asset purchases will continue "over coming months," and participants viewed this guidance for asset purchases as having served the Committee well so far. Most participants judged that the Committee should update this guidance at some point and implement qualitative outcome-based guidance that links the horizon over which the Committee anticipates it would be conducting asset purchases to economic conditions. These participants indicated that updating the Committee's guidance for asset purchases in this manner would help keep the market's expectation for future asset purchases aligned with the Committee's intentions. Some of these participants also saw such updated guidance as reinforcing the Committee's commitment to fostering outcomes consistent with maximum employment and inflation that averages 2 percent over time. A few participants were hesitant to make changes in the near term to the guidance for asset purchases and pointed to considerable uncertainty about the economic outlook and the appropriate use of balance sheet policies given that uncertainty.

Participants noted that it would be important for the Committee's guidance for future asset purchases to be consistent with the Committee's forward guidance for the federal funds rate so that the use of these tools would be well coordinated in terms of achieving the Committee's objectives. Most participants judged that the guidance for asset purchases should imply that increases in the Committee's securities holdings would taper and cease sometime before the Committee would begin to raise the target range for the federal funds rate. A number of participants highlighted the view that after net purchases cease there would likely be a period of time in which maturing assets would be reinvested to roughly maintain the size of the Federal Reserve's securities holdings.

Participants commented on how a higher level of reserves associated with the expansion in the Federal Reserve's asset holdings might affect the banking sector and money markets. A few participants raised concerns about the possibility that much higher levels of reserves might create pressure on banks' balance sheets, including on regulatory ratios, or could potentially put undue downward pressure on money market rates. Most participants judged that the Federal Reserve had effective tools to address these circumstances. Some participants noted that, if needed, the Federal Reserve could consider various steps to manage the levels of short-term interest rates and the quantity of reserves, such as adjusting administered rates, expanding the overnight reverse repurchase agreement program, or implementing a maturity extension program…

…Participants noted that the COVID-19 pandemic was causing tremendous human and economic hardship across the United States and around the world. Economic activity and employment had continued to recover but remained well below their levels at the beginning of the year. Weaker demand and earlier declines in oil prices had been holding down consumer price inflation. Overall financial conditions remained accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses. Participants agreed that the path of the economy would depend on the course of the virus and that the ongoing public health crisis would continue to weigh on economic activity, employment, and inflation in the near term and posed considerable risks to the economy's medium-term outlook.

Participants observed that the economy had registered a rapid though incomplete rebound, with third-quarter real GDP rising at an annual rate of 33 percent, reflecting gains across consumer spending, housing-sector activity, and business equipment investment. In recent months, however, the pace of improvement had moderated, with slower growth expected for the fourth quarter. Participants noted that economic activity thus far had recovered faster than had been expected earlier in the year. Household spending on goods, especially durable goods, had been strong and had moved above its pre-pandemic level. Participants commented that the rebound in consumer spending was due in part to federal stimulus payments and expanded unemployment benefits, which provided essential support to many households. Participants viewed accommodative monetary policy as also contributing to gains in durable goods and residential investment as well as the surge in home sales. In contrast, participants noted that consumer outlays for services were increasing more slowly than for durable goods, particularly for items such as air travel, hotel accommodations, and restaurant meals, which had been significantly disrupted by voluntary and mandated social-distancing measures. Participants generally expected the strength in household spending to continue, especially for durable goods and residential investment. A few participants noted that households' balance sheets generally appeared healthy and an unwinding of the large pool of household savings accumulated during the pandemic could provide greater-than-anticipated momentum to consumer spending over coming months. However, several participants expressed concern that, in the absence of additional fiscal support, lower- and moderate-income households might need to reduce their spending sharply when their savings were exhausted. A couple of these participants noted reports from their banking contacts that households appeared to be rapidly exhausting funds they received from fiscal relief programs.

Participants noted that business equipment investment had also picked up. A few participants expected the momentum in investment to extend into next year as the economic recovery continued, while a couple of other participants noted that many businesses in their Districts were deferring longer-term commitments because of heighted uncertainty about the economic outlook. The recovery was viewed as unevenly distributed across industries. While many business contacts, particularly those in the durable goods or housing industries, reported progress in adapting to the pandemic or improved business conditions, others—especially those with ties to small businesses and the hospitality, aviation, and nonresidential construction industries—were still seeing very difficult circumstances. Contacts reported improved conditions in the agricultural sector, boosted by strong demand from China as well as domestic ethanol production, higher crop prices, and federal aid payments. Looking ahead, some business contacts expressed concerns that many households and businesses were currently in a weaker position to weather additional economic shocks than they had been at the beginning of the pandemic.

Participants observed that labor market conditions had continued to improve in recent months, with roughly half of the 22 million jobs lost over March and April having been regained. The unemployment rate had declined further, and the employment gains since the spring were generally seen as larger than anticipated. Business contacts in a couple of Districts—particularly those in the manufacturing, health-care, and technology sectors—reported having trouble hiring workers for reasons likely related to virus cases or workers' need to provide childcare. Several participants noted that the decline in the unemployment rate in recent months had been accompanied by a fall in the labor force participation rate, particularly among those with a high school education or lower and among women. Although the number of workers on temporary layoff had fallen sharply, the number of permanent job losers had continued to rise. Most participants commented that the pace of labor market improvement was likely to moderate going forward. A couple of them noted that many businesses in industries severely affected by the pandemic were downsizing or that some businesses were focused on cutting costs or increasing productivity, including through automation. Many participants observed that high rates of job losses had been especially prevalent among lower-wage workers, particularly in the services sector, and among women, African Americans, and Hispanics. A few participants noted that these trends, if slow to reverse, could exacerbate racial, gender, and other social-economic disparities. In addition, a slow job market recovery would cause particular hardship for those with less educational attainment, less access to childcare or broadband, or greater need for retraining.

In their comments about inflation, participants noted that some consumer prices had increased more quickly than expected in recent months but that broader price trends were still quite soft. The upturn in consumer price inflation was primarily attributed to price increases in sectors where the pandemic had induced stronger demand, such as consumer durables. In contrast, services price inflation remained softer than pre-pandemic rates, as prices for the categories most affected by social distancing, such as accommodations and airfares, continued to be very depressed and housing services inflation moderated. Several participants commented on the unusually large relative price movements caused by the pandemic and the considerable uncertainty as to how long these price changes would persist.

Participants noted that financial conditions were generally accommodative and that actions by the Federal Reserve, including the establishment of emergency lending facilities with the approval of and, in some cases, provision of equity investments by the Treasury, were supporting the flow of credit to households, businesses, and communities. While these actions were viewed as contributing to accommodative financial conditions, participants noted important differences in credit availability across borrowers. In particular, financing conditions eased further for residential mortgage borrowers and for large corporations that were able to access capital markets, but surveys of credit availability indicated that bank lending conditions tightened further. A few participants noted that the financing conditions for small businesses were especially worrisome, as the PPP had ended and the prospect for additional fiscal support remained uncertain. They pointed to the most recent Census Bureau Small Business Pulse Survey, in which more than half of the respondents reported having no more than two months of cash on hand.

Participants continued to see the uncertainty surrounding the economic outlook as quite elevated, with the path of the economy highly dependent on the course of the virus; on how individuals, businesses, and public officials responded to it; and on the effectiveness of public health measures to address it. Participants cited several downside risks that could threaten the recovery. While another broad economic shutdown was seen as unlikely, participants remained concerned about the possibility of a further resurgence of the virus that could undermine the recovery. The majority of participants also saw the risk that current and expected fiscal support for households, businesses, and state and local governments might not be sufficient to sustain activity levels in those sectors, while a few participants noted that additional fiscal stimulus that was larger than anticipated could be an upside risk. Some participants commented that the recent surge in virus cases in Europe and the reimposition of restrictions there could lead to a slowdown in economic activity in the euro area and have negative spillover effects on the U.S. recovery. Some participants raised concerns regarding the longer-run effects of the pandemic, including sectoral restructurings that could slow employment growth or an acceleration of technological disruptions that could be limiting the pricing power of some firms.

A number of participants commented on various potential risks to financial stability. A few participants noted that the banking system showed considerable resilience through the end of the third quarter, and a few observed that this resilience partly reflected stronger-than-expected balance sheets of their customers, with delinquency rates declining or showing only moderate increases. Moreover, capital positions and loan loss reserves for large banks were higher than before the pandemic. Several participants emphasized the need to ensure that banks continue to maintain strong capital levels, as lower levels of capital are typically associated with tighter credit availability from banks. Several participants commented on the vulnerabilities witnessed during the March selloff in the Treasury market. The substantial maturity and liquidity transformations undertaken by some nonbank financial institutions—such as prime MMFs and corporate bond and bank loan mutual funds—were also discussed. A couple of participants expressed concerns that a prolonged period of low interest rates and highly accommodative financial market conditions could lead to excessive risk-taking, which in turn could result in elevated firm bankruptcies and significant employment losses in the next economic downturn. A few participants noted that climate change poses important challenges to financial stability and welcomed analysis of climate change as both a source of shocks and an underlying vulnerability. A couple of participants commented that the actions taken by the Federal Reserve to support the economy and achieve its mandated goals also supported financial stability. Relatedly, several participants emphasized the important roles various section 13(3) facilities played in restoring financial market confidence and supporting financial stability; they noted that these facilities were still serving as an important backstop in financial markets. A few participants noted that it was important to extend them beyond year-end.

…Regarding asset purchases, participants judged that it would be appropriate over coming months for the Federal Reserve to increase its holdings of Treasury securities and agency MBS at least at the current pace. These actions would continue to help sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses. Many participants judged that the Committee might want to enhance its guidance for asset purchases fairly soon. Most participants favored moving to qualitative outcome-based guidance for asset purchases that links the horizon over which the Committee anticipates it would be conducting asset purchases to economic conditions. A few participants were hesitant to make changes in the near term to the guidance for asset purchases and pointed to considerable uncertainty about the economic outlook and the appropriate use of balance sheet policies given that uncertainty…

Source: Federal Reserve Board