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Data Insights: FOMC Minutes

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July minutes: key signaling language Featured Important Very important

…With respect to the path of net asset purchases, respondents to the Open Market Desk's surveys of primary dealers and market participants expected communications on asset purchases to evolve gradually, with signals anticipated over coming months regarding both the Committee's assessment of conditions constituting "substantial further progress" and details on tapering plans. Almost 60 percent of respondents anticipated the first reduction in the pace of net asset purchases to come in January, though, on average, respondents placed somewhat more weight than in the June surveys on the possibility of tapering beginning somewhat earlier. With respect to the pace of tapering, respondents continued to anticipate that the Committee would take a gradual approach. While market participants discussed the possibility of an earlier or faster-than-proportional reduction in the pace of net purchases of agency mortgage-backed securities (MBS), most survey respondents appeared to expect the timing and pace of tapering of net purchases of agency MBS and Treasury securities to be similar.

…the manager summarized the proposed terms for the standing repurchase agreement (repo) facility (SRF) and the Foreign and International Monetary Authorities (FIMA) Repo Facility. In questions and comments following the manager's briefing, participants expressed broad support for the establishment of the SRF and FIMA Repo Facility. The vast majority of participants supported the proposed terms, although a few participants raised questions, including whether the proposed aggregate cap of $500 billion was necessary, whether the collateral eligible in SRF operations should be limited to Treasury securities only, and how the setting of the minimum bid rate in SRF operations would be expected to evolve over time relative to the primary credit rate and the interest on reserve balances rate. In general, participants viewed the SRF and FIMA Repo Facility as important new tools, serving in backstop roles, that would support effective policy implementation and smooth market functioning.

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Participants anticipated that the Committee would learn more about how these facilities operate over time and noted that it could adjust some parameters of the facilities on the basis of that experience.

The Committee voted unanimously to approve the establishment of the SRF. All but one member of the Committee voted to approve the FIMA Repo Facility. Governor Bowman abstained from voting on the FIMA Repo Facility and noted that she would have preferred that the liquidity arrangements accessible to foreign official institutions be maintained only during periods of extraordinary financial market stress rather than through a standing facility…

Discussion of Asset Purchases

Participants discussed aspects of the Federal Reserve's asset purchases, including progress made toward the Committee's maximum-employment and price-stability goals since the adoption of the asset purchase guidance in December 2020. They also considered the question of how asset purchases might be adjusted once economic conditions met the standards of that guidance. Participants agreed that their discussion at this meeting would be helpful background for the Committee's future decisions about modifying asset purchases. No decisions regarding future adjustments to asset purchases were made at this meeting.

The participants' discussion was preceded by staff presentations that reviewed the principal channels through which asset purchases exert effects on financial conditions and the economy, with a focus on the implications of these channels for the Committee's deliberations regarding future adjustments to the Federal Reserve's asset purchases. The presentations noted that, in the staff's standard empirical modeling framework, the effect of asset purchases on financial and economic conditions occurred primarily via their influence on the expected path of private-sector holdings of longer-term assets. In that framework, larger Federal Reserve holdings of these assets reduced private-sector holdings, exerting downward pressure on term premiums and, consequently, keeping longer-term interest rates and overall financial conditions more accommodative than they otherwise would be. The staff noted that, because plausible alternative approaches to the tapering of asset purchases would likely not lead to significant differences in the expected path of the

Federal Reserve's balance sheet, these approaches would have similar financial and economic effects in the staff's standard framework. The presentations highlighted, however, that alternative tapering approaches could have significant financial and economic effects not fully captured in the staff's standard empirical framework. In particular, changes in asset purchases could be interpreted by the public as signaling a shift in the Committee's view of the economic outlook or in its overall policy strategy, with implications for the expected path of the federal funds rate. Changes in the flow of asset purchases could also influence yields, but this influence would likely be modest outside of periods of stressed financial market conditions.

In their discussion of considerations related to asset purchases, various participants noted that these purchases were an important part of the monetary policy toolkit and a critical aspect of the Federal Reserve's response to the economic effects of the pandemic, supporting smooth financial market functioning and accommodative financial conditions, which aided the flow of credit to households and businesses and supported the recovery. Participants discussed a broad range of labor market and inflation indicators. All participants assessed that the economy had made progress toward the Committee's maximum-employment and price-stability goals since the adoption of the guidance on asset purchases in December. Most participants judged that the Committee's standard of "substantial further progress" toward the maximum-employment goal had not yet been met. At the same time, most participants remarked that this standard had been achieved with respect to the price-stability goal. A few participants noted, however, that the transitory nature of this year's rise in inflation, as well as the recent declines in longer-term yields and in market-based measures of inflation compensation, cast doubt on the degree of progress that had been made toward the price-stability goal since December. Looking ahead, most participants noted that, provided that the economy were to evolve broadly as they anticipated, they judged that it could be appropriate to start reducing the pace of asset purchases this year because they saw the Committee's "substantial further progress" criterion as satisfied with respect to the price-stability goal and as close to being satisfied with respect to the maximum-employment goal. Various participants commented that economic and financial conditions would likely warrant a reduction in coming months. Several others indicated, however, that a reduction in the pace of asset purchases was more likely to become appropriate early next year because they

saw prevailing conditions in the labor market as not being close to meeting the Committee's "substantial further progress" standard or because of uncertainty about the degree of progress toward the price-stability goal. Participants agreed that the Committee would provide advance notice before making changes to its balance sheet policy.

Participants expressed a range of views on the appropriate pace of tapering asset purchases once economic conditions satisfied the criterion laid out in the Committee's guidance. Many participants saw potential benefits in a pace of tapering that would end net asset purchases before the conditions currently specified in the Committee's forward guidance on the federal funds rate were likely to be met. At the same time, participants indicated that the standards for raising the target range for the federal funds rate were distinct from those associated with tapering asset purchases and remarked that the timing of those actions would depend on the course of the economy. Several participants noted that an earlier start to tapering could be accompanied by more gradual reductions in the purchase pace and that such a combination could mitigate the risk of an excessive tightening in financial conditions in response to a tapering announcement.

Participants exchanged views on what the composition of asset purchases should be during the tapering process. Most participants remarked that they saw benefits in reducing the pace of net purchases of Treasury securities and agency MBS proportionally in order to end both sets of purchases at the same time. These participants observed that such an approach would be consistent with the Committee's understanding that purchases of Treasury securities and agency MBS had similar effects on broader financial conditions and played similar roles in the transmission of monetary policy, or that these purchases were not intended as credit allocation. Some of these participants remarked, however, that they welcomed further discussion of the appropriate composition of asset purchases during the tapering process. Several participants commented on the benefits that they saw in reducing agency MBS purchases more quickly than Treasury securities purchases, noting that the housing sector was exceptionally strong and did not need either actual or perceived support from the Federal Reserve in the form of agency MBS purchases or that such purchases could be interpreted as a type of credit allocation.

Participants commented on other factors that were relevant for their consideration of future adjustments to the pace of asset purchases. Many participants noted that, when a reduction in the pace of asset purchases became appropriate, it would be important that the Committee clearly reaffirm the absence of any mechanical link between the timing of tapering and that of an eventual increase in the target range for the federal funds rate. A few participants suggested that the Committee would need to be mindful of the risk that a tapering announcement that was perceived to be premature could bring into question the Committee's commitment to its new monetary policy framework. With respect to the effects of the pandemic, several participants indicated that they would adjust their views on the appropriate path of asset purchases if the economic effects of new strains of the virus turned out to be notably worse than currently anticipated and significantly hindered progress toward the Committee's goals.

…In their discussion of current conditions, participants noted that, with progress on vaccinations and strong policy support, indicators of economic activity and employment had continued to strengthen. The sectors most adversely affected by the pandemic had shown improvement but had not fully recovered. Inflation had risen, largely reflecting transitory factors. 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 noted that the path of the economy would continue to depend on the course of the virus. Progress on vaccinations would likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remained.

…Participants commented on the continued improvement in labor market conditions in recent months driven by strong demand for workers. The monthly pace of job gains had picked up, with employment expanding 850,000 in June and with notable increases in the leisure and hospitality sector. Nevertheless, the household survey showed that the unemployment rate remained elevated at 5.9 percent in June, and the labor force participation rate and employment-to-population ratio were little changed in recent months. Participants indicated that the economy had not yet achieved the Committee's broad-based and inclusive maximum-employment goal. Several participants remarked that the labor market recovery continued to be uneven across demographic and income groups and across sectors. Participants generally

noted that supply-side factors related to the pandemic—such as caregiving needs, ongoing fears of the virus, increased retirements, and expanded unemployment insurance payments—continued to weigh on labor force participation and employment growth. A majority of participants anticipated that most of these factors would ease in the coming months. They also noted, however, that the spread of the Delta variant may temporarily delay the full reopening of the economy and restrain hiring and labor supply.

Participants observed that recent wage increases had been moderate on average. However, District contacts had continued to report having trouble hiring workers and had indicated that this difficulty was putting upward pressure on wages in some sectors or leading employers to provide additional incentives to attract and retain workers. Several participants noted that their District contacts expected that difficulties finding workers would likely extend into the fall.

In their discussion of inflation, participants observed that the inflation rate had increased notably and expected that it would likely remain elevated in coming months before moderating. Participants remarked that inflation had increased generally more than expected this year and attributed this increase to supply constraints in product and labor markets and a surge in consumer demand as the economy reopened. They noted that many of their District contacts had reported that higher input costs were also putting upward pressure on prices. Many participants pointed out that the largest contributors to recent increases in measures of inflation were a handful of sectors most affected by temporary supply bottlenecks or sectors in which price levels were rebounding from depressed levels as the economy continued to reopen. Looking ahead, while participants generally expected inflation pressures to ease as the effect of these transitory factors dissipated, several participants remarked that larger-than-anticipated supply chain disruptions and increases in input costs could sustain upward pressure on prices into 2022. In their comments on inflation expectations, some participants noted that measures of longer-term inflation expectations had remained in ranges that were viewed as broadly consistent with the Committee's longer-run inflation goal. Several participants indicated that the recent increases in survey-based measures signaled a risk that longer-term inflation expectations might be moving up above levels consistent with the Committee's goals. Other participants pointed to the substantial decline in TIPS-based longer-term

inflation compensation since June as suggesting that investors perceived reduced risks that inflation could run persistently above the Committee's 2 percent goal. A couple of participants noted that recent readings on forward inflation compensation could be read as suggesting investor concern that inflation over the longer term could run persistently below the Committee's 2 percent inflation goal.

In discussing the uncertainty and risks associated with the economic outlook, many participants remarked that uncertainty was quite high, with slowing in progress on vaccinations and developments surrounding the Delta variant posing downside risks to the economic outlook. A number of participants judged that the effects of supply chain disruptions and labor shortages would likely complicate the task of interpreting the incoming data and assessing the speed at which these supply-side factors would dissipate. Some participants noted that there were upside risks to inflation associated with concerns that supply disruptions and labor shortages might linger for longer than currently anticipated and might have larger or more persistent effects on prices and wages than they currently assumed.

Participants who commented on financial stability emphasized the risks associated with elevated valuations across many asset classes. A few participants highlighted scenarios in which a prolonged period of low interest rates and broadly elevated asset valuations could generate imbalances, which could increase financial stability risks. Some participants commented on the housing market and noted that ongoing rapid house price increases reflected both demand and supply factors. Several participants noted that the lack of evidence of deteriorating mortgage underwriting standards could mitigate risks associated with high housing valuations; a couple of other participants, however, expressed concern that a home price reversal could pose risks to financial stability. Some participants cited various potential risks to financial stability including the risks associated with expanded use of cryptocurrencies or the risks associated with collateral liquidity at central counterparties during episodes of market stress. In connection with the former set of risks, a few of these participants highlighted the fragility and the general lack of transparency associated with stablecoins, the importance of monitoring them closely, and the need to develop an appropriate regulatory framework to address any risks to financial stability associated with such products.

…Many participants remarked upon risk-management considerations when contemplating how and when to make changes to the Committee's pace of asset purchases. Some participants suggested that it would be prudent for the Committee to prepare for starting to reduce its pace of asset purchases relatively soon, in light of the risk that the recent high inflation readings could prove to be more persistent than they had anticipated and because an earlier start to reducing asset purchases would most likely enable additions to securities holdings to be concluded before the Committee judged it appropriate to raise the federal funds rate. A few participants expressed concerns that maintaining highly accommodative financial conditions might contribute to a further buildup in risk to the financial system that could impede the attainment of the Committee's dual-mandate goals. In contrast, a few other participants suggested that preparations for reducing the pace of asset purchases should encompass the possibility that the reductions might not occur for some time and highlighted the risks that rising COVID-19 cases associated with the spread of the Delta variant could cause delays in returning to work and school and so damp the economic recovery. Several participants also remained concerned about the medium-term outlook for inflation and the possibility of the reemergence of significant downward pressure on inflation, especially in light of the recent decline in longer-term inflation compensation. In addition, several participants emphasized that there was considerable uncertainty about the likely resolution of the labor market shortages and supply bottlenecks and about the influence of pandemic-related developments on longer-run labor market and inflation dynamics. Those participants stressed that the Committee should be patient in assessing progress toward its goals and in announcing changes to its plans on asset purchases.

Some participants emphasized that a decision to reduce the Committee's pace of asset purchases once the "substantial further progress" benchmark had been achieved would be fully consistent with the Committee's new monetary policy framework and would help foster the achievement of the Committee's longer-run objectives over time. A couple of participants also noted that a tapering of asset purchases did not amount to a tightening of the stance of monetary policy and instead only implied that additional monetary accommodation would be provided at a slower rate. Several participants emphasized that an announcement of a reduction in the Committee's pace of asset purchases should not be interpreted as the beginning

of a predetermined course for raising the federal funds rate from its current level. Those participants stressed that the Committee's assessment regarding the appropriate timing of an increase in the target range for the federal funds rate was separate from its current deliberations on asset purchases and would be subject to the higher standard, as laid out in the Committee's outcome-based guidance on the federal funds rate. Nonetheless, a couple of participants cautioned that it could be challenging for the public to disentangle deliberations about the two tools and that any decisions the Committee made on its asset purchases would likely influence the public's understanding of the Committee's other policy intentions, including with regard to future decisions concerning the target range for the federal funds rate.

Source: Federal Reserve Board