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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 of topics associated with potential adjustments in the Committee's policy tools that may be appropriate to support the achievement of sustained strong labor market conditions and a return of inflation to levels consistent with the Committee's longer-run 2 percent objective under a wide range of circumstances. At this meeting, participants discussed high-level principles that could be released to the public to describe the Committee's approach for reducing the size of the Federal Reserve's balance sheet. They agreed that the principles would address, at a high level, the sequence of adjustments in the interest rate and balance sheet tools to reduce policy accommodation, the Committee's approach to balance sheet runoff, and its intentions for the longer-run size and composition of the balance sheet. The participants' discussion was preceded by a staff presentation that reviewed key considerations raised by participants at the December FOMC meeting and examined how the proposed set of principles, which reflected those considerations, compared with the Policy Normalization Principles and Plans issued in 2014.

In their discussion, participants reaffirmed that changes in the target range for the federal funds rate are the Committee's primary means for adjusting the stance of monetary policy, as noted in the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy. Participants judged that the timing and pace of balance sheet reduction would be determined so as to promote the Committee's maximum-employment and price-stability goals and that it would be appropriate to begin the process of reducing the size of the balance sheet after the process of increasing the target range for the federal funds rate has begun. While participants agreed that details on the timing and pace of balance sheet runoff would be determined at upcoming meetings, participants generally noted that current economic and financial conditions would likely warrant a faster pace of balance sheet runoff than during the period of balance sheet reduction from 2017 to 2019. Participants observed that, in light of the current high level of the Federal Reserve's securities holdings, a significant reduction in the size of the balance sheet would likely be appropriate. Participants noted that the level of securities holdings consistent with implementing monetary policy efficiently and effectively in an ample reserves regime was uncertain and probably would remain so. Consequently, market conditions would have to be monitored closely to determine the appropriate longer-run level of reserves and the size of the balance sheet.

Participants agreed that the Committee should reduce the Federal Reserve's securities holdings over time in a predictable manner primarily by adjusting the amounts reinvested of principal payments received from securities held in the SOMA. They also agreed that the SOMA should hold primarily Treasury securities in the longer run. Regarding these two principles, many participants commented that sales of agency MBS or reinvesting some portion of principal payments received from agency MBS into Treasury securities may be appropriate at some point in the future to enable suitable progress toward a longer-run SOMA portfolio composition consisting primarily of Treasury securities.

Participants agreed that it was appropriate at this time for the Committee to publish its high-level principles for reducing the size of the Federal Reserve's balance sheet. They also agreed that it was important for the Committee to retain the flexibility to adjust any of the details of its approach in light of changing economic and financial conditions. Participants noted that the principles would serve as an important guide in future deliberations on balance sheet reduction. While no decisions regarding specific details for reducing the size of the balance sheet were made at this meeting, participants agreed to continue their discussions at upcoming meetings.

Following the conclusion of the discussion, all participants supported the proposed principles for reducing the size of the balance sheet. The Committee voted unanimously to adopt the Principles for Reducing the Size of the Federal Reserve's Balance Sheet...

In their discussion of current economic conditions, participants noted that indicators of economic activity and employment had continued to strengthen. The sectors most adversely affected by the pandemic had improved in recent months but continued to be affected by the recent sharp rise in COVID-19 cases. Job gains had been solid in recent months, and the unemployment rate had declined substantially. Supply and demand imbalances related to the pandemic and the reopening of the economy had continued to contribute to elevated levels of inflation. Overall financial conditions had remained accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses. Participants judged that the path of the economy continued to depend on the course of the virus. Progress on vaccinations and an easing of supply constraints were expected to support continued gains in economic activity and employment as well as a reduction in inflation. Risks to the economic outlook remained, including from new variants of the virus.

With regard to the economic outlook, participants agreed that the Omicron wave of the pandemic would weigh on economic activity in the first quarter of 2022. Indeed, sectors of the economy that are particularly sensitive to pandemic-related disruptions, including travel, leisure, and restaurants, were experiencing sharp reductions in activity as a result of the Omicron wave. Participants commented that, for many afflicted individuals and families, the virus continued to cause great hardship. Participants concurred that if the Omicron wave dissipated quickly, then economic activity would likely strengthen rapidly and economic growth for 2022 as a whole would be robust. Participants cited strong household balance sheets, rising wages, and effective adaptation to the pandemic by the business sector as factors supporting the outlook for strong growth this year. However, a number of participants noted that there was a risk that additional variants could weigh on economic activity this year.

Participants noted that supply chain bottlenecks and labor shortages had continued to limit businesses' ability to meet strong demand, with these challenges exacerbated by the emergence and spread of the Omicron variant. In particular, the Omicron wave had led to much more widespread worker absences due to illness, virus exposure, or caregiving needs, which had curtailed activity in many sectors including airlines, trucking, and warehousing. Some participants reported that their business contacts were hopeful that the effects of the Omicron wave would be relatively short lived. Nevertheless, several participants reported that their contacts expected the ongoing labor shortages and other supply constraints to persist well after the acute effects of the Omicron wave had waned. Participants' contacts also reported continued widespread input cost pressures, which, amid generally robust demand, they reported having largely been able to pass on to their customers. A few participants commented that agricultural businesses were experiencing higher input costs, and those higher costs were putting strain on the finances of those firms even as they experienced generally strong demand for their products.

In their discussion of the household sector, many participants noted that the onset of the Omicron wave had damped consumer demand, particularly for services, with much of the recent weakness concentrated in high-contact sectors such as travel, dining, and leisure and hospitality. Almost all of those participants anticipated that household demand would recover briskly if the Omicron wave subsided quickly, with spending supported by strong household balance sheets that were bolstered by high rates of saving earlier in the pandemic and ongoing robust gains in labor income.

Participants noted that the labor market had made remarkable progress in recovering from the recession associated with the pandemic and, by most measures, was now very strong. Increases in employment had been solid in recent months; the unemployment rate had declined sharply, reaching 3.9 percent in December; job openings and quits were near record high levels; and nominal wages were rising at the fastest pace in decades. Several participants commented that the gains, on balance, over recent months had been broad based, with notable improvements for lower-wage workers as well as African Americans and Hispanics. Against this backdrop of a generally strong and improving labor market, many participants observed that the effects of the Omicron variant likely would only temporarily suppress the rate of labor market gains. The labor force participation rate had edged up further over the past few months, and some participants indicated that they expected it to continue to increase as the pandemic eased. A couple of participants noted that the participation rate remained lower than trend levels that account for changing demographics.

Participants noted that their District contacts were reporting that labor demand remained historically strong and that labor supply remained constrained, resulting in a broad shortage of workers across many parts of the economy. As a result, there was widespread evidence that the labor market was very tight, including near-record rates of quits and job vacancies as well as nominal wage growth that was the highest recorded in decades. Several participants reported that District business contacts were either planning to implement or had implemented larger wage increases than those of recent years to retain current employees or attract new workers. A few participants also reported contacts having been forced to reduce operating hours or close businesses temporarily because of labor shortages.

Acknowledging that the maximum level of employment consistent with price stability evolves over time, participants expressed a range of views regarding their assessments of current labor market conditions relative to the Committee's goal of maximum employment. Many participants commented that they viewed labor market conditions as already at or very close to those consistent with maximum employment, citing indications of strong labor markets including the low levels of unemployment rates, elevated wage pressures, near-record levels of job openings and quits, and a broad shortage of workers across many parts of the economy. A couple of participants commented that, in their view, the economy likely had not yet reached maximum employment, noting that, even for prime-age workers, labor force participation rates were still lower than those that prevailed before the pandemic or that a reallocation of labor across sectors could lead to higher levels of employment over time.

Participants remarked that recent inflation readings had continued to significantly exceed the Committee's longer-run goal and elevated inflation was persisting longer than they had anticipated, reflecting supply and demand imbalances related to the pandemic and the reopening of the economy. However, some participants commented that elevated inflation had broadened beyond sectors most directly affected by those factors, bolstered in part by strong consumer demand. In addition, various participants cited other developments that had the potential to place additional upward pressure on inflation, including real wage growth in excess of productivity growth and increases in prices for housing services. Participants acknowledged that elevated inflation was a burden on U.S. households, particularly those who were least able to pay higher prices for essential goods and services. Some participants reported that their business contacts remained concerned about persistently high inflation and that they were adjusting their business practices to cope with higher input costs—for instance, by raising output prices or utilizing contracts that were contingent on their costs. Participants generally expected inflation to moderate over the course of the year as supply and demand imbalances ease and monetary policy accommodation is removed. Some participants remarked that longer-term measures of inflation expectations appeared to remain well anchored, which would support a return of inflation over time to levels consistent with the Committee's goals.

In their discussion of risks to the outlook, participants agreed that uncertainty regarding the path of inflation was elevated and that risks to inflation were weighted to the upside. Participants cited several such risks, including the zero-tolerance COVID-19 policy in China that had the potential to further disrupt supply chains, the possibility of geopolitical turmoil that could cause increases in global energy prices or exacerbate global supply shortages, a worsening of the pandemic, persistent real wage growth in excess of productivity growth that could trigger inflationary wage–price dynamics, or the possibility that longer-term inflation expectations could become unanchored. A few participants pointed to the possibility that structural factors that had contributed to low inflation in the previous decade, such as technological changes, demographics, and a low real interest rate environment, may reemerge when the effects of the pandemic abate. Uncertainty about real activity was also seen as elevated. Various participants noted downside risks to the outlook, including a possible worsening of the pandemic, the potential for escalating geopolitical tensions, or a substantial tightening in financial conditions.

Participants who commented on issues related to financial stability cited a number of factors that could represent potential vulnerabilities to the financial system. A few participants noted that asset valuations were elevated across a range of markets and raised the concern that a major realignment of asset prices could contribute to a future downturn. A couple of these participants judged that prolonged accommodative financial conditions could be contributing to financial imbalances. A couple of other participants cited reasons why elevated asset valuations might prove to be less of a threat to financial stability than in past reversals of asset prices. In particular, they noted the relatively healthy balance sheet positions of households and nonfinancial firms, the well-capitalized and liquid banking sector, and the fact that the rise in housing prices was not being fueled by a large increase in mortgage debt as suggesting that the financial system might prove resilient to shocks. Some participants saw emerging risks to financial stability associated with the rapid growth in crypto-assets and decentralized finance platforms. A few participants pointed to risks associated with highly leveraged, nonbank financial institutions or the potential vulnerability of prime money market funds to a sudden withdrawal of liquidity.

In their consideration of the stance of monetary policy, participants agreed that it would be appropriate for the Committee to keep the target range for the federal funds rate at 0 to 1/4 percent in support of the Committee's objectives of maximum employment and inflation at the rate of 2 percent over the longer run. They also anticipated that it would soon be appropriate to raise the target range. In discussing why beginning to remove policy accommodation could soon be warranted, participants noted that inflation continued to run well above 2 percent and generally judged the risks to the outlook for inflation as tilted to the upside. Participants also assessed that the labor market was strong, having made substantial, broad-based progress over the past year.

In light of elevated inflation pressures and the strong labor market, participants continued to judge that the Committee's net asset purchases should be concluded soon. Most participants preferred to continue to reduce the Committee's net asset purchases according to the schedule announced in December, bringing them to an end in early March. A couple of participants stated that they favored ending the Committee's net asset purchases sooner to send an even stronger signal that the Committee was committed to bringing down inflation.

Participants discussed the implications of the economic outlook for the likely timing and pace for removing policy accommodation. Compared with conditions in 2015 when the Committee last began a process of removing monetary policy accommodation, participants viewed that there was a much stronger outlook for growth in economic activity, substantially higher inflation, and a notably tighter labor market. Consequently, most participants suggested that a faster pace of increases in the target range for the federal funds rate than in the post-2015 period would likely be warranted, should the economy evolve generally in line with the Committee's expectation. Even so, participants emphasized that the appropriate path of policy would depend on economic and financial developments and their implications for the outlook and the risks around the outlook, and they will be updating their assessments of the appropriate setting for the policy stance at each meeting. Participants noted that the removal of policy accommodation in current circumstances depended on the timing and pace of both increases in the target range of the federal funds rate and the reduction in the size of the Federal Reserve's balance sheet. In this context, a number of participants commented that conditions would likely warrant beginning to reduce the size of the balance sheet sometime later this year.

In their discussion of the outlook for monetary policy, many participants noted the influence on financial conditions of the Committee's recent communications and viewed these communications as helpful in shifting private-sector expectations regarding the policy outlook into better alignment with the Committee's assessment of appropriate policy. Participants continued to stress that maintaining flexibility to implement appropriate policy adjustments on the basis of risk-management considerations should be a guiding principle in conducting policy in the current highly uncertain environment. Most participants noted that, if inflation does not move down as they expect, it would be appropriate for the Committee to remove policy accommodation at a faster pace than they currently anticipate. Some participants commented on the risk that financial conditions might tighten unduly in response to a rapid removal of policy accommodation. A few participants remarked that this risk could be mitigated through clear and effective communication of the Committee's assessments of the economic outlook, the risks around the outlook, and the appropriate path for monetary policy...

Source: Federal Reserve Board