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Data Insights: FOMC Minutes

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March minutes: key signaling language Featured Important Very important

…Plans for Reducing the Size of the Balance Sheet

Participants continued their discussion of topics related to plans for reducing the size of the Federal Reserve's balance sheet in a manner consistent with the approach described in the Principles for Reducing the Size of the Federal Reserve's Balance Sheet that the Committee released following its January meeting.

The participants' discussion was preceded by a staff presentation that reviewed the Committee's 2017–19 experience with balance sheet reduction and presented a range of possible options for reducing the Federal Reserve's securities holdings over time in a predictable manner. All of the options featured a more rapid pace of balance sheet runoff than in the 2017–19 episode. The options differed primarily with respect to the size of the monthly caps for securities redemptions in the SOMA portfolio. The presentation addressed the potential implications of each option for the path of the balance sheet during and after runoff. The staff presentation also featured alternative approaches the Committee could consider with respect to SOMA holdings of Treasury bills as well as alternative ways the Committee could eventually slow and then stop balance sheet runoff as the size of the SOMA portfolio approached levels consistent with the Committee's ample-reserves framework for policy implementation.

In their discussion, all participants agreed that elevated inflation and tight labor market conditions warranted commencement of balance sheet runoff at a coming meeting, with a faster pace of decline in securities holdings than over the 2017–19 period. Participants reaffirmed that the Federal Reserve's securities holdings should be reduced over time in a predictable manner primarily by adjusting the amounts reinvested of principal payments received from securities held in the SOMA. Principal payments received from securities held in the SOMA would be reinvested to the

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extent they exceeded monthly caps. Several participants remarked that they would be comfortable with relatively high monthly caps or no caps. Some other participants noted that monthly caps for Treasury securities should take into consideration potential risks to market functioning. Participants generally agreed that monthly caps of about $60 billion for Treasury securities and about $35 billion for agency MBS would likely be appropriate. Participants also generally agreed that the caps could be phased in over a period of three months or modestly longer if market conditions warrant.

Participants discussed the approach toward implementing caps for Treasury securities and the role that the Federal Reserve's holdings of Treasury bills might play in the Committee's plan to reduce the size of the balance sheet. Most participants judged that it would be appropriate to redeem coupon securities up to the cap amount each month and to redeem Treasury bills in months when Treasury coupon principal payments were below the cap. Under this approach, redemption of Treasury bills would typically bring the total amount of Treasury redemptions up to the monthly cap. Several participants remarked that reducing the Federal Reserve's Treasury bill holdings over time would be appropriate because Treasury bills are highly valued as safe and liquid assets by the private sector, and the Treasury could increase bill issuance to the public as SOMA bill holdings decline. In addition, participants generally noted that maintaining large holdings of Treasury bills is not necessary under the Federal Reserve's ample-reserves operating framework; in the previous scarce-reserves regime, Treasury bill holdings were useful as a tool that could be used to drain reserves from the banking system when necessary to control short-term interest rates. A couple of participants commented that holding some Treasury bills could be appropriate if the Federal Reserve wished to keep its Treasury portfolio neutral with respect to the universe of outstanding Treasury securities.

With respect to the Federal Reserve's agency MBS redemptions, participants generally noted that MBS principal prepayments would likely run under the proposed monthly cap in a range of plausible interest rate scenarios but that the cap could guard against outsized reductions in the Federal Reserve's agency MBS holdings in scenarios with especially high prepayments. Some participants noted that under the proposed approach to running off Treasury and agency securities primarily through adjustments to reinvestments, agency MBS holdings would still make up a sizable

share of the Federal Reserve's asset holdings for many years. Participants generally agreed that after balance sheet runoff was well under way, it will be appropriate to consider sales of agency MBS to enable suitable progress toward a longer-run SOMA portfolio composed primarily of Treasury securities. A Committee decision to implement a program of agency MBS sales would be announced well in advance.

Several participants noted the significant uncertainty around the future level of reserves that would be consistent with the Committee's ample-reserves operating framework. Against this backdrop, participants generally agreed that it would be appropriate to first slow and then stop the decline in the size of the balance sheet when reserve balances were above the level the Committee judged to be consistent with ample reserves, thereby allowing reserves to decline more gradually as nonreserve liabilities increased over time. Participants agreed that lessons learned from the previous balance sheet reduction episode should inform the Committee's current approach to reaching ample reserve levels and that close monitoring of money market conditions and indicators of near-ample reserves should help inform adjustments to the pace of runoff. A couple of participants noted that the establishment of the SRF, which did not exist in the previous runoff episode, could address unexpected money market pressures that might emerge if the Committee adopted an approach to balance sheet reduction in which reserves declined relatively rapidly, but several others noted that the facility was not intended as a substitute for ample reserves. Participants generally agreed that it was important for the Committee to be prepared to adjust any of the details of its approach to reducing the size of the balance sheet in light of economic and financial developments.

No decision regarding the Committee's plan to reduce the Federal Reserve's balance sheet was made at this meeting, but participants agreed they had made substantial progress on the plan and that the Committee was well placed to begin the process of reducing the size of the balance sheet as early as after the conclusion of its upcoming meeting in May.

…Participants' Views on Current Conditions and the Economic Outlook

…In their discussion of current economic conditions, participants noted that indicators of economic activity and employment had continued to strengthen. Job

gains had been strong in recent months, and the unemployment rate had declined substantially. Inflation remained elevated, reflecting continued supply and demand imbalances, higher energy prices, and broader price pressures. With appropriate firming in the stance of monetary policy, participants expected inflation to return to the Committee's 2 percent objective over time and the labor market to remain strong. Participants recognized that the invasion of Ukraine by Russia was causing tremendous human and economic hardship for the Ukrainian people. They judged that the implications of the war for the U.S. economy were highly uncertain, but in the near term, the invasion and related events were likely to create significant additional upward pressure on inflation and could weigh on economic activity.

With regard to the economic outlook, participants noted that real GDP growth had slowed from its rapid pace in the fourth quarter of 2021, largely reflecting weaker inventory investment, but consumption and business investment continued to rise solidly. The Omicron variant left only a mild and brief imprint on economic data, as households and firms appeared resilient to this wave of the virus. Relative to their December forecasts, participants had revised down their projections for real GDP growth this year, reflecting factors such as a slowdown in inventory investment from its strong pace late last year, reduced fiscal and monetary policy accommodation, and the Russian invasion of Ukraine, which had led to higher prices of energy and other commodities, increased uncertainty, and weighed on broader financial conditions and consumer sentiment. Even so, participants judged that economic fundamentals remained solid and that they expected above-trend growth to continue, sustaining a strong labor market.

Participants commented that demand for labor continued to substantially exceed available supply across many parts of the economy and that their business contacts continued to report difficulties in hiring and retaining workers. Participants observed that various indicators pointed to a very tight labor market. Employment growth remained strong through the Omicron wave. A couple of participants highlighted that the annual benchmark revision to the establishment survey employment data revealed stronger employment growth in the second half of 2021 than was initially reported. The unemployment rate had fallen to a post-pandemic low, and quits and job openings were at all-time highs. Although payroll employment remained below its pre-pandemic level, the shortfall was concentrated in a few sectors and reflected a

shortage of workers rather than insufficient demand for labor. Consistent with a tight labor market, nominal wages were rising at the fastest pace in many years. While wage gains thus far had been the strongest among the lowest quartile of earners and among production and supervisory workers, wage pressures had begun to spread across the income and skill distributions. Many participants commented that they expected the labor market to remain strong and wage pressures to remain elevated. A few participants noted that there were signs that the pandemic-related factors that had held back labor supply might be abating and pointed to the notable increase in the labor force participation rate among prime-age men in February.

Participants remarked that recent inflation readings continued to significantly exceed the Committee's longer-run goal and noted that developments associated with Russia's invasion of Ukraine, including the related surge in energy prices, will add to near-term inflation pressures. Some participants noted that elevated inflation had continued to broaden from goods into services, especially rents, and into sectors that had not yet experienced large price increases, such as education, apparel, and health care. A few participants also noted that the number of spending categories experiencing inflation rates above 4 percent had continued to rise, or that the trimmed mean inflation measure from the Federal Reserve Bank of Dallas had risen to its highest level since the early 1980s. Many participants indicated that their business contacts continued to report substantial increases in wages and input prices that were being passed through into higher prices to their customers without any significant decrease in demand. Participants commented on a few factors that might lead the high inflation readings to persist, including strong aggregate demand, significant increases in energy and commodity prices, and supply chain disruptions that were likely to require a lengthy period to resolve. In addition, some participants noted that recent higher inflation could affect future inflation dynamics. For example, a few participants commented that persistently high inflation readings might lead businesses, when setting prices, to be more attentive to aggregate inflation or more willing to raise prices. In addition, a couple of other participants noted that some household survey data suggested that near-term consumer inflation expectations have become more sensitive to actual inflation readings since the beginning of the pandemic. A few participants commented that both survey- and market-based measures of short-term inflation expectations were at historically high levels. Several

other participants noted that longer-term measures of inflation expectations from households, professional forecasters, and market participants still appeared to remain well anchored, which—together with appropriate monetary policy and an eventual easing of supply constraints—would support a return of inflation over time to levels consistent with the Committee's longer-run goal.

Participants agreed that developments surrounding the Russian invasion of Ukraine, including the resulting sanctions, were adding to inflation pressures and posing upside risks to the inflation outlook. Participants noted that Russia and Ukraine were major suppliers of various commodities used in the production of energy, food, and some industrial inputs. A continued cutoff of that supply from the world market would further push up prices for those commodities and, over time, lead to price increases in downstream industries. The invasion had also exacerbated the disruptions of supply chains. Participants commented that, by leading to higher energy and food prices, weighing on consumer sentiment, and contributing to tighter financial conditions, the invasion also negatively affected the growth outlook. A few participants highlighted additional downside risks to growth associated with the war, such as the risk that a more protracted conflict than the public currently expects could lead to much tighter global financial conditions or other disruptions. A couple of participants commented that the increased uncertainty might lead businesses and consumers to reduce spending, though their business contacts currently were not seeing signs of such shifts or expecting a significant pullback in demand. Several participants judged that the upside risk to inflation associated with the war appeared more significant than the downside risk to growth, as inflation was already high, the United States had a relatively low level of financial and trade exposure to Russia, and the U.S. economy was well positioned to absorb additional adverse demand shocks.

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 ongoing supply bottlenecks and rising energy and commodity prices, both of which were exacerbated by the Russian invasion; recent COVID-related lockdowns in China that had the potential to further disrupt supply chains; and the possibility that longer-run inflation expectations might become unanchored. Uncertainty about real activity was also seen as elevated. Various participants noted downside risks to the outlook, including

risks associated with the Russian invasion, a broad tightening in global financial conditions, and a prolonged rise in energy prices.

In their consideration of the appropriate stance of monetary policy, all participants concurred that the U.S. economy was very strong, with an extremely tight labor market, and that inflation was high and well above the Committee's 2 percent inflation objective. Against this backdrop, all participants agreed that it was appropriate to begin a process of removing policy accommodation by raising the target range for the federal funds rate at this meeting. They further judged that ongoing increases in the target range for the federal funds rate would be warranted to achieve the Committee's objectives. Participants also agreed that reducing the size of the Federal Reserve's balance sheet would play an important role in firming the stance of monetary policy and that they expected it would be appropriate to begin this process at a coming meeting, possibly as soon as in May. Participants judged that the firming of monetary policy, alongside an eventual waning of supply–demand imbalances, would help to keep longer-term inflation expectations anchored and bring inflation down over time to levels consistent with the Committee's 2 percent longer-run goal while sustaining a strong labor market.

Many participants noted that—with inflation well above the Committee's objective, inflationary risks to the upside, and the federal funds rate well below participants' estimates of its longer-run level—they would have preferred a 50 basis point increase in the target range for the federal funds rate at this meeting. A number of these participants indicated, however, that, in light of greater near-term uncertainty associated with Russia's invasion of Ukraine, they judged that a 25 basis point increase would be appropriate at this meeting. Many participants noted that one or more 50 basis point increases in the target range could be appropriate at future meetings, particularly if inflation pressures remained elevated or intensified. A number of participants noted that the Committee's previous communications had already contributed to a tightening of financial conditions, as evident in the notable increase in longer-term interest rates over recent months.

All participants indicated their strong commitment and determination to take the measures necessary to restore price stability. In that context, participants judged that the Committee's approach of commencing increases in the target range for the

federal funds rate, and indicating that ongoing increases were likely, was fully warranted. Participants judged that it would be appropriate to move the stance of monetary policy toward a neutral posture expeditiously. They also noted that, depending on economic and financial developments, a move to a tighter policy stance could be warranted. A few participants judged that, at the current juncture, a significant risk facing the Committee was that elevated inflation and inflation expectations could become entrenched if the public began to question the Committee's resolve to adjust the stance of policy as appropriate to achieve the Committee's 2 percent longer-run objective for inflation. These participants suggested that expediting the removal of policy accommodation would reduce this risk while also leaving the Committee well positioned to adjust the stance of policy if geopolitical and other developments led to a more rapid dissipation of demand pressures than expected.

Source: Federal Reserve Board