U.S. FOMC Review

- FOMC: cool to yield curve control…

  … but more forward guidance seems likely

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The June FOMC Meeting

Fed officials did not consider any adjustments to their key policy levers at the June meeting of the Federal Open Market Committee, as they judged the current stance as “appropriate”. However, a portion of the meeting was interesting in that the Committee discussed the possibility of providing more explicit forward guidance and of adding so-called yield curve control (the pegging of Treasury interest rates) to the monetary policy tool kit.

The minutes suggested broad support for more explicit forward guidance: various officials noted that it was “important” to provide greater clarity regarding the likely path of the federal funds rate and plans for asset purchases. Officials seemed most interested in outcome-based guidance, where future policy changes would be dictated by policy variables reaching certain threshold levels. Inflation attracted the most attention as the key variable in guidance, with some policymakers suggesting the possibility of allowing “a modest temporary overshooting of the Committee’s longer-run inflation goal”. Some signaled a preference for forward guidance tied to the unemployment rate. Whatever policy variable is selected, the minutes offered a strong hint that the Committee soon will be more explicit in its guidance: “Participants agreed that the current stance of monetary policy remained appropriate, but many noted that the Committee could, at upcoming meetings, further clarify its intentions with respect to its future monetary policy decisions as the economic outlook becomes clearer.”

Some market participants expect the Fed to adopt “yield curve control” as a policy tool at an upcoming meeting. However, officials did not seem to be leaning in this direction. “Many” officials noted that if the Committee provided credible forward guidance, pegging interest rates would not provide meaningful additional support. In addition, officials were concerned about a possible loss of control over the size of the Fed’s balance sheet and possible difficulties in unwinding such policies at some future date. “All” Fed officials felt that the staff should “conduct further analysis” of the design and implementation of such policies. In other words, this proposal is not happening anytime soon.

As an aside, the staff and Fed officials do not seem to favor the term “yield curve control” (or YCC). The minutes referred to such policies as “yield caps or targets” (or YTC). This is not surprising. The Fed seems to prefer to coin its own terminology: it still speaks of large scale asset purchases (LSAP) rather than quantitative easing (QE).

Speaking of QE, we found another segment of the minutes interesting. In reviewing its QE and forward guidance efforts, the Committee noted the “extensive experience” with these tools had made them key parts of the monetary policy tool kit. We recall a preference among Fed officials during the financial crisis for using short-term interest rates as the key policy lever because of inexperience with QE and forward guidance and uncertainty regarding their influence. Times change. Now, QE and guidance are “key parts” of the Fed’s tool kit.