

# U.S. FOMC Review

- FOMC Minutes: keen interest in market developments (i.e. changes in interest rates)

**Michael Moran**

Daiwa Capital Markets America  
212-612-6392  
michael.moran@us.daiwacm.com

## The March FOMC Meeting

The March meeting of the Federal Open Market Committee was largely uneventful, although we found coverage of recent market developments interesting. The meeting opened with a longer-than-normal discussion of developments in financial markets and open market operations, with changes in interest rates capturing most of the attention. Short-term interest rates (especially rates on repurchase agreements) had moved to unusually low levels while long-term interest rates had increased noticeably.

The drop in RP rates was associated with a large increase in bank reserves, which in turn, was triggered by a reduction in the Treasury's cash balance and by the asset purchases of the Federal Reserve. Fed officials seemed concerned about the rock-bottom level of short-term rates, and they took a small step to ease the downward pressure. Specifically, the Fed increased the per-counterparty limit on overnight reverse repurchase agreements (RRPs) from \$30 billion to \$80 billion, which would reduce the volume of funds searching for an investment outlet in the market and presumably increase RP rates.

Fed officials seemed prepared to do more to lift short-term interest rates, noting the possibility of increasing the rates on overnight RRP and on bank reserves. The minutes even noted that these administered rates could be hiked at any time; changes were not necessarily actions that would occur only at FOMC meetings.

Policymakers took note of the increase in long-term interest rates, viewing recent changes as primarily an increase in real interest rates with some additional pressure from a shift in inflation expectations. Officials seemed to view these changes in a favorable light, seeing them as a sign of brighter economic outlooks by market participants. With increased optimism the driving force, policymakers did not seem inclined to counter the pressure by increasing the volume of asset purchases.

While the FOMC was not inclined to increase its asset purchases, it also was not prepared to begin tapering. Officials had increased their forecasts of economic activity, but they also noted that the economy was far from meeting the Committee's objectives. Officials planned to maintain the QE program (and ultra-low short-term interest rates) until they have achieved substantial progress in meeting their employment and inflation goals. Policy changes will be driven by observed outcomes rather than forecasts.

Fed officials have focused on genuine progress and observed outcomes rather than forecasts since last August, when they adopted the new strategic framework. This perspective shows a determination to get the economy on track, but it also flies in the face of one of the bedrock principles of monetary policy: lags are long and variable, and thus policy should attempt to move preemptively. Perhaps the current unique environment represents an exception to this principle, but one wonders.