U.S. FOMC Review

- FOMC: little insight into QE
- No change in inflation views

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Monetary Policy

Market participants were hoping for information on the plans of the Federal Open Market Committee for its asset purchase program. A sentence added to the forward guidance portion of the policy statement implied that tapering asset purchases was under discussion, but the new statement provided no hints on when the program might begin or how quickly it might proceed.

The issue of tapering QE was naturally raised at the press briefing, and Chair Powell noted that the Committee took a “deep dive” into the timing, pace, and composition of changes in the program, but officials made no decisions. He noted again that the standard of “substantial further progress” toward the goals of maximum employment and stable prices had not been met and that there was still “ground to cover”.

The questions surrounding quantitative easing did not generate blinding insights, but we found two bits of information useful. First, some Fed officials (and market participants) have suggested that the Fed should consider tapering mortgage-backed securities before Treasuries. Home prices have increased sharply in the past year, and the Fed buying, the argument goes, might be playing a role in this possible bubble. Chair Powell noted that early tapering of MBS did not receive broad support among Fed officials. He indicated that he believed tapering on MBS and Treasuries would start simultaneously. However, he kept a door open to the possibility of faster tapering on MBS. The second notable point involved interest rate lift-off. Mr. Powell indicated that only tapering is under consideration now; the Committee has no thoughts of raising interest rates any time soon.

The policy statement and Chair Powell’s comments at the press briefing showed no change in the Fed’s view on inflation. Recent price pressure has been more pronounced than expected, but the pressure is viewed as transitory. He sees the possibility of pressure persisting for some time, but he believes it will eventually fade as supply-side adjustments allow production to catch up with the burst of demand.

We viewed the policy statement as a tad more optimistic than the previous one. The statement in June noted that sectors most affected by the pandemic have remained weak but have shown improvement. The new statement dropped the “remain weak” characterization, noting only the improvement. However, the statement was not wildly optimistic because it also noted that the weak sectors had not fully recovered.

The FOMC approved a so-called standing repo facility at this meeting. This facility is a tool that automatically will inject reserves into the banking system by allowing primary dealers to borrow from the Fed at their discretion via a repurchase agreement. The program is irrelevant at this time because there are more-than-ample reserves in the banking system. In fact, market participants are pushing reserves out of the banking system and back to the Fed by utilizing the reverse RP facility. Because of its irrelevance at this time, the facility was introduced with little fanfare.