

FOMC Minutes 'Patient' On Tail Risks; Discuss Possible Future Twist

- The US Treasury curve steepened following the release of the minutes not only because of reaffirmed 'patience' language regarding nearer term policy rate changes but also due to the introduction of discussion surrounding possibly altering the maturity composition of the Treasury holdings within the SOMA portfolio. The purpose of the minutes was also to convey flexible options to address any future repeats of upward pressure upon short-term market rates as reserves are drained from the system as well as flexibility in managing the SOMA portfolio.
- **The messaging toward the outlook for the economy, the Fed's dual mandate and policy rate remains constructive in the majority sense while monitoring risks to the outlook that they wish to take a bit of time to evaluate.** The risks are not part of their consensus base case versus tail risks. That's prudent, given, among other things, three key risks that are weighing upon markets and all with March deadlines like the March 1st expiration of the US-China tariff moratorium, the March 1st reinstatement of the debt ceiling amidst the present government shutdown and ineptness reflected by an inability to strike a funding agreement, and the March 29th Brexit deadline. Overall, participants generally agree that inflation will remain around 2% "on a sustained basis", that "the economy was evolving about as anticipated" and "some further gradual increases in the target range" would be merited and that risks "appeared roughly balanced." The frequency of citation surrounding risks to this outlook is not expressed in the majority. As a consequence to monitoring the risks, "many" FOMC participants support being 'patient' in timing further tightening.
- What I think clients should take from the discussion thus far is that markets have expressed overly great certainty with respect to how the risks being monitored by FOMC participants will unfold and have gone too light on pricing the risk of rate hikes over the duration of the year.
- As expected, there was a further discussion between Fed staffers and FOMC participants about policy normalization tools. Key takeaways from that discussion include:
 - **There was a discussion about how to keep the effective fed funds rate within the FOMC's target range as reserves are drained** from the system beyond utilizing IOER cuts relative to the upper limit (that they implemented by cutting the FF-IOER spread by another 5bps at this meeting) including adding new counterparties to the Open Market Desk's operations.
 - On managing potential upward pressure upon money market rates as excess reserves decline, 'several' participants flagged using IOER technical adjustments, 'some' advocated slowing the pace of decline in reserves using standard open market operations, or ending portfolio redemptions at relatively high reserves. 'Several' participants were concerned that slowing redemptions "could be misinterpreted as a signal about the stance of monetary policy." 'Some' participants wanted to learn about further options. Our rates strategist Roger Quick doesn't think such tools will have to be called

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upon but the FOMC is conveying to markets that they have more than one trick up their sleeves should pressures mount.

- **There was a discussion about the long-run composition of the SOMA portfolio.** ‘Several’ preferred shortening maturities of Treasuries being held to “provide greater flexibility to lengthen maturity if warranted by an economic downturn” while a couple preferred to match maturities to the outstanding Treasury market.
 - This latter point a) is not signalling imminent change given the emphasis upon the longer run which is the point of a more normalized balance sheet that lies a long way off yet, and b) is not yet being signalled as a majority belief across FOMC participants. Nevertheless, the prospect of a ‘twist’ of sorts to Treasury holdings could not only serve the purpose of being able to ramp up longer term Treasury holdings in the event of a future downside surprise to the economy, but also first serve the purpose of steepening the curve.
 - On managing the MBS portfolio over the longer run, ‘several’ suggested reducing agency MBS holdings “somewhat more quickly than the passive approach” by selling MBS “sometime after the size of the balance sheet had been normalized.”
 - The discussion of long-run implementation frameworks will continue at upcoming meetings.
- The Full minutes are available [here](#). A breakdown of salient points using the Fed’s language that connotes the frequency of opinion across FOMC members is offered below.

All

- none

‘Generally Agreed’ or ‘In General’

“In general, participants agreed that **risks to the outlook appeared roughly balanced.**”

“**Participants generally revised down their individual assessments of the appropriate path for monetary policy and indicated either no material change or only a modest downward revision in their assessment of the economic outlook.**”

“Participants generally **characterized real PCE growth as remaining strong.**”

“Participants generally continued to view recent price developments as consistent with their expectation that inflation would remain near the Committee’s symmetric 2 percent objective on a sustained basis.”

“In their consideration of monetary policy at this meeting, participants generally judged that **the economy was evolving about as anticipated**, with real economic activity rising at a strong rate, labor market conditions continuing to strengthen, and inflation near the Committee’s objective.”

“With regard to the outlook for monetary policy beyond this meeting, participants generally judged that **some further gradual increases in the target range for the federal funds rate would most likely be consistent with a sustained economic expansion, strong labor market conditions, and inflation near 2 percent over the medium term.**”

Nearly All

- none

Almost all

- none

All but one

- none

Majority

- none

Most

“Based on their current assessments, most participants expressed the view that it would be appropriate for the Committee to raise the target range for the federal funds rate 25 basis points at this meeting.”

Many

“Many participants expressed the view that, especially in an environment of muted inflation pressures, **the Committee could afford to be patient about further policy firming.**”

“Many participants observed that, at the national level, most measures of nominal wage growth had risen and were currently at levels that were broadly in line with trends in productivity growth and inflation.”

More than half

- none

Fewer than half

- none

Several

“Several participants expressed the view that **it might be appropriate over upcoming meetings to remove forward guidance entirely and replace it with language emphasizing the data-dependent nature of policy decisions.**”

“Several participants noted that business fixed investment remained solid despite a slowdown in the third quarter, as more recent data pointed to a rebound in investment spending.”

“Several participants observed that labor force participation had been improving for low skilled workers and for prime-age workers.”

“Several participants remarked that longer-term TIPS-based inflation compensation had declined notably since November, concurrent with both falling oil prices and a deterioration in investor risk sentiment.”

“A few participants pointed to the decline in longer-term inflation compensation as an indication that longer-run inflation expectations may have edged lower, while several others cited survey-based measures as suggesting that longer-run expectations likely remained anchored.”

A number

“A number of participants noted that, **before making further changes to the stance of policy, it was important for the Committee to assess factors such as how the risks that had become more pronounced in recent months might unfold and to what extent they would affect economic activity, and the effects of past actions to remove policy accommodation, which were likely still working their way through the economy.**”

Some

“Some participants commented that **these developments may reflect an increased focus among market participants on tail risks** such as a sharp escalation of trade tensions or could be a signal of a significant slowdown in the pace of economic growth in the future.”

“Some noted that downside risks may have increased of late.”

A few

“A few participants noted that the recent declines in energy prices would likely only temporarily weigh on headline inflation.”

“A few participants pointed to the decline in longer-term inflation compensation as an indication that longer-run inflation expectations may have edged lower, while several others cited survey-based measures as suggesting that longer-run expectations likely remained anchored.”

“Although a few participants pointed to anecdotal and survey evidence indicating rising input costs and pass-through of these higher costs to consumer prices, reports from business contacts and surveys in some other Districts suggested some moderation in inflationary pressure.”

“A few participants expressed concern that longer-run inflation expectations would remain low, particularly if economic growth slowed more than expected.”

“A few participants, however, favored no change in the target range at this meeting, judging that the absence of signs of upward inflation pressure afforded the Committee some latitude to wait and see how the data would develop amid the recent rise in financial market volatility and increased uncertainty about the global economic growth outlook.”

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A couple

“A couple of participants commented that the recent decline in oil prices could be a sign of a weakening in global demand that could weigh on capital spending by oil production companies and affect companies providing services to the oil industry.”

“A couple of participants noted that the recent oil price decline could also be associated with increasing oil supply rather than softening global demand.”

“A couple of participants saw scope for further improvements in the labor force participation rate relative to its historical downward trend, while a couple of others judged that there was little scope for significant further improvements.”

“A couple of participants noted that the tightening in financial conditions so far did not appear to be restraining real activity, although a more persistent tightening would undoubtedly weigh on business and household spending.”

“While a couple of participants suggested that tightening resource utilization in conjunction with an increase in the ability of firms to pass through increases in input costs to consumer prices could generate undesirable upward pressure on inflation.”

“A couple of participants pointed to risks to financial stability stemming from high levels of corporate borrowing, especially by riskier firms, and elevated CRE prices.”

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