US Fed minutes reveal divisions but money flow set to continue

Nick Beams
7 July 2021

The minutes of the US Federal Reserve's June 15–16 meeting reveal there were significant differences among the members of its governing body over the direction of monetary policy amid considerable uncertainty over the path of the US economy.

Pointing to what it called a "vigorous debate," the *Financial Times* said the meeting of the Federal Open Market Committee "showed two prevailing camps wrangling over whether the US economy was ready for a speedier reduction of its $120bn asset purchasing program." The debate would take "centre stage" in coming months, it suggested.

The minutes are written in anodyne language, which does not fully capture the extent of the differences, but what happened is clearly evident from the record and what followed.

The differences centred on two key questions: the direction of interest rate policy and at what point the Fed should start winding back its program of monthly asset purchases comprising $80 billion of Treasury bonds and $40 billion of mortgage-backed securities (MBS).

The Fed has said it will start to wind back support for financial markets, initiated in response to the near meltdown in March 2020, when there is "substantial further progress" towards its stated goals of inflation at 2 percent and full employment.

According to the minutes, the committee's standard was "generally seen as not having been met, though participants expected progress to continue."

They went on to note that "various participants mentioned they expected the conditions for beginning to reduce the pace of asset purchases to be met somewhat earlier than they had anticipated at previous meetings in light of incoming data."

However, this assessment was countered by others who urged caution in reading too much into current data and that information in coming months would provide a "better assessment of the path of the labour market and inflation."

However, in a concession to those pushing for a speedier move towards a tighter monetary policy, the minutes noted that "as a matter of prudent planning, it was important to be well-positioned to reduce the pace of asset purchases, if appropriate, in response to unexpected economic developments."

The issues centre on whether present level of inflation, running at 5 percent in the year to May, is "transitory"—as maintained by Fed chair Jerome Powell and others—or whether it will become a permanent feature as a result of government and monetary stimulus—as warned by former Treasury Secretary Lawrence Summers and others.

The minutes recorded that "a few" officials said they expected the economy would be ready for a rise in interest rates sooner than had been previously expected. But there was a pushback against this assessment.

"Several participants emphasised… that uncertainty surrounding the economic outlook was elevated" and this implied "significant uncertainty about the appropriate path for the federal funds rate."

At the meeting 13 of 18 participants revised their projections for interest rates—the so-called "dot plot"—indicating they expected rates to rise in 2023, rather than 2024. Seven expected a rise next year. In March most officials thought rates would remain at their current rate of near zero throughout 2023.

The meeting anticipated that the revision would attract the attention of the financial markets because of the mountain of corporate debt being sustained by the Fed's ultra-loose monetary policies. It noted "it would be important to emphasise that the committee's reaction function or commitment to its monetary policy framework had not changed."

Powell followed this line at his press conference following the meeting, saying the "dot plot" projections were not a statement of future policy and had to be taken with a "large grain of salt."

However, following the meeting, St Louis Fed president James Bullard said interest rates may start to rise in 2022. The Dow fell by 500 points and the S&P 500 had its worst week in four months.

In seeking to counter the effect of Bullard's remarks, Powell told Congress the Fed would not raise rates "pre-emptively" because it considered employment was too high or because of the possible onset of inflation. Price rises were "something we'll go through," he said, but they "should not leave much of a mark on the on-going inflationary process."

The Wall Street fall pointed to what has been characterised as the "debt trap" in which the Fed is caught. In previous times, it would have already started to tighten monetary policy even if only to a small degree.

But such is the extent of the corporate debt that has been created on the basis of its supply of cheap money, stretching back to its response to the global financial crisis of 2008, the Fed is fearful any move in this direction could spark major market turbulence.

The same issue came up in relation to the continued purchases of mortgage-backed securities. These have been blamed for helping to fuel the escalation in US prices, up by more than 13 percent over the course of the past year.

These views were reflected at the meeting. "Several participants saw benefits to reducing the pace of these purchases more quickly… in light of valuation pressures in housing markets," the minutes noted.

However, clearly fearful of how such a move might be interpreted, "several other participants" said the present approach of a commensurate reduction in the purchases of Treasuries and MBS was "preferable." This is because it was aligned with previous communications and "purchases of Treasury securities both provide accommodation through their influence on broader financial conditions."

Wall Street gave the thumbs up to the minutes with two major indexes reaching new record highs. The S&P 500 rose by 0.3 percentage points and the Nasdaq Composite rose marginally, also reaching a new record.

The bond market also indicated that financial investors expect the flow of money to continue. Earlier this year the bond yields had risen on the expectation that the Fed may tighten monetary policy. But yesterday, yields on the benchmark 10-year Treasury bond went to their lowest level since mid-February as a result of bond buying due to concerns that earlier forecasts of economic growth may have been too optimistic. (Yields and bond prices move in opposite directions.)

The general assessment in financial circles is that the flow of money from the Fed and other central banks is going to continue and the Fed minutes, despite the divisions, did not change that.

According to Morgan Stanley, the world's four major central banks in the US, Japan, Britain and Europe will add $13 trillion to their balance sheets through asset purchases by the end of 2022. The Fed is increasing its holdings by $4 trillion on top of the more than $5 trillion it has added since the beginning of 2020.