

# U.S. FOMC Review

- FOMC: tapering on the horizon

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## Minutes from the July FOMC Meeting

The Federal Open Market Committee focused its discussion at the July 27-28 meeting on its asset purchase program. Interestingly, the Committee seemed close to beginning the tapering process. “Most” officials felt that the FOMC’s criterion of “substantial further progress” toward its policy goals had already been met with respect to inflation and that it was close to being satisfied with respect to maximum employment. “Various” policymakers felt that economic and financial conditions would warrant an adjustment in coming months (apparently meaning later this year), although “several others” believed that tapering would most likely be appropriate early next year. Either way, tapering is not far off. Chair Powell has noted on several occasions that the Fed would provide ample notice of an adjustment to the asset purchase program. Notice has effectively been given.

In addition to achieving “substantial further progress” toward its policy goals, the minutes noted several other reasons for slowing the pace of asset purchases. An early start to tapering could allow for a more gradual pace of adjustment, which would mitigate the risk of excessive tightening. Excessive tightening might be a concern to some Fed officials, but the persistence of above-target inflation was noted by others, and an early start to tapering could limit such risks. An early start also would allow for a time lag between the end of asset purchases and the beginning of interest rate hikes. Such a pattern is preferred by most Fed officials because they do not want to create the perception of a link between the two forms of accommodation. Some Fed officials also expressed concern about risks of financial instability from maintaining a highly accommodative stance for an extended period.

In terms of the composition of tapering, several officials felt that MBS purchases should be reduced more quickly than those for Treasury securities because the housing market was strong and did not need support from the Federal Reserve. However, “most” Fed officials felt that MBS purchases were providing overall accommodation similar to that from Treasury securities, and thus both should be ended at the same time. A simultaneous end seems more likely.

The minutes left a distinct impression that officials were open to tapering, but the meeting summary also noted that the Delta variant of Covid created downside risks to the economic outlook and could affect decisions on tapering.

The minutes will most likely increase speculation among market participants about an announcement of plans for tapering at next week’s Jackson Hole conference. To be sure, the likelihood has increased, but we would favor an announcement after the September FOMC meeting. We suspect that officials would like a thorough discussion of the plan for tapering, and that would be best achieved at an FOMC meeting. More important, policymakers would probably like to observe more economic data (especially employment-related statistics) to assess the effect of Covid on the economy.