Fed Officials Divided on When to Begin Balance-Sheet Unwind

By **Craig Torres**
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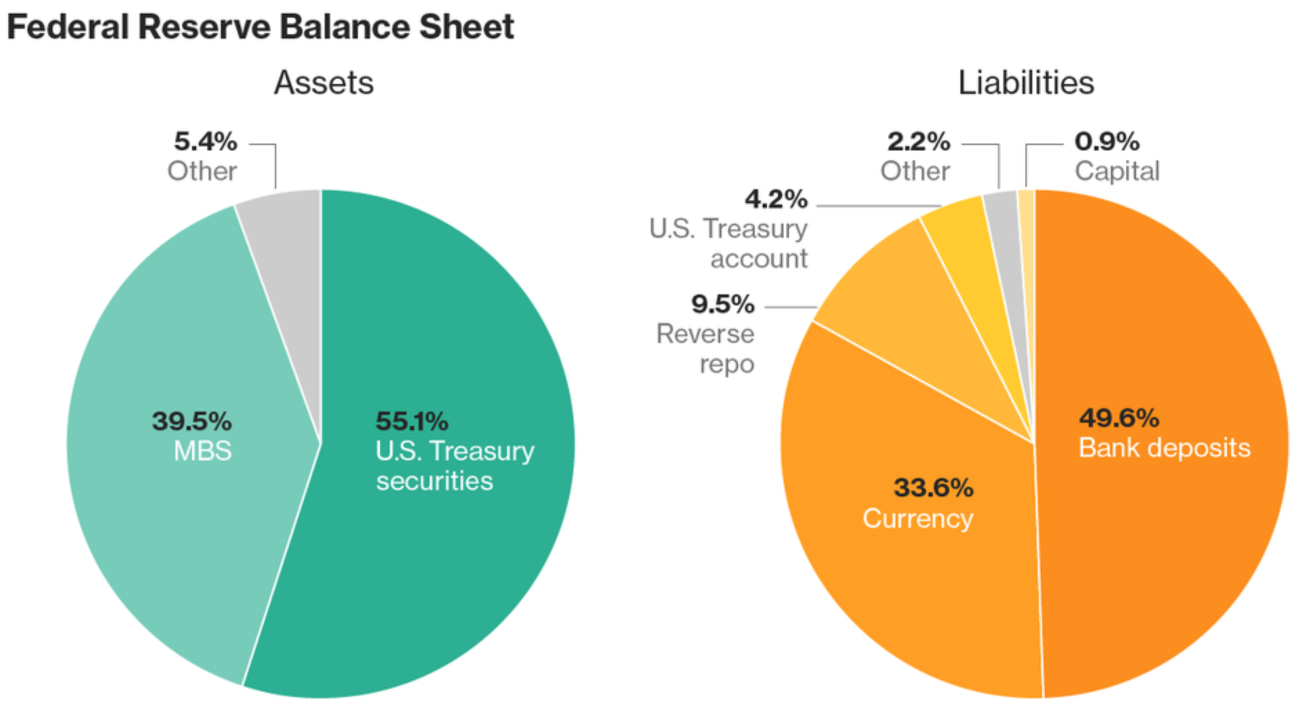
- Policy makers repeated their support for gradual rate hikes
- A few expressed concern about high equity-price valuations

A divided Federal Reserve policy committee couldn't reach an agreement in June on the timing of when to begin shrinking its massive balance sheet, according to minutes of the meeting.

"Several preferred to announce a start to the process within a couple of months," the minutes of the June 13-14 meeting released on Wednesday in Washington showed. "Some others emphasized that deferring the decision until later in the year would permit additional time to assess the outlook for economic activity and inflation."

U.S. central bankers in June raised the benchmark lending rate for a second time this year to a range of 1 percent to 1.25 percent, while describing monetary policy as "accommodative" in their statement. They reiterated their support for continued gradual rate increases, according to the minutes.

Fed officials updated their balance-sheet policy in the gathering, laying out a path of gradual reductions with caps. The central bank wants to start winding down the $4.5 trillion bond portfolio without roiling longer-term interest rates, while gradually raising the policy rate. The minutes indicated that the committee wants to begin the balance-sheet process this year.



Source: Federal Reserve

Bloomberg

The Fed said in June it would runoff maturing principal payments on Treasuries initially at $6 billion per month, increasing by $6 billion every three months over 12 months, until it reaches $30 billion.

For agency and mortgage-backed securities debt, the cap starts at $4 billion, and rises by $4 billion every three months until it hits a $20 billion a month.

Key Metrics

The minutes showed Fed officials split on other key metrics for monetary policy.

The minutes said "several participants endorsed a policy approach" where the labor market would undershoot their estimate of full employment "for a sustained period." Meanwhile, several other participants "expressed concern that a substantial and sustained unemployment undershooting might make the economy more likely to experience financial instability or could lead to a sharp rise in inflation."

Financial conditions were also debated at the meeting, with some participants arguing that "increased risk tolerance" among investors could be lifting asset prices. A few others expressed concern that "subdued market volatility" could lead to financial stability risks.

"A few participants also judged that the case for a policy rate increase at this meeting was strengthened by the easing, by some measures, in overall financial conditions," according to the minutes.

Yellen said last month that asset valuations look "somewhat rich" using traditional metrics like price-earnings ratios.

Political Gridlock

Washington political gridlock is also starting to creep into the outlook of the Fed's business contacts, the minutes showed. "Contacts at some large firms indicated that they had curtailed their capital spending, in part because of uncertainty about changes in fiscal and other government policies," the minutes showed.

Yellen begins her semi-annual testimony to Congress on July 12 before the House Financial Services Committee.

Inflation has remained almost continuously below the central bank's 2 percent target for more than five years. The minutes said "most participants viewed the recent softness" in inflation indicators "as largely reflecting idiosyncratic factors." They added those trends weren't likely to persist in the medium term.

On the other side of the Fed's dual mandate, the jobless rate declined to a 16-year low in May of 4.3 percent, beneath most Fed officials' estimate of the maximum use of labor resources. The U.S. Labor Department releases the June employment report Friday.