November 2, 2017

November FOMC Review

FOMC Review Snapshot
- The FOMC kept the federal funds rate target range at 1.00-1.25%, as expected.
- Inflation remains below the Fed's 2% target, which led the Fed to pause on interest rate hikes since June.
- The Fed's plan to allow its balance sheet to shrink in small increments commenced last month.

Details

The Federal Reserve's Federal Open Market Committee (FOMC) unanimously decided to hold the federal funds rate target at 1.00-1.25%. The Fed sets monetary policy to satisfy its dual mandate to maximize employment and maintain price stability.

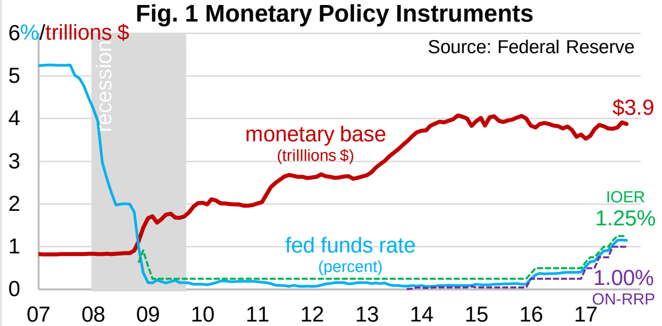

Fig. 1 Monetary Policy Instruments

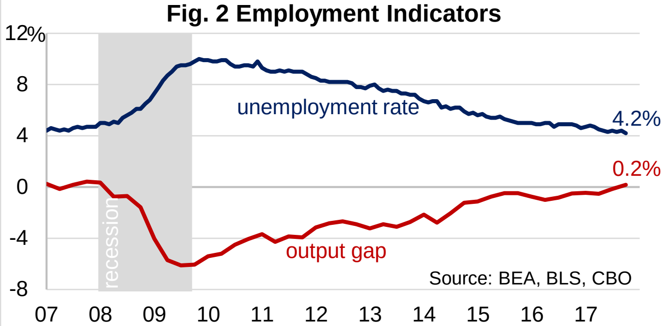

Fig. 2 Employment Indicators

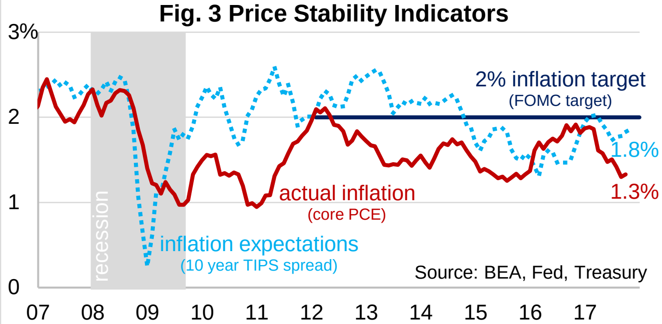

Fig. 3 Price Stability Indicators

The upper bound of the fed funds target is the interest rate the Fed pays on banks' excess reserves (IOER),[1] which at 1.25%, continues to maintain the fed funds rate at historic lows. The lower bound is the overnight reverse repurchase (ON-RRP) rate. The Fed uses the latter to temporarily drain reserves on a rolling basis in order to put upward pressure on the federal funds rate.[2]

Before the 2008-09 recession the fed funds rate target was 5.25% and the monetary base (a large portion of the Fed's balance sheet) was $0.8 trillion (Fig. 1). The Fed's normalization plans include raising its fed funds rate target (which was as low as 0.00-0.25%) and gradually reducing the size of its balance sheet. Details of the program can be found in the "Noteworthy" section of JEC's July FOMC Review. It started raising the fed funds rate target in December 2015 and reducing its balance sheet last month. Nevertheless, the monetary base remains enlarged at $3.9 trillion.

The expected[3] inflation rate continued to trend upward and the actual inflation rate also ticked up in September, which may be a transitory effect from hurricanes Harvey and Irma. However, inflation still remains below the Fed's 2% inflation target (Fig. 3). Although the low unemployment rate (Fig. 2) implies the economy is near or at full employment, persistent below-target inflation and a low employment-to-population ratio suggest the American economy still has significant untapped growth potential.

The next FOMC meeting will be held December 12-13.

The Federal Open Market Committee (FOMC)

The FOMC meets 8 times per year. It consists of the 7 governors from the Fed's Board of Governors in DC (3 seats are currently vacant), and 12 regional Fed bank presidents.

While all Fed governors have a vote on the FOMC, only 5 Fed bank presidents can vote. The NY Fed president is a permanent voting member, and 4 others can vote on a rotating basis.

Minutes of the FOMC meeting are released three weeks later.

Context

The FOMC decided to hold its federal funds interest rate target constant, as measures of inflation remain below the Fed's 2% inflation target. The fed funds futures market anticipates the Fed will raise its federal funds interest rate target by 0.25% at its next meeting in December.

Noteworthy

Earlier in the year Fed Vice Chair Stanley Fischer announced his resignation, although his term would not have expired until June 2018. The previous FOMC meeting in September was his last. The current FOMC meeting was Vice Chair for Supervision Randal Quarles's first after being confirmed by the Senate in early October. Janet Yellen's term as chair expires in February 2018 and the White House is expected to announce its nominee for the next Fed Chairman later today. Pending the Senate's confirmation, the next Fed chair will serve a four-year term starting February 3, 2018. Three governors' positions remain vacant.

Governors of the Federal Reserve System

Randal Quarles [1]	vacant	vacant	Janet Yellen [3]	Lael Brainard	Jerome Powell [4]	vacant
Governor	Governor	Governor	Governor	Governor	Governor	Governor
Jan 31, 2018	Jan 31, 2020	Jan 31, 2022	Jan 31, 2024	Jan 31, 2026	Jan 31, 2028	Jan 31, 2030
VC for Supervision	**Vice Chair** [2]		**Chair**			
Oct 13, 2021			**Feb 3, 2018**			

Positions are ordered by when the term as governor is set to expire. Special positions within the Board are in **bold**. The dates beneath the titles denote when the position's term is set to expire.

[1] Since Randal Quarles's term as governor expires before his term as vice chair of supervision, he must be reappointed and confirmed by the Senate to another vacancy on the Board of Governors.
[2] The vice chair position, which has a term of four years, was vacated by Stanley Fischer in October. The next vice chair, need not hold the same governor's seat that Fischer held.
[3] If Yellen is not reappointed as chair – a position with a four-year term – she can remain a governor until 2024.
[4] Jerome Powell, along with Yellen, John Taylor (Hoover Institution) and Kevin Warsh (Hoover Institution) are candidates for the Fed's chair position.

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[1] In 2008, the Fed began paying banks interest on reserves held at the Fed, both on required reserves (IORR) and excess reserves (IOER). Banks used to hold few excess reserves, choosing instead to lend these funds. If banks wanted more funds they would borrow from other banks at the fed funds rate. Since 2008, however, the Fed has been paying IOER and banks have been holding substantial excess reserves, currently about $2.2 trillion (56% of the monetary base). The other components of the monetary base consist of currency, 40%, and required reserves, 4%.

[2] This is especially for firms such as the government-sponsored enterprises, Fannie Mae and Freddie Mac, which are not eligible for IOER.

[3] The average expected inflation rate is measured by the difference between yields on Treasuries and Treasury Inflation Protected Securities (TIPS).