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Fed Watch

US

12 October 2011
Economic Analysis

US
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FOMC Minutes: October 12

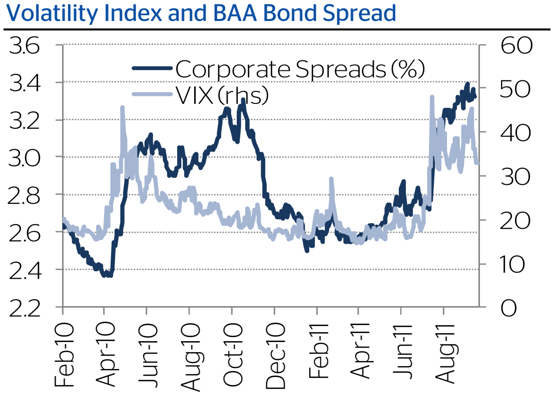
Committee focuses on options and effectiveness

- **Several participants view the transition mechanism as "attenuated"**
- **FOMC considering how best to use more forward policy guidance**
- **Many members think costs of lower IOER outweigh benefits**

Debate over cyclical and structural influences on labor markets continues

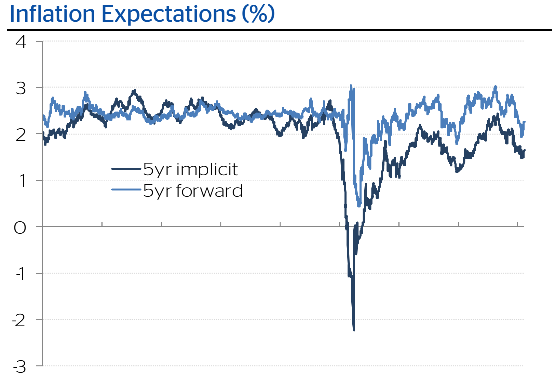
With regard to economic conditions, the FOMC today made clear in the minutes the following trends: the pace of growth in the following quarters will only marginally lower the unemployment rate, risks to growth are significantly to the downside stemming from financial market strains, the economy is vulnerable to new shocks, core and headline inflation will settle at or below the Fed's mandate, and high forecast uncertainty exists. During the course of discussions over the extended two-day session in September, the FOMC came to some tentative conclusions with regard to the operation of monetary policy. First, many FOMC members regarded lowering the rate of interest on excess reserves as too costly a means of providing additional stimulus to the economy due to its disruptive effect on short-term funding markets, although several agreed that it could provide a signal of intentions or further lower interest rates. Second, most participants agreed that the FOMC should use more forward policy guidance in its communications to the public. However, the exact mechanism of this guidance remains to be determined and other FOMC members cautioned about the risk of misperception. With regard to current policy actions, the FOMC continues to debate the effectiveness of further balance sheet actions such as the present maturity extension program. The FOMC is not necessarily more divided on these issues than in previous meetings: the number of members for and against further accommodation has been known since the previous meetings. However, these conversations are becoming more urgent given weakness in confidence as a result of financial market dislocations in August. Tied to this discussion are a few members' sentiments that higher core inflation combined with higher unemployment may be a sign of lower potential growth and higher structural unemployment, conditions which would obfuscate current policy objectives. Additionally, many FOMC members regarded the transmission mechanism of monetary policy as "attenuated" due to housing market distress, a further complication for policy action.

Chart 1
Volatility Index and BAA Bond Spread



Source: BBVA Research and Haver

Chart 2
Inflation Expectations (%)



Source: BBVA Research and Haver