Richmond Fed President Jeffrey M. Lacker Comments on Policy Normalization Principles and Plans
Richmond, Va.

"At the end of its meeting on Wednesday, the Federal Open Market Committee released a statement on policy normalization principles and plans. This statement was the result of the Committee's discussions over recent meetings regarding ways to normalize the stance of monetary policy and the Federal Reserve's securities holdings. I did not support the full statement. Specifically, I did not support plans for the assets on the Fed's balance sheet.

"I support the planned approach to conducting interest rate policy when the time comes to raise rates. This part of the statement describes the tools the Committee will use to influence the federal funds rate and other short-term interest rates. The interest rate paid on excess reserves will be adjusted to move the federal funds rate into the target range established by the Committee. The overnight reverse repurchase facility will be a backstop, used only as necessary, and will be phased out when no longer needed.

"I also support the principle that the Federal Reserve will, in due course, hold no more securities than necessary to implement monetary policy efficiently and effectively, and that it will hold primarily Treasury securities, thereby minimizing the effect of Federal Reserve holdings on the allocation of credit across sectors of the economy.

"I cannot support the Committee's planned approach to moving the Fed's balance sheet toward its normal state, however. In particular, the statement says that the Committee currently does not anticipate selling agency mortgage-backed securities (MBS). I believe this approach unnecessarily prolongs our interference in the allocation of credit. The Fed's MBS holdings may put downward pressure on mortgage rates, compared to holding an equivalent amount of Treasury securities, but if so, then other borrowers would likely face higher interest rates. While this would favor home mortgage borrowers, it tilts the playing field against other borrowing by consumers.

"The desire to avoid such effects is a long-standing principle in the conduct of U.S. monetary policy over the last half-century (Haltom and Sharp 2014) and is articulated in the Committee's Guidelines for the Conduct of System Open Market Operations. On March 23, 2009, the Federal Reserve and the Treasury reaffirmed this principle in a Joint Statement. "Actions taken by the Federal Reserve should also aim to improve financial or credit conditions broadly, not to allocate credit to narrowly-defined sectors or classes of borrowers. Government decisions to influence the allocation of credit are the province of the fiscal authorities."

"I agree with the Joint Statement. Interference in the allocation of credit by altering relative interest rates, and thus tilting the flow of credit toward some sectors and away from others, is an inappropriate use of the central bank’s balance sheet. It is unnecessary to the conduct of
monetary policy, the central bank’s primary responsibility, and involves distributional choices that
should be made through the democratic process and carried out by fiscal authorities, not by an
independent central bank.

"The Fed’s statutory mandate of price stability and maximum employment would be best served,
I believe, by a well-articulated plan to actively reduce our holdings of MBS through sales at a
steady, predictable pace."

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