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Data Insights: FOMC Minutes

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March minutes: key signaling language Featured Important Very important

The System Open Market Account (SOMA) manager first reviewed developments in domestic and global financial markets. Financial markets remained exceptionally volatile amid the global spread of the coronavirus and uncertainty regarding its effects. Since the meeting of the FOMC in late January, the S&P 500 index declined 18 percent, nominal U.S. Treasury yields moved 60 to 100 basis points lower, and market-based measures of inflation compensation fell 75 to 100 basis points. Investment-grade and high-yield credit spreads widened about 120 basis points and 360 basis points, respectively. The U.S. dollar appreciated notably against most currencies, with the exception of other safe-haven currencies, and crude oil prices dropped 40 percent. Against this backdrop, expectations for the path of the federal funds rate adjusted sharply. Implied rates on federal funds futures contracts suggested the Committee was expected to reduce the target range 1 full percentage point at its upcoming scheduled meeting following the 50 basis point reduction in the target range in early March. In addition, market participants reportedly anticipated that the Committee would announce additional purchases of Treasury securities and agency mortgage-backed securities (MBS).

Trading conditions across a range of markets were severely strained. In corporate bond markets, trading activity and liquidity were at very low levels, although not back to the low point reached in 2008. Market participants expected that actions taken to slow the spread of the virus could have significant effects on the credit worthiness of certain borrowers, particularly those at the lower end of the credit spectrum. Market participants also increasingly pointed to concerns in other segments of the debt market. In securitized markets, including those for asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS), primary market issuance slowed, and secondary market trading had become less orderly, with money managers selling short-dated liquid products to meet investor redemptions.

In the Treasury market, following several consecutive days of deteriorating conditions, market participants reported an acute decline in market liquidity. A number of primary dealers found it especially difficult to make markets in off-the-run Treasury securities and reported that this segment of the market had ceased to function effectively. This disruption in intermediation was attributed, in part, to sales of off-the-run Treasury securities and flight-to-quality flows into the most liquid, on-the-run Treasury securities.

Conditions in short-term funding markets also deteriorated sharply amid a decline in market liquidity and challenges in dealer intermediation. Over recent days, the premium paid to obtain dollars through the foreign exchange swap market increased sharply, and the volumes in term repurchase agreement (repo) markets dropped significantly. Issuance of commercial paper (CP) maturing beyond one week reportedly almost dried up at the end of the week before the meeting, and primary- and secondary-market liquidity for financial and nonfinancial CP was described as nearly nonexistent at a time when investor concern about issuer credit risk was rising.

The manager then summarized actions taken by the Desk to address some of the strains in financial markets. …By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. No intervention operations occurred in foreign currencies for the System's account during the intermeeting period.

…The projection for the U.S. economy prepared by the staff for the March FOMC meeting was downgraded significantly from the January meeting forecast in response to news on the spread of the coronavirus at home and abroad and in response to a related substantial markdown of the staff's foreign economic outlook, along with recent financial market movements. Real GDP was forecast to decline and the unemployment rate to rise, on net, in the first half of this year. Given the downside risks and the elevated uncertainty about how much the economy would weaken and how long it would take to recover, the staff provided two plausible economic scenarios that spanned a range of possibilities. Importantly, the future performance of the economy would depend on the evolution of the virus outbreak and the measures undertaken to contain it. In one scenario, economic activity started to rebound in the second half of this year. In a more adverse scenario, the economy entered recession this year, with a recovery much slower to take hold and not materially under way until next year. In both scenarios, inflation was projected to weaken, reflecting both the deterioration in resource utilization and sizable expected declines in consumer energy prices.

…Participants noted that the coronavirus outbreak was harming communities and disrupting economic activity in many countries, including the United States, and that global financial conditions had also been significantly affected. Participants expressed their deep concern for those whose health had been harmed and observed that the matter was, above all, a public health emergency. They commented that the measures—such as social distancing—taken in response to the pandemic, while needed to contain the outbreak, would nevertheless take a toll on U.S. economic activity in the near term.

Participants noted that available economic data showed that the U.S. economy came into this challenging period on a strong footing. Information received since the Committee met in January indicated that the labor market remained strong through February and that economic activity rose at a moderate rate. Job gains had been solid, on average, in recent months, and the unemployment rate had remained low. Although household spending had risen at a moderate pace, business fixed investment and exports had remained weak; furthermore, in recent weeks the energy sector had come under stress due to the sharp drop in oil prices. On a 12-month basis, overall inflation and inflation for items other than food and energy had been running below 2 percent. Survey-based measures of longer-term inflation expectations had been little changed. However, market-based measures of inflation compensation had declined.

All participants viewed the near-term U.S. economic outlook as having deteriorated sharply in recent weeks and as having become profoundly uncertain. Many participants had repeatedly downgraded their outlook of late in response to the rapidly evolving situation. All saw U.S. economic activity as likely to decline in the coming quarter and viewed downside risks to the economic outlook as having increased significantly. Participants noted that the timing of the resumption of growth in the U.S. economy depended on the containment measures put in place, as well as the success of those measures, and on the responses of other policies, including fiscal policy.

With regard to households' behavior, participants noted that, although consumption spending had been a key driver of growth in economic activity through the first two months of this year, the pandemic was starting to impair consumer confidence and to exert an adverse effect on household balance sheets. Participants reported that wide-ranging social-distancing measures were in operation or in prospect in their Districts. These measures—which included temporary closures of some physical locations, such as stores and restaurants, in which consumers purchased goods and services—would have the effect of reducing in-person transactions by households. Online shopping could substitute for some of this activity but was unlikely to replace it fully. The housing market was likely to be disrupted by social distancing, by financial uncertainty—including difficulties that households and businesses would face in meeting mortgage or rental payments—and by volatility in the market for MBS. Participants stressed the major downside risk that the spread of the virus might intensify in those areas of the country currently less affected, thereby sidelining many more U.S. workers and further damping purchases by consumers. Participants expressed concern that households with low incomes had less of a savings buffer with which to meet expenses during the interruption to economic activity. This situation made those households more vulnerable to a downturn in the economy and tended to magnify the reduction in aggregate demand associated with the nation's response to the pandemic.

Participants relayed reports on business sectors already badly hit by the response to the coronavirus outbreak. These sectors included those affected by the cancellation of many events, decisions by firms and households to reduce travel, government-mandated reductions in entry from abroad, and cutbacks on economic activity that required in-person interaction. Firms directly affected included those connected to air travel, cruise lines, hotels, tourism services, sports and recreation, entertainment, hospitality, and restaurants. In the past week, pullbacks in purchases at retail stores, except for emergency buying, had reportedly intensified significantly. In addition, the energy sector had come under stress because of recent large declines in oil prices. Many U.S. businesses had moved to telework arrangements; other businesses, however, could not readily shift to telework status or had limited telework technology. Participants observed that the coronavirus outbreak had inevitably hurt business confidence and that the expected length and severity of the restrictions on economic activity that involved in-person interaction would importantly affect the size of the response of investment spending to the situation. Participants expressed concern about the financial strain that many U.S. firms were under because of the loss of business and the extraordinary turbulence in financial markets. With regard to supply chains, many contacts had reported that some linkages in China had been restored and that they were able to draw on inventory supplies and on alternative supply chains; however, in some areas of the country, the construction industry had reported continuing disruptions to supply chains from China. Participants indicated that disruptions in the European economy and recent restrictions on travel from Europe to the United States would adversely affect the U.S. economy's supply chains; so too, if it eventuated, would a large increase in U.S. worker unavailability because of health reasons. Several participants emphasized concern about the capacity of the health care system in the current situation and welcomed measures taken to prevent the system's overall capacity from being exceeded.

…With regard to the labor market, participants noted that some firms would likely need to cut employment immediately. Other firms, however, were looking for ways to retain employees during the period of reduced economic activity, in order to maintain capacity and be able to ramp up production once the public health crisis abated and demand rebounded. Measures that reportedly helped partially substitute for layoffs included the encouragement by employers of voluntary leaves of absence, non-replacement of departing workers, and increased reliance on the delivery of goods to customers in place of on-site purchases. Participants observed that businesses would be more likely to lay off workers on a major scale if the downturn in economic activity came to be perceived as likely to be protracted. Participants commented that workers most severely affected in the current situation were those who were ill, those with low incomes, those connected to the most hard-hit sectors, and those with irregular or contingent employment. They also noted that many workers had jobs that did not permit working from home.

With regard to inflation, participants noted that it had been running below the Committee's 2 percent longer-run objective before the coronavirus outbreak. They remarked that a stronger dollar, weaker demand, and lower oil prices were factors likely to put downward pressure on inflation in the period ahead and observed that this meant that the return of inflation to the Committee's 2 percent longer-run objective would likely be further delayed. Participants indicated, however, that implementing a more accommodative stance of monetary policy at this meeting could be useful in helping offset these factors over time and in achieving the 2 percent inflation objective over the longer run, by helping prevent circumstances of persistent resource slack or a lasting decline in inflation expectations.

Participants all agreed that the effects of the pandemic would weigh on economic activity in the near term and that the duration of this period of weakness was uncertain. They further concurred that the unpredictable effects of the coronavirus outbreak were a source of major downside risks to the economic outlook. Participants raised several alternative scenarios with regard to the likely behavior of economic activity in the second half of this year. These scenarios differed from one another in the assumed length and severity of disruptions to economic activity. Several participants emphasized that the temporary nature of the shock to economic activity, the fact that the shock arose in the nonfinancial sector, and the healthy state of the U.S. banking system all implied that the current situation was not directly comparable with the previous decade's financial crisis and it need not be followed by negative effects on economic activity as long-lasting as those associated with that crisis. Participants stressed that measures taken in the areas of health care policy and fiscal policy, together with actions by the private sector, would be important in shaping the timing and speed of the U.S. economy's return to normal conditions. Participants agreed that the Federal Reserve's efforts to relieve stress in financial markets would help limit downside near-term outcomes by supporting credit flows to households and businesses, and that a more accommodative monetary policy stance would provide support to economic activity beyond the near term. Among the downside risks to this year's U.S. economic outlook, participants prominently cited the possibility of the virus outbreak becoming more widespread than expected. Such an event could lead to more wide-ranging temporary shutdowns, with adverse implications for the production of goods and services and for aggregate demand.

…In their consideration of monetary policy at this meeting, most participants judged that it would be appropriate to lower the target range for the federal funds rate by 100 basis points, to 0 to 1/4 percent. In discussing the reasons for such a decision, these participants pointed to a likely decline in economic activity in the near term related to the effects of the coronavirus outbreak and the extremely large degree of uncertainty regarding how long and severe such a decline in activity would be. In light of the sharply increased downside risks to the economic outlook posed by the global coronavirus outbreak, these participants noted that risk-management considerations pointed toward a forceful monetary policy response, with the majority favoring a 100 basis point cut that would bring the target range to its effective lower bound (ELB). With regard to monetary policy beyond this meeting, these participants judged that it would be appropriate to maintain the target range for the federal funds rate at 0 to 1/4 percent until policymakers were confident that the economy had weathered recent events and was on track to achieve the Committee's maximum employment and price stability goals.

A few participants preferred a 50 basis point cut at this meeting and noted that such a decision would provide support to economic activity in the face of the anticipated effects of the coronavirus. These participants preferred to wait until there was greater assurance that the transmission mechanism of monetary policy via financial markets and the supply of credit to households and businesses was working effectively. This would allow fiscal and public health policy responses to the coronavirus outbreak to take hold and preserve the ability of the Committee to lower the target range, which was close to the ELB, in the event of a further deterioration in the economic outlook. In addition, these participants noted that a lowering of the target range by 100 basis points, coming so soon after the reduction of 50 basis points less than two weeks earlier, ran the risk of sending an overly negative signal about the economic outlook.

Participants also considered open market operations to purchase Treasury securities and agency MBS to support the smooth functioning of these securities markets, which in turn would help support the supply of credit to households and businesses. Participants generally agreed that, over the coming months, it would be appropriate to increase the Federal Reserve's holdings of Treasury securities by at least $500 billion and its holdings of agency MBS by at least $200 billion. Additionally, all principal payments from the Federal Reserve's holdings of agency debt and agency MBS would be reinvested in agency MBS. Those Treasury and agency MBS purchases would be in addition to the recently expanded overnight and term repo operations conducted by the Desk. Participants stressed that it was important to communicate that the Committee would be prepared to increase the size of the securities purchases, as needed, on the basis of its close monitoring of market conditions. Some participants noted that it was important to stress in communications that the primary purpose of these asset purchases was to support the smooth functioning of Treasury and agency MBS markets rather than to provide further monetary policy accommodation by pushing down longer-term yields. A couple of participants noted that because some of the purchases would be at longer maturities, the purchases could provide some accommodation by lowering longer-term yields.

Participants discussed some of the possible communications challenges associated with the Committee's policy decisions at this meeting. Several participants noted that it would be important to communicate clearly and consistently about the rationale for the policy decisions taken at this meeting. Some participants remarked that the Committee's policy actions regarding the target range and balance sheet could be interpreted as conveying negative news about the economic outlook. A few participants also remarked that lowering the target range to the ELB could increase the likelihood that some market interest rates would turn negative, or foster investor expectations of negative policy rates. Such expectations would run counter to participants' previously expressed views that they would prefer to use other monetary policy tools to provide further accommodation at the ELB. Additionally, several participants remarked that the public might view the ability of the Committee to provide further monetary policy accommodation as being limited. However, some participants noted that the Committee would still be able to provide monetary policy accommodation even after lowering the target range for the federal funds rate to the ELB. In particular, new forward guidance or balance sheet measures could be introduced.

Participants also indicated strong support for related actions taken by the Board of Governors to support the credit needs of households and businesses: to lower the primary credit rate by 150 basis points to 1/4 percent and to allow depository institutions to borrow from the discount window for periods as long as 90 days in order to encourage more active use of the discount window on the part of depository institutions to meet unexpected funding needs to encourage depository institutions to utilize intraday credit to support the provision of liquidity to households and businesses and the smooth functioning of payment systems to encourage banks to use their capital and liquidity buffers as they provide loans to households and businesses affected by the coronavirus and undertake other supportive actions in a safe and sound manner to reduce reserve requirements to 0 percent in light of the shift to an ample-reserves regime and to support lending to households and businesses by depository institutions

Participants also indicated support for enhancing, in coordination with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank, the provision of liquidity via the standing U.S. dollar liquidity swap line arrangements. The pricing on the standing U.S. dollar swap arrangements would be lowered by 25 basis points so that the new rate would be the U.S. dollar OIS rate plus 25 basis points, and U.S. dollars would be offered by foreign central banks with an 84-day maturity, in addition to the 1-week maturity operations. Following this discussion, the Chair indicated that these changes to the standing U.S. dollar liquidity swap line arrangements would be implemented consistent with the procedures described in the Authorization for Foreign Currency Operations.

Participants generally commented that these additional measures would be helpful in supporting the flow of credit to households and businesses. A few participants commented that stigma associated with the discount window may still be present or that further action, such as a relaunch of the Term Auction Facility, might be needed to encourage banks to take up additional funding. A few other participants noted that discount window stigma should be less of a concern than it was previously. In particular, these participants cited the lowering of the primary credit rate to the top of the target range for the federal funds rate, offering term funding for up to 90 days, and regulators encouraging banks to use the discount window to continue prudently lending to households and businesses. Several participants commented that banks should be discouraged from repurchasing shares from, or paying dividends to, their equity holders in the wake of the proposed measures. Participants generally noted that other measures to support the flow of credit to households and businesses, including those that relied on section 13(3) of the Federal Reserve Act, might be needed in such an uncertain and rapidly evolving environment and that it would be prudent for the Federal Reserve to develop and remain prepared to implement such measures.

…Members judged that the effects of the coronavirus would weigh on economic activity in the near term and would pose risks to the economic outlook. In light of these developments, almost all members agreed to lower the target range for the federal funds rate to 0 to 1/4 percent. These members expected that the target range would be maintained at this level until they were confident that the economy had weathered recent events and was on track to achieve the Committee's maximum employment and price stability goals. One member preferred to lower the target range by 50 basis points, to 1/2 to 3/4 percent, at this meeting, in support of the actions taken to promote smooth market functioning and the flow of credit to households and businesses and in light of the anticipated effects of the coronavirus on economic activity and the economic outlook. In this participant's view, a 50 basis point cut would preserve space for further cuts in the target range that could be implemented when market conditions had improved enough to ensure that the monetary policy transmission mechanism was functioning.

…Voting for this action: Jerome H. Powell, John C. Williams, Michelle W. Bowman, Lael Brainard, Richard H. Clarida, Patrick Harker, Robert S. Kaplan, Neel Kashkari, and Randal K. Quarles.

Voting against this action: Loretta J. Mester

President Mester was fully supportive of all of the actions taken to promote the smooth functioning of markets and the flow of credit to households and businesses but voted against the FOMC action because she preferred to reduce the target range for the federal funds rate to 1/2 to 3/4 percent at this meeting.

Videoconference meeting of March 2

…FOMC participants discussed the significant outbreaks of the coronavirus that had emerged recently in a few countries outside China and the likelihood that the virus would spread widely around the world, including in the United States. While the economic outlook at the time of the Committee's January meeting had been favorable, the potential spread of the virus and the measures needed to protect communities from it represented a material downside risk to the U.S. economy. A forceful monetary policy action could provide a clear signal to the public that policymakers recognized the potential economic significance of the situation and were willing to move decisively to support the achievement of the Committee's dual mandate goals and counter the recent tightening of financial conditions. Although a reduction in the policy rate would not slow the spread of infection or remedy broken supply chains, it could help shore up the confidence of households, businesses, and financial markets; ease financial strains of consumers and firms; and provide meaningful support to the economy in the face of a large shock to demand. Accordingly, participants supported a reduction of 50 basis points in the target range for the federal funds rate.

Source: Federal Reserve Board