Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

Data Insights: FOMC Minutes

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April minutes: key signaling language Featured Important Very important

…the Chair noted that he intended to offer the following remarks at the end of the postmeeting press conference. All participants supported the statement affirming the Federal Reserve's core values and its commitment to do everything it can to foster racial equality as well as diversity and inclusion both within the Federal Reserve System and in society more broadly.

…Participants discussed tools for conducting monetary policy when the federal funds rate is at its effective lower bound (ELB). The discussion addressed two topics: (1) the roles of forward guidance and large-scale asset purchase programs in supporting the attainment of the Committee's maximum-employment and price-stability goals and (2) in light of the foreign and historical experience with approaches that cap or target interest rates along the yield curve, whether such approaches could be used to support forward guidance and complement asset purchase programs. The staff briefing on the first topic focused on outcome-based forward guidance for the federal funds rate—which ties changes in the target range for the federal funds rate to the achievement of specified macroeconomic outcomes, such as reaching a given level of the unemployment rate or inflation—and asset purchase programs of the kind used during and following the previous recession. The staff presented results from model simulations that suggested that forward guidance and large-scale asset purchases can help support the labor market recovery and the return of inflation to the Committee's symmetric 2 percent inflation goal. The simulations suggested that the Committee would have to maintain highly accommodative financial conditions for many years to quicken meaningfully the recovery from the current severe downturn. The briefing addressed factors that might alter the potency of forward guidance and asset purchase programs, along with a number of considerations for the design of these actions. The staff cautioned that businesses and households might not be as forward looking as assumed in the model simulations, which could reduce the

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effectiveness of policies that are predicated on influencing expectations about the path of policy several years into the future. Alternatively, prompt and forceful policy actions by the Committee might help focus the public's expectations around better outcomes or reduce perceived risks of worst-case scenarios, which could generate more immediate macroeconomic benefits than those featured in the staff analysis.

The second staff briefing reviewed the yield caps or targets (YCT) policies that the Federal Reserve followed during and after World War II and that the Bank of Japan and the Reserve Bank of Australia are currently employing. These three experiences illustrated different types of YCT policies: During World War II, the Federal Reserve capped yields across the curve to keep Treasury borrowing costs low and stable; since 2016, the Bank of Japan has targeted the 10-year yield to continue to provide accommodation while limiting the potential for an excessive flattening of the yield curve; and, since March 2020, the Reserve Bank of Australia has targeted the three-year yield, a target that is intended to reinforce the bank's forward guidance for its policy rate and to influence funding rates across much of the Australian economy. The staff noted that these three experiences suggested that credible YCT policies can control government bond yields, pass through to private rates, and, in the absence of exit considerations, may not require large central bank purchases of government debt. But the staff also highlighted the potential for YCT policies to require the central bank to purchase very sizable amounts of government debt under certain circumstances—a potential that was realized in the U.S. experience in the 1940s—and the possibility that, under YCT policies, monetary policy goals might come in conflict with public debt management goals, which could pose risks to the independence of the central bank.

In their discussion of forward guidance and large-scale asset purchases, participants agreed that the Committee has had extensive experience with these tools, that they were effective in the wake of the previous recession, that they have become key parts of the monetary policy toolkit, and that, as a result, they have important roles to play in supporting the attainment of the Committee's maximum-employment and price-stability goals. Various participants noted that the economy is likely to need support from highly accommodative monetary policy for some time and that it will be important in coming months for the Committee to provide greater clarity regarding the likely path of the federal funds rate and asset purchases. Participants generally

indicated support for outcome-based forward guidance. A number of participants spoke favorably of forward guidance tied to inflation outcomes that could possibly entail a modest temporary overshooting of the Committee's longer-run inflation goal but where inflation fluctuations would be centered on 2 percent over time. They saw this form of forward guidance as helping reinforce the credibility of the Committee's symmetric 2 percent inflation objective and potentially preventing a premature withdrawal of monetary policy accommodation. A couple of participants signaled a preference for forward guidance tied to the unemployment rate, noting that it would be more credible to focus on labor market outcomes that have been achieved in the recent past or that—given how high the unemployment rate currently is—such guidance would clearly signal a high degree of accommodation for an extended period. A few others suggested that calendar-based guidance—which specifies a date beyond which accommodation could start to be reduced—might be at least as effective as outcome-based guidance. They noted that calendar-based guidance had been very effective when the Committee used it in 2011 and 2012 or that it would be very challenging to provide credible outcome-based guidance in light of the substantial uncertainty surrounding the current economic outlook. Regardless of the specific form of forward guidance, a couple of participants expressed the concern that policies that effectively committed the Committee to maintaining very low interest rates for a long time could ultimately pose significant risks to financial stability.

Participants agreed that asset purchase programs can promote accommodative financial conditions by putting downward pressure on term premiums and longer-term yields. Several participants remarked that declines in the neutral rate of interest and in term premiums over the past decade and prevailing low levels of longer-term yields would likely act as constraints on the effectiveness of asset purchases in the current environment and noted that these constraints were not as acute when the Committee implemented such programs in the wake of the Global Financial Crisis. These participants noted, however, that large-scale asset purchases could still be beneficial under current circumstances by offsetting potential upward pressures on longer-term yields or by helping reinforce the Committee's commitment to maintaining highly accommodative financial conditions. A few participants questioned the desirability of large-scale asset purchases following the current purchases to support market

functioning, noting that they likely would lead to a further considerable expansion of the Federal Reserve's balance sheet or have potentially adverse implications for financial stability.

In their discussion of the foreign and historical experience with YCT policies and the potential role for such policies in the United States, nearly all participants indicated that they had many questions regarding the costs and benefits of such an approach. Among the three episodes discussed in the staff presentation, participants generally saw the Australian experience as most relevant for current circumstances in the United States. Nonetheless, many participants remarked that, as long as the Committee's forward guidance remained credible on its own, it was not clear that there would be a need for the Committee to reinforce its forward guidance with the adoption of a YCT policy. In addition, participants raised a number of concerns related to the implementation of YCT policies, including how to maintain control of the size and composition of the Federal Reserve's balance sheet, particularly as the time to exit from such policies nears; how to combine YCT policies—which at least in the Australian case incorporate aspects of date-based forward guidance—with the types of outcome-based forward guidance that many participants favored; how to mitigate the risks that YCT policies pose to central bank independence; and how to assess the effects of these policies on financial market functioning and the size and composition of private-sector balance sheets. A number of participants commented on additional challenges associated with YCT policies focused on the longer portion of the yield curve, including how these policies might interact with large-scale asset purchase programs and the extent of additional accommodation they would provide in the current environment of very low interest rates. Some of these participants also noted that longer-term yields are importantly influenced by factors such as longer-run inflation expectations and the longer-run neutral real interest rate and that changes in these factors or difficulties in estimating them could result in the central bank inadvertently setting yield caps or targets at inappropriate levels. A couple of participants remarked that an appropriately designed YCT policy that focused on the short-to-medium part of the yield curve could serve as a powerful commitment device for the Committee. These participants noted that, even if market participants currently expect the federal funds rate to remain at its ELB through the medium term, the introduction of an effective YCT policy could help prevent those expectations from

changing prematurely—as happened during the previous recovery—or that the size of a large-scale asset purchase program, which also poses risks to central bank independence, could be reduced by an effective YCT policy. All participants agreed that it would be useful for the staff to conduct further analysis of the design and implementation of YCT policies as well as of their likely economic and financial effects.

…The projection for the U.S. economy prepared by the staff for the June FOMC meeting was downgraded, on balance, as compared with the April meeting forecast in response to information on the spread of the coronavirus and changes in the measures undertaken to contain it both at home and abroad, along with incoming economic data. U.S. real GDP was forecast to show a historically large decline in the second quarter of this year, and the unemployment rate was expected to be sharply higher than in the first quarter. The substantial fiscal policy measures and appreciable support from monetary policy, along with the Federal Reserve's liquidity and lending facilities, were expected to help mitigate the deterioration in current economic conditions and to help boost the recovery.

The staff continued to judge that the future performance of the economy would depend importantly on the evolution of the coronavirus outbreak and the measures undertaken to contain it. Under the staff's baseline assumptions that the current restrictions on social interactions and business operations would continue to ease gradually this year, real GDP was forecast to rise appreciably and the unemployment rate to decline considerably in the second half of the year, al-though a complete recovery was not expected by year-end. Inflation was projected to weaken this year, reflecting both the deterioration in resource utilization and sizable expected declines in consumer energy prices. Under the baseline assumptions, economic conditions were projected to continue to improve, and inflation to pick back up, over the next two years.

The staff still observed that the uncertainty related to the economic effects of the coronavirus pandemic was extremely elevated and that the historical behavior of the U.S. economy in response to past economic shocks provided limited guidance for making judgments about how the economy might evolve in the future. In light of the significant uncertainty and downside risks associated with the pandemic, including

how much the economy would weaken and how long it would take to recover, the staff judged that a more pessimistic projection was no less plausible than the baseline forecast. In this scenario, a second wave of the coronavirus outbreak, with another round of strict limitations on social interactions and business operations, was assumed to begin later this year, leading to a decrease in real GDP, a jump in the unemployment rate, and renewed downward pressure on inflation next year. Compared with the baseline, the disruption to economic activity was more severe and protracted in this scenario, with real GDP and inflation lower and the unemployment rate higher by the end of the medium-term projection.

…In conjunction with this FOMC meeting, participants submitted their projections of the most likely outcomes for real GDP growth, the unemployment rate, and inflation for each year from 2020 through 2022 and over the longer run, based on their individual assessments of appropriate monetary policy—including the path for the federal funds rate. The longer-run projections represented each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. These projections are described in the Summary of Economic Projections, which is an addendum to these minutes.

Participants noted that the coronavirus outbreak was causing tremendous human and economic hardship across the United States and around the world. The virus and the measures taken to protect public health induced sharp declines in economic activity and a surge in job losses. Weaker demand and significantly lower oil prices were holding down consumer price inflation. Financial conditions had improved, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

Participants agreed that lowering the federal funds rate to its ELB had established more accommodative financial conditions and that the Federal Reserve's ongoing purchases of sizable quantities of Treasury securities and agency MBS had helped restore smooth market functioning to support the economy and the flow of credit to U.S. households and businesses. The fiscal response to economic developments had been large and timely and was providing much needed support for economic activity. Credit flows and economic activity were also being supported by the lending facilities

established under the authority of section 13(3) of the Federal Reserve Act with the approval of the Secretary of the Treasury.

Participants judged that the effects of the coronavirus outbreak and the ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term and would pose considerable risks to the economic outlook over the medium term. Participants agreed that the data for the second quarter would likely show the largest decline in economic activity in post–World War II history. Based in part on information from their Districts, participants observed that the burdens of the present crisis were not falling equally on all Americans and noted that the rise in joblessness was especially severe for lower-wage workers, women, African Americans, and Hispanics. Participants agreed that recently enacted fiscal policy programs had been delivering valuable direct financial aid to households, businesses, and communities, as well as providing relief to disadvantaged groups.

Regarding household spending, participants pointed to information from District contacts, to surveys of consumer behavior, and to high-frequency indicators—such as credit card transactions, automated teller machine visits, and cellphone data tracking—as suggesting that consumer expenditures may be stabilizing or rebounding modestly. Limited available sources of standard economic data, such as retail purchases and motor vehicle sales, also seemed in line with this impression. With supportive monetary policy and payments to households under the CARES Act (Coronavirus Aid, Relief, and Economic Security Act), including enhanced unemployment insurance payments, participants expected personal consumption expenditures to grow strongly in the second half of the year, albeit from very low levels. However, the recovery in consumer spending was not expected to be particularly rapid beyond this year, with voluntary social distancing, precautionary saving, and lower levels of employment and income restraining the pace of expansion over the medium term.

Participants noted that levels of uncertainty and risks perceived by businesses remained high and that these factors continued to contribute to restraints on capital expenditures, despite easing in financing conditions stemming in part from recent policy measures. Some business contacts pointed to halting improvements in consumer demand, a dearth in public infrastructure projects due to strained state and

local government budget conditions, or the decline in energy prices as factors likely to depress business spending. Some participants also noted reports of firms stating that they have had some challenges in rehiring employees, in part related to temporary enhanced unemployment insurance benefits. Participants generally agreed that practices and developments in public health to address the pandemic would be critical for ensuring a strong and lasting reopening of businesses and reducing the likelihood of an outsized wave of closures, but monetary policy and, especially, fiscal policy would play important roles. Nevertheless, participants concluded that voluntary social distancing and structural shifts stemming from the pandemic would likely mean that some proportion of businesses would close permanently. Noting ongoing changes in the composition of production and the processes by which production takes place, participants suggested that some business adaptations were likely to endure long after the coronavirus subsides, resulting in notable dislocation and sectoral reallocation of firms and workers across industries.

Participants noted that conditions in the energy sector remained difficult amid still-low oil prices. Several participants anticipated continued low drilling activity, at least until excess inventories were reduced later this year, and expressed concern that a wave of bankruptcies in the energy sector could be forthcoming. In addition, the agricultural sector continued to be under stress due to low prices for some farm commodities, reduced ethanol production, and pandemic-related limitations on production for some food processing plants.

With regard to the labor market, participants remarked on the surprisingly positive news from the labor market report for May but emphasized that nearly 20 million jobs had been lost, on net, since February. Participants noted that because of misclassification errors in the Current Population Survey, the official unemployment rate for May likely understated the extent of unemployment; others observed that government reliance on unemployment insurance as a vehicle for income support under the CARES Act complicates the interpretation of the data. Participants also noted that unemployment insurance claims continued to run at a historically elevated level, but the proportion of laid-off workers who expected to be recalled was unusually large. Taken together, the data suggested that April could turn out to be the trough of the recession, but participants agreed that it was too early to draw any firm conclusions.

Prospects for further substantial improvement in the labor market were seen as depending on a sustained reopening of the economy, which in turn depended in large part on the efficacy of health measures taken to limit the effects of the coronavirus. On this issue, participants judged there to be a great deal of uncertainty and expressed concerns about the possibility that an early reopening would contribute to a significant increase of infections. Participants also regarded highly accommodative monetary policy and sustained support from fiscal policy as likely to be needed to facilitate a durable recovery in labor market conditions. Overall, participants expected that a full recovery in employment would take some time.

With regard to inflation, participants reiterated their view that the negative effect from the pandemic on aggregate demand was likely to more than offset any upward pressure from supply constraints so that the overall effect of the outbreak on prices was seen as disinflationary. Consistent with that interpretation, participants observed the recent negative readings on the monthly CPI and noted that they anticipated that the 12-month PCE inflation measure would likely run well below the Committee's 2 percent objective for some time. Observing that inflation had been running somewhat below the Committee's 2 percent longer-run objective before the coronavirus outbreak, some participants noted a risk that long-term inflation expectations might deteriorate. Participants noted that a highly accommodative stance of monetary policy would likely be needed for some time to achieve the 2 percent inflation objective over the longer run.

Participants commented that there remained an extraordinary amount of uncertainty and considerable risks to the economic outlook. Participants shared views on possible outcomes for the reopening of the economy, the prospects for effective voluntary social distancing, and the efficacy of public health initiatives for their implications for economic activity and employment. A number of participants judged that there was a substantial likelihood of additional waves of outbreaks, which, in some scenarios, could result in further economic disruptions and possibly a protracted period of reduced economic activity. Other possibilities included economic activity that might recover more quickly if sizable, widespread outbreaks could be avoided even as households and businesses relax or modify social-distancing behaviors. Among the other sources of risk noted by participants were that fiscal support for households, businesses, and state and local governments might prove to be insufficient and that

foreign economies could come under greater pressure than anticipated as a result of the spread of the pandemic abroad. Participants stressed that measures taken in the areas of health-care policy and fiscal policy, together with actions by households and businesses, would shape the prospects for a prompt and timely return of the U.S. economy to more normal conditions. In addition, participants agreed that recent actions taken by the Federal Reserve had helped reduce risks to the economic outlook.

As part of their discussions of longer-run risks, participants noted that in some adverse scenarios, more business closures would occur, and workers would experience longer spells of unemployment that could lead to a loss of skills that could impair their employment prospects. In addition, to the extent that transmission-mitigation procedures adopted by firms reduced their productivity, or if the reallocation of industry output resulted in a lasting reduction in business investment, the longer-run level of potential output could be reduced.

…Participants also agreed that, to support the flow of credit to households and businesses, over coming months it would be appropriate for the Federal Reserve to increase its holdings of Treasury securities and agency MBS and agency CMBS at least at the current pace to sustain smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions. In addition, the Desk would continue to offer large-scale overnight and term repo operations. Participants noted that it would be important to continue to monitor developments closely and that the Committee would be prepared to adjust its plans as appropriate.

Participants also commented that the lending facilities established by the Federal Reserve under the authority of section 13(3) of the Federal Reserve Act were supporting financial market functioning and the flow of credit to households, businesses of all sizes, and state and local governments. Several participants commented further that it would be important for the Federal Reserve to remain ready to adjust these emergency lending facilities as appropriate based on its monitoring of financial market functioning and credit conditions.

Participants agreed that the current stance of monetary policy remained appropriate, but many noted that the Committee could, at upcoming meetings, further clarify its

intentions with respect to its future monetary policy decisions as the economic outlook becomes clearer. In particular, most participants commented that the Committee should communicate a more explicit form of forward guidance for the path of the federal funds rate and provide more clarity regarding purchases of Treasury securities and agency MBS as more information about the trajectory of the economy becomes available. A number of participants judged that it was important for forward guidance and asset purchases to be structured in a way that provides the accommodation necessary to support rapid economic recovery and fosters a durable return of inflation and inflation expectations to levels consistent with the Committee's symmetric 2 percent objective. Many participants remarked that the completion of the monetary policy framework review, together with the announcement of the conclusions arising from the review and the release of a revised Committee statement on its goals and policy strategy, would help clarify further how the Committee intends to conduct monetary policy going forward.

Source: Federal Reserve Board