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Data Insights: FOMC Minutes

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July minutes: key signaling language Featured Important Very important

Participants continued their discussion related to the ongoing review of the Federal Reserve's monetary policy strategy, tools, and communication practices. At this meeting, they discussed potential changes to the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy. Participants agreed that, in light of fundamental changes in the economy over the past decade—including generally lower levels of interest rates and persistent disinflationary pressures in the United States and abroad—and given what has been learned during the monetary policy framework review, refining the statement could be helpful in increasing the transparency and accountability of monetary policy. Such refinements could also facilitate well-informed decisionmaking by households and businesses, and, as a result, better position the Committee to meet its maximum-employment and price-stability objectives. Participants noted that the Statement on Longer-Run Goals and Monetary Policy Strategy serves as the foundation for the Committee's policy actions and that it would be important to finalize all changes to the statement in the near future.

…The staff provided an update on its assessment of the stability of the financial system, and, on balance, characterized the financial vulnerabilities of the U.S. financial system as notable, while noting an unusually high level of uncertainty associated with this assessment. The staff judged that asset valuation pressures were notable. In particular, high-yield and investment-grade corporate bond spreads were within historical norms, and commercial real estate prices were continuing to increase despite rising vacancy rates. The staff assessed vulnerabilities due to nonfinancial leverage to have risen from moderate to notable, reflecting declines in household incomes and business profits; such declines implied less resilient borrowers. The expected sharp decline in second-quarter real GDP would likely result in a rise in the ratio of household debt to nominal GDP. The ratio of business debt to nominal GDP rose in the first quarter from levels that were already historically high—amid declining profits and deteriorating credit quality—although low interest rates had helped ease firms' debt servicing burdens. The staff assessed vulnerabilities arising from financial leverage to have increased from low to moderate, citing uncertainty about losses connected to business loans for banks and a higher weight on vulnerabilities connected to leverage at nonbank financial institutions. Vulnerabilities associated with maturity and liquidity transformation were characterized as moderate, and the staff noted that Federal Reserve facilities reduced these vulnerabilities at nonbanks.

…Participants noted that the coronavirus pandemic was causing tremendous human and economic hardship across the United States and around the world. Following sharp declines, economic activity and employment had picked up somewhat in recent months but remained well below levels at the beginning of the year. Weaker demand and significantly lower oil prices were holding down consumer price inflation. Overall financial conditions had improved in recent months, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses. Participants agreed that the path of the economy would depend on the course of the virus, which was seen as highly uncertain.

Participants noted that the rebound in consumer spending from its trough in April had been particularly strong. Resumption in economic activity, as well as payments to households under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, had supported household income and consumer expenditures. Participants observed that with this rebound, household spending likely had recovered about half of its previous decline. Consumers' purchases of goods—including motor vehicles, other durables, and especially goods sold online—had bounced back much more than their purchases of services, such as air travel, hotel accommodations, and restaurant meals, which were disrupted significantly by social distancing and other effects of the virus. With regard to the behavior of household spending in recent weeks, participants pointed to information from District contacts and high-frequency indicators (such as credit and debit card transactions and mobility indicators based on cellphone location tracking) as suggesting that increases in some consumer expenditures had likely slowed in reaction to the further spread of the virus. Participants noted that households' spending on discretionary services—such as leisure, travel, and hospitality—would likely be subdued for some time and thus would be a factor restraining the pace of recovery.

In contrast to the sizable rebound in consumer spending, participants saw less improvement in the business sector in recent months, and they noted that their District business contacts continued to report extraordinarily high levels of uncertainty and risks. Several participants relayed examples of some operational difficulties their business contacts were reportedly facing in the current environment. These difficulties included managing disruptions in supply chains, challenges associated with closure and reopening, and elevated employee absenteeism in some cases. Furthermore, some participants noted that small businesses were under significant strain. Also, further near-term fiscal support was uncertain. Participants noted that, in light of conditions in the business sector, business investment spending continued to be subdued. Participants generally agreed that actions of consumers and businesses in taking steps to slow the spread of the virus, along with developments in public health, would be critical in ensuring a durable reopening of businesses. In addition, monetary policy and particularly fiscal policy would also play important roles in supporting business activity.

Several participants also commented on ongoing challenges facing the energy or farm sector despite recent improvements. In the energy sector, these challenges included still-low oil demand, excess inventories, and low oil prices, while in the farm sector they included low prices of some farm commodities, pandemic-related disruptions in some food processing plants, and a significant decline in demand for ethanol.

Regarding the labor market, many participants commented that the pace of employment gains, which was quite strong in May and June, had likely slowed. The increasing number of virus cases in many parts of the country had led to delays in some business reopenings and to some reclosures as well. The pace of declines in initial unemployment insurance claims had slowed in recent weeks, and claims remained at an elevated level. In addition, participants emphasized that the labor market was a long way from a full recovery even after the positive May and June employment reports; these reports indicated that, through June, only about one-third of the roughly 22 million loss in jobs that occurred over March and April had been offset by subsequent gains. Participants generally agreed that prospects for further substantial improvement in the labor market would depend on a broad and sustained reopening of businesses. In turn, such a reopening would depend in large part on the efficacy of health measures taken to limit the spread of the virus.

Participants also discussed the nature of the current situation in the labor market. They noted that the downturn in employment was concentrated among lower-wage and service-sector workers, many of whom were employed in industries most adversely affected by social-distancing measures. And with lower-wage and service-sector jobs disproportionately held by African Americans, Hispanics, and women, these portions of the population were bearing a disproportionate share of the economic hardship caused by the pandemic. Participants noted that the fiscal support initiated in the spring through the CARES Act had been very important in granting some financial relief to millions of families. A number of participants observed that, with some provisions of the CARES Act set to expire shortly against the backdrop of a still-weak labor market, additional fiscal aid would likely be important for supporting vulnerable families, and thus the economy more broadly, in the period ahead.

In their comments about inflation, participants generally judged that the negative effect of the pandemic on aggregate demand was more than offsetting upward pressures on some prices stemming from supply constraints or from higher demand for certain products, so that the overall effect of the pandemic on prices was seen as disinflationary. Recent low monthly readings of PCE prices suggested that the 12-month change measure of PCE price inflation would likely continue to run well below the Committee's 2 percent objective for some time. Against this backdrop, a few participants noted a risk that longer-term inflation expectations might move below levels consistent with the Committee's symmetric 2 percent objective. Participants also noted that a highly accommodative stance of monetary policy would likely be needed for some time to support aggregate demand and achieve 2 percent inflation over the longer run.

Participants observed that many measures of financial market functioning were indicating that improvements achieved since the extreme turbulence in March had been sustained. Actions by the Federal Reserve, including emergency lending facilities established with approval of (and, in many cases, financial support from) the Treasury, had helped ease the strains in some financial markets seen earlier in the year and were supporting the flow of credit to households, businesses, and communities. Participants observed that the volume of borrowing in recent months at many of the Federal Reserve's liquidity facilities had stayed low, reflecting improved availability of funding from market sources. And participants agreed that the Federal Reserve's ongoing provision of backstop credit in various forms continued to be important to sustain the market improvements already achieved.

Participants observed that uncertainty surrounding the economic outlook remained very elevated, with the path of the economy highly dependent on the course of the virus and the public sector's response to it. Several risks to the outlook were noted, including the possibility that additional waves of virus outbreaks could result in extended economic disruptions and a protracted period of reduced economic activity. In such scenarios, banks and other lenders could tighten conditions in credit markets appreciably and restrain the availability of credit to households and businesses. Other risks cited included the possibility that fiscal support for households, businesses, and state and local governments might not provide sufficient relief of financial strains in these sectors and that some foreign economies could come under greater pressure than anticipated as a result of the spread of the pandemic abroad. Several participants noted potential longer-run effects of the pandemic associated with possible restructuring in some sectors of the economy that could slow the growth of the economy's productive capacity for some time.

A number of participants commented on various potential risks to financial stability. Banks and other financial institutions could come under significant stress, particularly if one of the more adverse scenarios regarding the spread of the virus and its effects on economic activity was realized. Nonfinancial corporations had carried high levels of indebtedness into the pandemic, increasing their risk of insolvency. There were also concerns that the anticipated increase in Treasury debt over the next few years could have implications for market functioning. There was general agreement that these institutions, activities, and markets should be monitored closely, and a few participants noted that improved data would be helpful for doing so. Several participants observed that the Federal Reserve had recently taken steps to help ensure that banks remain resilient through the pandemic, including by conducting additional sensitivity analysis in conjunction with the most recent bank stress tests and imposing temporary restrictions on shareholder payouts to preserve banks' capital. A couple of participants noted that they believed that restrictions on shareholder payouts should be extended, while another judged that such a step would be premature.

In their consideration of monetary policy at this meeting, participants reaffirmed their commitment to using the Federal Reserve's full range of tools to support the U.S. economy during this challenging time, thereby promoting its maximum employment and price stability goals. They noted that the path of the economy would depend significantly on the course of the virus and that the ongoing public health crisis would weigh heavily on economic activity, employment, and inflation in the near term and posed considerable risks to the economic outlook over the medium term. In light of this assessment, all participants considered it appropriate to maintain the target range for the federal funds rate at 0 to 1/4 percent. Furthermore, participants continued to judge that it would be appropriate to maintain this target range 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.

Participants also judged that, in order to continue to support the flow of credit to households and businesses, it would be appropriate over coming months for the Federal Reserve to increase its holdings of Treasury securities and agency residential mortgage-backed securities (RMBS) and CMBS at least at the current pace. These actions would be helpful in sustaining smooth market functioning, thereby fostering the effective transmission of monetary policy to broader financial conditions. In addition, participants noted that it was appropriate that the Desk would continue to offer large-scale overnight and term repo operations. Participants observed 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 discussed the current stance of monetary policy and the circumstances under which they might increase monetary policy accommodation or clarify their intentions regarding policy. Participants generally judged that the Committee's policy actions over the past several months had provided substantial accommodation; several of them observed that the Committee's asset purchases, which were designed to support financial market functioning and the smooth flow of credit, were likely also providing a degree of policy accommodation. Noting the increase in uncertainty about the economic outlook over the intermeeting period, several participants suggested that additional accommodation could be required to promote economic recovery and return inflation to the Committee's 2 percent objective. Some participants observed that, due to the nature of the shock that the U.S. economy was experiencing, strong fiscal policy support would be necessary to encourage expeditious improvements in labor market conditions.

With regard to the outlook for monetary policy beyond this meeting, a number of participants noted that providing greater clarity regarding the likely path of the target range for the federal funds rate would be appropriate at some point. Concerning the possible form that revised policy communications might take, these participants commented on outcome-based forward guidance—under which the Committee would undertake to maintain the current target range for the federal funds rate at least until one or more specified economic outcomes was achieved—and also touched on calendar-based forward guidance—under which the current target range would be maintained at least until a particular calendar date. In the context of outcome-based forward guidance, various participants mentioned using thresholds calibrated to inflation outcomes, unemployment rate outcomes, or combinations of the two, as well as combinations with calendar-based guidance. In addition, many participants commented that it might become appropriate to frame communications regarding the Committee's ongoing asset purchases more in terms of their role in fostering accommodative financial conditions and supporting economic recovery. More broadly, in discussing the policy outlook, a number of participants observed that completing a revised Statement on Longer-Run Goals and Monetary Policy Strategy would be very helpful in providing an overarching framework that would help guide the Committee's future policy actions and communications.

A majority of participants commented on yield caps and targets—approaches that cap or target interest rates along the yield curve—as a monetary policy tool. Of those participants who discussed this option, most judged that yield caps and targets would likely provide only modest benefits in the current environment, as the Committee's forward guidance regarding the path of the federal funds rate already appeared highly credible and longer-term interest rates were already low. Many of these participants also pointed to potential costs associated with yield caps and targets. Among these costs, participants noted the possibility of an excessively rapid expansion of the balance sheet and difficulties in the design and communication of the conditions under which such a policy would be terminated, especially in conjunction with forward guidance regarding the policy rate. In light of these concerns, many participants judged that yield caps and targets were not warranted in the current environment but should remain an option that the Committee could reassess in the future if circumstances changed markedly. A couple of participants remarked on the value of yield caps and targets as a means of reinforcing forward guidance on asset purchases, thereby providing insurance against adverse movements in market expectations regarding the path of monetary policy, and as a tool that could help limit the amount of asset purchases that the Committee would need to make in pursuing its dual-mandate goals.

Source: Federal Reserve Board