3-16-2010

Minutes of the Federal Open Market Committee March 16, 2010

Federal Reserve System: Board of Governors: Federal Open Market Committee (FOMC)

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A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, March 16, 2010, at 8:00 a.m.

PRESENT:

Ben Bernanke, Chairman
William C. Dudley, Vice Chairman
James Bullard
Elizabeth Duke
Thomas M. Hoenig
Donald L. Kohn
Sandra Pianalto
Eric Rosengren
Daniel K. Tarullo
Kevin Warsh

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser, Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Brian F. Madigan, Secretary and Economist
Matthew M. Luecke, Assistant Secretary
David W. Skidmore, Assistant Secretary
Michelle A. Smith, Assistant Secretary
Scott G. Alvarez, General Counsel
Thomas C. Baxter, Deputy General Counsel
Nathan Sheets, Economist
David J. Stockton, Economist

Thomas A. Connors, William B. English, Steven B. Kamin, Lawrence Slifman, Christopher J. Waller, and David W. Wilcox, Associate Economists

Brian Sack, Manager, System Open Market Account

Jennifer J. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson, Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson, Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

James A. Clouse, Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson, Assistant to the Board, Office of Board Members, Board of Governors

Sherry Edwards and Andrew T. Levin, Senior Associate Directors, Division of Monetary Affairs, Board of Governors; David Reifschneider and William Wascher, Senior Associate Directors, Division of Research and Statistics, Board of Governors

Michael G. Palumbo, Deputy Associate Director, Division of Research and Statistics, Board of Governors

David H. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Min Wei, Senior Economist, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie, Assistant to the Secretary, Office of the Secretary, Board of Governors

Valerie Hinojosa and Randall A. Williams, Records Management Analysts, Division of Monetary Affairs, Board of Governors

James M. Lyon, First Vice President, Federal Reserve Bank of Minneapolis

Jamie J. McAndrews and Harvey Rosenblum, Executive Vice Presidents, Federal Reserve Banks of New York and Dallas, respectively

David Altig, Craig S. Hakkio, Loretta J. Mester, Glenn D. Rudebusch, Mark E. Schweitzer, Daniel G. Sullivan, and John A. Weinberg, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Kansas City, Philadelphia, San Francisco, Cleveland, Chicago, and Richmond, respectively

Giovanni Olivei, Vice President, Federal Reserve Bank of Boston

Joshua Frost, Assistant Vice President, Federal Reserve Bank of New York

Jonathan Heathcote, Senior Economist, Federal Reserve Bank of Minneapolis

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets during the period since the Committee met on January 26-27, 2010. The net effect of these developments was that financial conditions had become modestly more supportive of economic growth. No market strains emerged in conjunction with the Federal Reserve's closing of nearly all of its remaining special liquidity facilities over the intermeeting period. On February 1, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and the Term Securities Lending Facility were closed, and the Federal Reserve's temporary currency swap lines with foreign central banks expired. Financial markets also adjusted smoothly to the final offering of funds through the Term Auction Facility on March 8.

The Manager noted that securitized credit markets had not shown substantial strain from the anticipated end of new credit extensions under the Term Asset-Backed Securities Loan Facility (TALF), which was scheduled to close on June 30 for loans backed by new-issue commercial mortgage-backed securities (CMBS) and on March 31 for loans backed by all other types of collateral.[1] Spreads on asset-backed securities remained tight while issuance—the bulk of which was being financed outside of TALF—continued to be fairly strong. While the cumulative volume of borrowing from the TALF had expanded fairly steadily in recent months, the volume of repayments of TALF loans had also risen as borrowers were able to secure funding from other sources on more favorable terms. As a result, the net amount of outstanding TALF credit had leveled out and would likely decline going forward as a result of continuing repayments.

In his report on System open market operations, the Manager noted that over the period since the Committee had met in January, the Federal Reserve's total assets had risen to about $2.3 trillion, as an increase in the System's holdings of securities was partly offset by the declining usage of the System's credit and liquidity facilities. The Desk continued to gradually slow the pace of its purchases of agency mortgage-backed securities (MBS) and agency debt as it moved toward completing the Committee's previously announced asset purchases by the end of March. The Desk's purchases of agency MBS were on track to meet the targeted amount of $1.25 trillion, while its purchases of agency debt would likely cumulate to slightly less than $175 billion. The Desk continued to engage in dollar roll transactions in agency MBS securities to facilitate settlement of its outright purchases. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions. Participants also agreed that the Desk should continue the interim approach of allowing all maturing agency debt and all prepayments of agency MBS to be redeemed without replacement.

In addition, the Manager reported on recent progress in the development of reserve draining tools, including the initiation of a program for expanding the set of counterparties in conducting reverse repurchase agreements, and the staff gave a presentation on potential approaches for tightening the link between short-term market interest rates and the interest rate paid on reserve balances held at the Federal Reserve Banks.

> Secretary's note: A staff memorandum was provided to members of the Board of Governors and Federal Reserve Bank presidents summarizing public comments on last December's *Federal Register* notice regarding the establishment of a term deposit facility, but that topic was not discussed at this meeting.

The staff also briefed the Committee on potential approaches for managing the Treasury securities held by the Federal Reserve. To date, the Desk had been reinvesting all maturing Treasury securities by exchanging those holdings for newly issued Treasury securities, but an alternative strategy would be to allow some or all of those Trea-

[1] The final non-CMBS subscription had already occurred in early March and the final subscription for legacy CMBS would take place soon after the FOMC meeting; subscriptions for new-issue CMBS would continue through June.

sury securities to mature without reinvestment. Redeeming all of its maturing Treasury holdings would significantly reduce the size of the Federal Reserve's balance sheet over coming years and hence could be helpful in limiting the need to use other reserve draining tools such as reverse repurchase agreements and term deposits. Redemptions would also lower the interest rate sensitivity of the Federal Reserve's portfolio over time. Nevertheless, the initiation of a redemption strategy might generate upward pressure on market rates, especially if that measure led investors to move up their expected timing of policy firming. Participants agreed that the Committee would give further consideration to these matters and that in the interim the Desk should continue its current practice of reinvesting all maturing Treasury securities.

Staff Review of the Economic Situation

The information reviewed at the March 16 meeting suggested that economic activity expanded at a moderate pace in early 2010. Business investment in equipment and software seemed to have picked up, consumer spending increased further in January, and private employment would likely have turned up in February in the absence of the snowstorms that affected the East Coast. Output in the manufacturing sector continued to trend higher as firms increased production to meet strengthening final demand and to slow the pace of inventory liquidation. On the downside, housing activity remained flat and the nonresidential construction sector weakened further. Meanwhile, a sizable increase in energy prices pushed up headline consumer price inflation in recent months; in contrast, core consumer price inflation was quite low.

Available indicators suggested that the labor market might be stabilizing. Declines in private payrolls slowed markedly in recent months, and, in the absence of the snowstorms, private employment probably would have risen in February. The average workweek for production and nonsupervisory workers fell back in February after ticking up in January; however, the drop was likely due to the storms. The unemployment rate was unchanged at 9.7 percent in February, and the labor force participation rate inched up over the past two months. However, the level of initial claims for unemployment insurance benefits remained high.

After increasing briskly in the second half of 2009, industrial production (IP) continued to expand, on net, in the early months of 2010, rising sharply in January and remaining little changed in February despite some adverse effects of the snowstorms. Recent production gains remained broadly based across industries, as firms continued to boost production to meet rising domestic and foreign demand and to slow the pace of inventory liquidation. Capacity utilization in manufacturing rose further, to a level noticeably above its trough in June, but remained well below its longer-run average. As a result, incentives for manufacturing firms to expand production capacity were weak. The available indicators of near-term manufacturing activity pointed to moderate gains in IP in coming months.

Consumer spending continued to move up. Although sales of new automobiles and light trucks softened slightly, on average, in January and February, real outlays for a wide variety of non-auto goods and food services increased appreciably, and real outlays for other services remained on a gradual uptrend. In contrast to the modest recovery in spending, measures of consumer sentiment remained relatively downbeat in February and had improved little, on balance, since a modest rebound last spring. Household income appeared less supportive of spending than at the January meeting, reflecting downward revisions to estimates by the Bureau of Economic Analysis of wages and salaries in the second half of 2009. The ratio of household net worth to income was little changed in the fourth quarter after two consecutive quarters of appreciable gains.

Activity in the housing sector appeared to have flattened out in recent months. Sales of both new and existing homes had turned down, while starts of single-family homes were about unchanged despite the substantial reduction in inventories of unsold new homes. Some of the recent weakness in sales might have been due to transactions that had been pulled forward in anticipation of the originally scheduled expiration of the tax credit for first-time homebuyers in November 2009; nonetheless, the underlying pace of housing demand likely remained weak. The slowdown in sales notwithstanding, housing demand was being supported by low interest rates for conforming fixed-rate 30-year mortgages and reportedly by a perception that real estate values were near their trough.

Real spending on equipment and software increased at a solid pace in the fourth quarter of 2009 and apparently rose further early in the first quarter of 2010. Business outlays for motor vehicles seemed to be holding up after a sharp increase in the fourth quarter, purchases of high-tech equipment appeared to be rising briskly, and incoming data pointed to some firming in outlays on other equipment. The recent gains in investment spending were consistent with improvements in many indicators of business demand. In contrast, conditions in the nonresidential construction sector generally remained poor. Real outlays on structures outside of the drilling and mining sector fell again in the fourth quarter, and nominal expenditures dropped further in January. The weakness was widespread across categories and likely reflected rising vacancy rates, falling property prices, and difficult financing conditions for new projects. However, real spending on drilling and mining structures increased strongly in response to the earlier rebound in oil and natural gas prices.

The pace of inventory liquidation slowed considerably in late 2009. As measured in the national income and product accounts, real nonfarm inventories excluding motor vehicles were drawn down at a much slower pace in the fourth quarter than in each of the preceding two quarters. Available data for January indicated a further small liquidation of real stocks early this year in the manufacturing and wholesale trade sectors. The ratio of book-value inventories to sales (excluding motor vehicles and parts) edged down again in January and stood well below the recent peak recorded near the end of 2008. Inventories remained elevated for equipment, materials, and, to a lesser degree, construction supplies, while inventories of consumer goods and business supplies appeared to be low relative to demand.

Although rising energy prices continued to boost overall consumer price inflation, consumer prices excluding food and energy were soft, as a wide variety of goods and services exhibited persistently low inflation or outright price declines. On a 12-month change basis, core personal consumption expenditures (PCE) price inflation slowed in January 2010 compared with a year earlier, as a marked and fairly widespread deceleration in market-based core PCE prices was partly offset by an acceleration in nonmarket prices. Survey expectations for near-term inflation were unchanged over the intermeeting period; median longer-term inflation expectations edged down to near the lower end of the narrow range that prevailed over the previous few years. With regard to labor costs, the revised data on wages and salaries showed that last year's deceleration in hourly compensation was even sharper than was evident at the January meeting.

The U.S. international trade deficit widened in December but narrowed slightly in January, ending the period a little larger. Both exports and imports rose sharply in December before pulling back somewhat the following month. For the period as a whole, the rise in exports was broadly based, with notable gains in aircraft and industrial supplies. Oil and other industrial supplies accounted for much of the increase in imports over the two months, while purchases of consumer products declined.

Economic performance in the advanced foreign economies was mixed in the fourth quarter, with real gross domestic product (GDP) advancing sharply in Canada and Japan but rising only slightly in the euro area and the United Kingdom. That divergence appeared to have persisted in the first quarter, as indicators pointed to continued rapid economic growth in Canada and moderate expansion in Japan but somewhat anemic growth in Europe. In the emerging market economies, rebounding global trade, inventory restocking, and increased domestic demand supported generally robust fourth-quarter growth. Continued rapid expansion in China and several other Asian economies offset slowdowns elsewhere in the region. In Latin America, Mexican activity was buoyed by rising manufacturing and exports to the United States, while Brazil's economy again grew briskly. Headline consumer price inflation picked up around the world over the past two months, principally reflecting increases in food and energy prices. Excluding food and energy, consumer prices were generally more subdued.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at the January meeting to keep the target range for the federal funds rate unchanged and to retain the "extended period" language in the statement was widely anticipated by market participants. However, investors reportedly read the statement's characterization of the economic outlook as somewhat more upbeat than they had anticipated, and Eurodollar futures rates rose a bit in response. The changes to the terms for primary credit and the Term Auction Facility that were announced on February 18 resulted in a small increase in near-term futures rates, but this reaction proved short lived, as the statement and subsequent Federal Reserve communications—including the Chairman's semiannual congressional testimony—emphasized that the modifications were technical adjustments and did not signal any near-term shifts in the overall stance of monetary policy.

On balance, incoming economic data led investors to mark down the expected path of the federal funds rate over the intermeeting period. By contrast, yields on 2-year and 10-year nominal Treasury securities edged up, on net, over the period. Yields on Treasury inflation-protected securities (TIPS) rose at all maturities, reportedly buoyed by investor anticipation of heavier TIPS issuance and by reduced demand for TIPS by retail investors. Reflecting these developments, inflation compensation—the difference between nominal yields and TIPS yields for a given term to maturity—declined over the period, a move that was supported by the somewhat weaker-than-expected economic data and the publication of lower-than-expected readings on consumer prices.

Conditions in short-term funding markets remained generally stable over the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates at one- and three-month maturities stayed low, while six-month spreads edged down somewhat further. Spreads of rates on A2/P2-rated commercial paper and on AA-rated asset-backed commercial paper over the AA nonfinancial rate were also little changed at low levels. The Federal Reserve continued to taper its large-scale asset purchases and wind down the emergency lending facilities with no apparent adverse effects on financial markets or institutions.

Broad stock price indexes rose, on net, over the intermeeting period, boosted in part by favorable earnings reports from the retail sector. Bank equity prices outperformed the broader equity markets. Option-implied volatility on the S&P 500 index dropped back to post-crisis lows after increasing earlier in the period on concerns about Chinese monetary policy tightening and fiscal strains in Europe. Nonetheless, the gap between the staff's estimate of the expected real equity return over the next 10 years for S&P 500 firms and the real 10-year Treasury yield—a rough measure of the equity risk premium—remained well above its average over the past decade. Yields on investment-grade corporate bonds, as well as their spreads over yields on comparable-maturity Treasury securities, were about unchanged over the intermeeting period; investment-grade risk spreads were near the levels that prevailed late in 2007. Yields and spreads on speculative-grade bonds edged down, and secondary-market prices of leveraged loans rose further.

Overall, net debt financing by nonfinancial firms was about zero over the first two months of 2010, consistent with firms' weak demand for credit and banks' tight credit policies. Gross public equity issuance by nonfinancial firms was robust in the fourth quarter of 2009. Since the turn of the year, gross public equity issuance by nonfinancial firms slowed somewhat, while announcements of both new share repurchase programs and cash-financed mergers and acquisitions picked up. Public equity issuance by financial firms declined in January and February following very strong issuance in December, when several large banks issued equity to facilitate the repayment of capital received under the Troubled Asset Relief Program. Gross bond issuance by financial firms remained solid. The contraction in commercial mortgage debt accelerated in the fourth quarter. The dollar value of commercial real estate sales remained very low in February, and the share of properties sold at a nominal loss inched higher. The delinquency rate on commercial mortgages in securitized pools increased in January, and the delinquency rate on commercial mortgages at commercial banks rose in the fourth quarter. The percentage of delinquent construction loans at banks also ticked higher in the fourth quarter. Nonetheless, indexes of commercial mortgage credit default swaps changed little, on balance, over the intermeeting period.

Since the January meeting, yields and spreads on agency MBS were little changed despite the continued tapering of the Federal Reserve's purchases of these securities, and residential mortgage interest rates and spreads were roughly flat. Net issuance of MBS by Fannie Mae and Freddie Mac remained subdued through the end of January. Consumer credit expanded in January, its first increase since January 2009. Despite low and stable spreads on consumer asset-backed securities (ABS), the amount of ABS issued in the first two months of the year was somewhat below that in the fourth quarter, reflecting the very weak pace of consumer credit originations late last year. The spread of credit card interest rates over two-year Treasury yields ticked up in January, while spreads on new auto loans declined slightly, on net, over the intermeeting period. Delinquency rates on credit card loans in securitized pools and on auto loans at captive finance companies remained elevated in January but were down a bit from their recent peaks.

Total bank credit contracted substantially in January and February. Banks' securities holdings declined at a modest pace after several months of steady growth, and total loans on banks' books continued to drop. Commercial and industrial (C&I) loans continued falling, as spreads of interest rates on C&I loans over comparable-maturity market instruments climbed further in the first quarter and nonfinancial firms' need for external finance apparently remained subdued. Commercial real estate loans also posted significant declines. Household loans on banks' books contracted as well, in part because of a pickup in bank securitizations of first-lien residential mortgages with the government-sponsored enterprises in February. Consumer loans originated by banks declined, primarily reflecting a large drop in credit card loans. In contrast, other consumer loans—including auto, student, and tax advance loans—were roughly flat during January and February.

M2 decreased in January, owing partly to a contraction in liquid deposits. Many institutions opted out of the Federal Deposit Insurance Corporation's Transaction Account Guarantee Program because of the higher fees associated with participation after year-end, reportedly driving depositors to transfer funds out of transaction accounts and into alternative investments outside of M2. M2 expanded in February, however, as liquid deposits resumed their growth. Small time deposits and retail money market mutual funds contracted in January and, to a lesser extent, in February, while currency declined a bit in January but advanced notably in February. The monetary base rose in both months, as the increase in reserve balances resulting from the ongoing large-scale asset purchases by the Federal Reserve more than offset the contraction in balances associated with the decline in credit outstanding under the System's liquidity and credit facilities.

Movements in foreign financial markets since the January meeting were importantly influenced by concerns over fiscal problems in Greece. Spreads on Greek government debt relative to German bunds widened appreciably before falling back as press reports indicated that euro-area countries were discussing a possible aid package for Greece and the Greek government announced further deficit reduction measures. Spreads on debt issued by several other European countries followed a similar pattern over the intermeeting period. The Bank of England (BOE) and the European Central Bank (ECB) held rates steady during the period, and the BOE elected not to expand its Asset Purchase Facility, which reached its limit at the end of January. In early March, the ECB announced several steps to normalize its provision of liquidity. Equity prices in most foreign countries were up moderately since the January FOMC meeting. Likely reflecting the concerns about Greece as well as weak economic data in Europe, the dollar appreciated notably against sterling and the euro over the intermeeting period. However, the dollar declined against most emerging market currencies, which were buoyed by brightening growth prospects, leaving the broad trade-weighted value of the dollar down a bit since the January meeting.

Staff Economic Outlook

In the forecast prepared for the March FOMC meeting, the staff's outlook for real economic activity was broadly similar to that at the time of the January meeting. In particular, the staff continued to anticipate a moderate pace of economic recovery over the next two years, reflecting the accommodative stance of monetary policy and a further diminution of the factors that had weighed on spending and production since the onset of the financial crisis. The staff did make modest downward adjustments to its projections for real GDP growth in response to unfavorable news on housing activity, unexpectedly weak spending by state and local governments, and a substantial reduction in the estimated level of household income in the second half of 2009. The staff's forecast for the unemployment rate at the end of 2011 was about the same as in its previous projection.

Recent data on consumer prices and unit labor costs led the staff to revise down slightly its projection for core PCE price inflation for 2010 and 2011; as before, core inflation was projected to be quite subdued at rates below last year's pace. Although increased oil prices had boosted overall inflation over recent months, the staff anticipated that consumer prices for energy would increase more slowly going forward, consistent with quotes on oil futures contracts. Consequently, total PCE price inflation was projected to run a little above core inflation this year and then edge down to the same rate as core inflation in 2011.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, participants agreed that economic activity continued to strengthen and that the labor market appeared to be stabilizing. Incoming information on economic activity received over the intermeeting period was somewhat mixed but generally confirmed that the economic recovery was likely to proceed at a moderate pace. On the positive side, recent data pointed to significant gains in retail sales, a substantial pickup in business spending on equipment and software, and a further expansion of goods exports. Moreover, the latest labor market readings had been mildly encouraging, with a considerable increase in temporary employment, especially in the manufacturing and information technology sectors. However, housing starts had remained flat at a depressed level, investment in nonresidential structures was still declining, and state and local government expenditures were being depressed by lower revenues. Moreover, consumer sentiment continued to be damped by very weak labor market conditions, and firms remained reluctant to add to payrolls or to commit to new capital projects. Participants saw recent inflation readings as suggesting a slightly greater deceleration in consumer prices than had been expected. In light of stable longer-term inflation expectations and the likely continuation of substantial resource slack, they generally anticipated that inflation would be subdued for some time.

Participants agreed that financial market conditions remained supportive of economic growth. Spreads in short-term funding markets were near pre-crisis levels, and risk spreads on corporate bonds and measures of implied volatility in equity markets were broadly consistent with historical norms given the outlook for the economy. Participants were also reassured by the absence of any signs of renewed strains in financial market functioning as a consequence of the Federal Reserve's winding down of its special liquidity facilities. In contrast, bank lending was still contracting and interest rates on many bank loans had risen further in recent months. Participants anticipated that credit conditions would gradually improve over time, and they noted the possibility of a beneficial feedback loop in which the economic recovery would contribute to stronger bank balance sheets and so to an increased availability of credit to households and small businesses, which would in turn help boost the economy further.

While participants saw incoming information as broadly consistent with continued strengthening of economic activity, they also highlighted a variety of factors that would be likely to restrain the overall pace of recovery, especially in light of the waning effects of fiscal stimulus and inventory rebalancing over coming quarters. While recent data pointed to a noticeable pickup in the pace of consumer spending during the first quarter, participants agreed that household spending going forward was likely to remain constrained by weak labor market conditions, lower housing wealth, tight credit, and modest income growth. For example, real disposable personal income in January was virtually unchanged from a year earlier and would have been even lower in the absence of a substantial rise in federal transfer payments to households. Business spending on equipment and software picked up substantially over recent months, but anecdotal information suggested that this pickup was driven mainly by increased spending on maintaining existing capital and updating technology rather than expanding capacity. The continued gains in manufacturing production were bolstered by growing demand from foreign trading partners, especially emerging market economies. However, a few participants noted the possibility that fiscal retrenchment in some foreign countries could trigger a slowdown of those economies and hence weigh on the demand for U.S. exports.

Some labor market indicators displayed positive signals over the intermeeting period, including a pickup in temporary employment and increased job postings. Indeed, nonfarm payrolls might well have increased in February in the absence of weather disruptions. Nevertheless, participants were concerned about the scarcity of job openings, the elevated level of unemployment, and the extent of longer-term unemployment, which was seen as potentially leading to the loss of worker skills. Moreover, the downward trend in initial unemployment insurance claims appeared to have leveled off in recent weeks, while hiring remained at historically low rates. Information from business contacts and evidence from regional surveys generally underscored the degree to which firms' reluctance to add to payrolls or start large capital projects reflected their concerns about the economic outlook and uncertainty regarding future government policies. A number of participants pointed out that the economic recovery could not be sustained over time without a substantial pickup in job creation, which they still anticipated but had not yet become evident in the data.

Participants were also concerned that activity in the housing sector appeared to be leveling off in most regions despite various forms of government support, and they noted that commercial and industrial real estate markets continued to weaken. Indeed, housing sales and starts had flattened out at depressed levels, suggesting that previous improvements in those indicators may have largely reflected transitory effects from the first-time homebuyer tax credit rather than a fundamental strengthening of housing activity. Participants indicated that the pace of foreclosures was likely to remain quite high; indeed, recent data on the incidence of seriously delinquent mortgages pointed to the possibility that the foreclosure rate could move higher over coming quarters. Moreover, the prospect of further additions to the already very large inventory of vacant homes posed downside risks to home prices.

Participants referred to a wide array of evidence as indicating that underlying inflation trends remained subdued. The latest readings on core inflation—which exclude the relatively volatile prices of food and energy—were generally lower than they had anticipated, and with petroleum prices having leveled out, headline inflation was likely to come down to a rate close to that of core inflation over coming months. While the ongoing decline in the implicit rental cost for owner-occupied housing was weighing on core inflation, a number of participants observed that the moderation in price changes was widespread across many categories of spending. This moderation was evident in the appreciable slowing of inflation measures such as trimmed means and medians, which exclude the most extreme price movements in each period.

In discussing the inflation outlook, participants took note of signs that inflation expectations were reasonably well anchored, and most agreed that substantial resource slack was continuing to restrain cost pressures. Measures of gains in nominal compensation had slowed, and sharp increases in productivity had pushed down producers' unit labor costs. Anecdotal information indicated that planned wage increases were small or nonexistent and suggested that large margins of underutilized capital and labor and a highly competitive pricing environment were exerting considerable downward pressure on price adjustments. Survey readings and financial market data pointed to a modest decline in longer-term inflation expectations over recent months. While all participants anticipated that inflation would be subdued over the near term, a few noted that the risks to inflation expectations and the medium-term inflation outlook might be tilted to the upside in light of the large fiscal deficits and the extraordinarily accommodative stance of monetary policy.

Committee Policy Action

In their discussion of monetary policy for the period ahead, members agreed that it would be appropriate to maintain the target range of 0 to ¼ percent for the federal funds rate and to complete the Committee's previously announced purchases of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of March. Nearly all members judged that it was appropriate to reiterate the expectation that economic conditions— including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period, but one member believed that communicating such an expectation would create conditions that could lead to financial imbalances. A number of members noted that the Committee's expectation for policy was explicitly contingent on the evolution of the economy rather than on the passage of any fixed amount of calendar time. Consequently, such forward guidance would not limit the Committee's ability to commence monetary policy tightening promptly if evidence suggested that economic activity was accelerating markedly or underlying inflation was rising notably; conversely, the duration of the extended period prior to policy firming might last for quite some time and could even increase if the economic outlook worsened appreciably or if trend inflation appeared to be declining further. A few members also noted that at the current juncture the risks of an early start to policy tightening exceeded those associated with a later start, because the Committee could be flexible in adjusting the magnitude and pace of tightening in response to evolving economic circumstances; in contrast, its capacity for providing further stimulus through conventional monetary policy easing continued to be constrained by the effective lower bound on the federal funds rate.

Members noted the importance of continued close monitoring of financial markets and institutions—including asset prices, levels of leverage, and underwriting standards—to help identify significant financial imbalances at an early stage. At the time of the meeting the information collected in this process, including that by supervisory staff, had not revealed emerging misalignments in financial markets or widespread instances of excessive risk-taking. All members agreed that the Committee would continue to monitor the economic outlook and financial developments and would employ its policy tools as necessary to promote economic recovery and price stability.

In light of the improved functioning of financial markets, Committee members agreed that it would be appropriate for the statement to be released following the meeting to indicate that the previously announced schedule for closing the Term Asset-Backed Securities Loan Facility was being maintained. The Committee also discussed possible approaches for formulating and communicating key elements of its strategy for removing extraordinary monetary policy accommodation at the appropriate time. No decisions about the Committee's exit strategy were made at this meeting, but participants agreed to give further consideration to these issues at a later date.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to complete the execution of its purchases of about $1.25 trillion of agency MBS and of about $175 billion in housing-related agency debt by the end of March. The Committee directs the Desk to engage in dollar roll transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in January suggests that economic activity has continued to strengthen and that the labor market is stabilizing. Household spending is expanding at a moderate rate but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software has risen significantly. However, investment in nonresidential structures is declining, housing starts have been flat at a depressed level, and employers remain reluctant to add to payrolls. While bank lending continues to contract, financial market conditions remain supportive

of economic growth. Although the pace of economic recovery is likely to be moderate for a time, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve has been purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt; those purchases are nearing completion, and the remaining transactions will be executed by the end of this month. The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to promote economic recovery and price stability.

In light of improved functioning of financial markets, the Federal Reserve has been closing the special liquidity facilities that it created to support markets during the crisis. The only remaining such program, the Term Asset-Backed Securities Loan Facility, is scheduled to close on June 30 for loans backed by new-issue commercial mortgage-backed securities and on March 31 for loans backed by all other types of collateral."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he believed it was no longer advisable to indicate that economic and financial conditions were likely to warrant "exceptionally low levels of the federal funds rate for an extended period." Mr. Hoenig was concerned that communicating such an expectation could lead to the buildup of future financial imbalances and increase the risks to longer-run macroeconomic and financial stability. Accordingly, Mr. Hoenig believed that it would be more appropriate for the Committee to express its anticipation that economic conditions were likely to warrant "a low level of the federal funds rate for some time." Such a change in communication would provide the Committee flexibility to begin raising rates modestly. He further believed that making such an adjustment to the Committee's target for the federal funds rate sooner rather than later would reduce longer-run risks to macroeconomic and financial stability while continuing to provide needed support to the economic recovery.

It was agreed that the next meeting of the Committee would be held on Tuesday-Wednesday, April 27-28, 2010. The meeting adjourned at 1:00 p.m. on March 16, 2010.

Notation Vote

By notation vote completed on February 16, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on January 26-27, 2010.

Brian F. Madigan
Secretary