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Federal Reserve System: Federal Reserve Bank of New York

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Conference Call of the Federal Open Market Committee on October 7, 2008

A conference call of the Federal Open Market Committee was held on Tuesday, October 7, 2008, at 5:30 p.m. Those present were the following:

Mr. Bernanke, Chairman
Mr. Geithner, Vice Chairman
Ms. Duke
Mr. Fisher
Mr. Kohn
Mr. Kroszner
Ms. Pianalto
Mr. Plosser
Mr. Stern
Mr. Warsh

Ms. Cumming, Messrs. Evans, Lacker, and Lockhart, and Ms. Yellen, Alternate Members of the Federal Open Market Committee

Mr. Rosengren, President of the Federal Reserve Bank of Boston

Mr. Rasdall, First Vice President, Federal Reserve Bank of Kansas City

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist

Messrs. Connors, English, and Kamin, Ms. Mester, Messrs. Rolnick, Rosenblum, Slifman, Sniderman, Tracy, and Wilcox, Associate Economists

Mr. Dudley, Manager, System Open Market Account

Mr. Cole, Director, Division of Banking Supervision and Regulation, Board of Governors

Mr. Parkinson, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Ms. Liang and Mr. Reifschneider, Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Nelson, Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Gagnon, Visiting Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Luecke, Section Chief, Division of Monetary Affairs, Board of Governors

Mr. Fuhrer, Executive Vice President, Federal Reserve Bank of Boston

Messrs. Rasche, Sellon, Sullivan, and Williams, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Kansas City, Chicago, and San Francisco, respectively

Mr. Bryan, Vice President, Federal Reserve Bank of Atlanta

Mr. Schetzel, Assistant Vice President, Federal Reserve Bank of New York

Transcript of the Federal Open Market Committee Conference Call on October 7, 2008

CHAIRMAN BERNANKE. All right. Let's begin. Thank you all for joining this meeting. We're having a lot of meetings off the regular cycle. I think it's just a sign of the extraordinary times that we're currently living through. The only agenda item for this meeting is the discussion of a proposed coordinated action with five other major central banks. It will be a six-bank coordinated action. Besides ourselves, the other banks involved are the European Central Bank, the Bank of England, and the Bank of Canada, and since I spoke to you, the Swiss National Bank and the Bank of Sweden have joined in this collective action. Japan has its own issues and will not be cutting but will be expressing support and has been consulted. The plan, conditional on our approval, would be for all six major central banks to cut policy rates by 50 basis points jointly and announce tomorrow at 7:00 a.m. Eastern time before the U.S. markets open. There are two statements. There's a short joint statement by all of the central banks, which has been negotiated. I don't know if you have access to it. I will read it to you shortly, if necessary. Then it is proposed that we have our own short statement, which I know has been circulated and which you should have in front of you.

So that's the issue we're here to discuss. My proposal would be, first, to begin with some short briefings by the staff. Bill Dudley in New York, Larry Slifman here at the Board, and Nathan Sheets here at the Board would just give us a short update on what's transpiring in the financial markets and the broader economy. We will have an opportunity for Q&A with the staff. I'd then like to introduce the subject briefly and just talk about the rationale, and the floor will be open for your comments on the action, on the economy, and on the statement, as you see fit. So without further ado, let me turn to Bill Dudley. Bill, are you there?

MR. DUDLEY. Yes. Thank you, Mr. Chairman. Despite our massive escalation on the liquidity provision front and passage of legislation granting the Treasury authority

to set up a $700 billion troubled asset relief program, or TARP, market conditions continue to deteriorate. This is occurring in three broad respects.

First, market participants continue to pull back in their willingness to engage with one another. This pullback is evident in elevated interbank lending rates and elevated foreign exchange swap bases and market liquidity more generally. The one-month and three-month LIBOR–OIS spreads have widened to 271 and 296 basis points, respectively. That is up more than 175 basis points in the past three weeks since the September 16 FOMC meeting. The all-in cost of dollar funding via the foreign exchange swap market, although bouncing around day to day, has actually been even higher than LIBOR, often by 100 basis points or more. In addition to the interbank market, the commercial paper market has come under stress. The breaking of the buck by the Reserve Fund led to a wholesale flight out of prime institutional money market funds. This forced the liquidation of assets, which has led to impairment of the commercial paper market. Term commercial paper rates are elevated, and the average tenor of commercial paper has shortened considerably.

Second, financial conditions continue to tighten, and in recent weeks, the tightening has been substantial. Equity prices have plunged both in the United States and abroad. Corporate bond yields, especially for non-investment-grade debt, have increased substantially. Short- and long-term tax-exempt rates have climbed, and credit availability has been even further impaired. On the equity market side, for example, the S&P 500 index has fallen about 18 percent since the September 16 FOMC meeting. Although there is considerable uncertainty about the appropriate metrics and weights to use in examining the evolution of financial conditions over time, most data are consistent with the judgment that conditions have tightened significantly since the onset of the crisis, despite the 325 basis point reduction in the federal funds rate target. Compared with the previous two monetary policy easing cycles, there have been four important divergences. First, corporate bond yields have climbed. In previous cycles, the widening credit spreads were more than offset by the decline in Treasury note and bond yields, causing corporate bond yields to fall. Second, credit availability has declined greatly in this cycle. In the two previous cycles, the proportion of banks tightening credit standards actually fell through the easing cycle. That stands in sharp contrast to what has been happening in this cycle. Third, housing price declines have been far larger than in previous cycles, in real and in nominal terms. Fourth, the dollar has weakened actually much less than in the previous two easing cycles.

The third aspect of the market that I think warrants noting is that the U.S. financial sector in particular remains under pressure, especially with respect to share prices and banks' ability to obtain funding, especially term funding. Today was a particularly bad day for financial shares, with double-digit declines common for many banks. The only good news was that credit default swaps actually narrowed a bit, maybe helped by the introduction of our commercial paper backstop facility or the fact that we've escalated so massively in terms of the term auction facility and the foreign exchange swaps with our foreign central bank counterparts.

On the inflation side of the ledger, pressures continue to abate. Since the last FOMC meeting, both industrial and agricultural commodity price indexes have fallen about 15 percent. At the same time, the dollar has strengthened. The fall in the commodity prices and the strength in the dollar are two factors that have contributed to a fall in breakeven measures of inflation on both the spot and the five-year, five-year-forward basis. For example, the Barclays measure of five-year, five-year-forward breakeven inflation has declined more than 60 basis points since the September FOMC meeting. Today it was around 1.5 percent.

The interbank, money market, and capital market dysfunction, the tightening of financial conditions, and the apparent easing in inflation risks have caused investors to conclude that the FOMC is likely to lower its federal funds rate target in the near future. Late today, the November federal funds futures contract implied an effective rate for the coming month of about 1.4 percent. That's more than 50 basis points below the current target. Interestingly, the failure of the FOMC to ease today actually led to a rise in October and November federal funds futures contracts. Market participants presumably interpreted the introduction of the commercial paper funding facility as potentially a substitute for further monetary policy accommodation at this time. Obviously, this is an extremely fragile and dangerous environment. I am struck by the feeble market response to the substantial escalations implemented over the past ten days. These include expanding standing foreign exchange swap facilities' capacity to $620 billion from $290 billion; expanding the TAF auction cycles to $900 billion from $150 billion; and proposing a major backstop for the commercial paper market. With respect to the commercial paper market backstop facility, the market reaction today was generally positive, but market participants clearly want to know more in terms of the specifics, especially when the program will be up and operational. Of course, I'm happy to take any questions.

CHAIRMAN BERNANKE. We'll take any questions or comments at this point. Since Bill has covered the financial area, are there any questions for him? President Lacker.

MR. LACKER. Bill, you said you were struck by the feeble reaction of markets to expanding our credit programs?

MR. DUDLEY. Yes. The markets didn't take as much solace as I would have hoped, given the degree of escalation of those provisions.

MR. LACKER. So what would it have looked like for them to have taken much solace? I mean, what prices and quantities would change?

MR. DUDLEY. Well, for example, I would expect that LIBOR–OIS spreads might narrow rather than widen. I might expect that equity prices would have taken some comfort from our efforts. So generally I think the reaction was somewhat disappointing, frankly.

MR. LACKER. Could it be that some fundamentals are going on there that market participants don't view it as addressing?

MR. DUDLEY. Well, a fair point is that the Federal Reserve cannot by its actions solve the balance sheet constraints of the U.S. banking system. The Federal Reserve by its actions cannot create capital for banks, and that's obviously one of the problems at the core of what is going on in the financial system.

MR. LACKER. I want to ask you about the LIBOR spread. It's pretty striking, but I'm wondering, Do you have data on the quantity of borrowing that's going on in that market and what that LIBOR figure really represents? We have a bank in our District that reports on the LIBOR panel but reports borrowing at 100 to 150 basis points below it.

MR. DUDLEY. The LIBOR panel may understate the pressure on funding costs for some banks. But if you remember, the way the LIBOR is calculated, it actually is a truncated sample size. They throw out the highs, and they throw out the lows. They get the median of people in that market. Also, other measures, such as the New York NYFR, have actually tended to be elevated relative to LIBOR, and the FX swap rate—the all-in basis for dollar funding in the FX swap market—has actually been elevated relative to LIBOR. So I think that what we're seeing in the LIBOR market is a pretty fair indication of the strains in term funding markets.

MR. LACKER. In that LIBOR panel, there are places where you can get individual banks' reports. I haven't looked in a week, but the last time I looked, the spread between the bottom bank and the top bank was over 150 basis points.

MR. DUDLEY. I think the reality right now is that LIBOR does not mean very much because there's very little term funding going on at all. So I think that there are rates that are posted in LIBOR, and they pull them off. But you could argue that in some ways it's even worse than the rate that is posted because, according to the reports that we've gotten, there's just very little activity at term not just in the interbank market but in the broad array of markets.

MR. LACKER. Okay. So the LIBOR–OIS spread may be misleading—not that sensitive an indicator. If it goes up or down 50 basis points, we maybe shouldn't read a lot into that.

MR. DUDLEY. Well, I wouldn't go quite that far. Where it is today tells you that there's significant strain. I wouldn't say that, if it goes up 10 basis points tomorrow or down 10 basis points tomorrow, I would conclude that the strains had lessened.

MR. LACKER. That is what I was getting at.

CHAIRMAN BERNANKE. Other questions for Bill? President Lockhart.

MR. LOCKHART. Bill, how would you interpret yesterday's size of the TAF auction?

MR. DUDLEY. Well, the escalation in the size of the TAF auction was obviously quite significant, and I think that it tells you two things: Maybe there are limits to the demand for term funding, and maybe it represents a constraint in terms of collateral pledged at the discount window, especially given the fact that we announced the auction on Monday morning and the auction happened Monday afternoon. So it is very possible that there was a bit of a lag in terms of the ability to mobilize collateral or take advantage of that auction capacity. I thought it was actually pretty well subscribed. I think it was $130-something billion in bids for $150 billion of available credit. So in retrospect, I think that it was sized about right.

CHAIRMAN BERNANKE. All right. Let's go on now and hear from Larry Slifman and Nathan Sheets.

MR. SLIFMAN. Let me first talk a bit about the near-term outlook. Most of the economic data that we've gotten since the September Greenbook have come in to the soft side of our expectations. The PCE number for August was surprisingly weak. Auto sales dropped sharply in September. Shipments and orders for nondefense capital goods fell in August, and in the labor market, as you know, private payrolls fell about 168,000 in September. In addition, the Boeing strike is going to last longer than we thought at the time of the September Greenbook, and the hurricane effects from Hurricanes Gustaf and Ike appear to be more substantial in terms of the production adjustments than we had been thinking at the time of the September Greenbook. So all told, we now expect GDP to be about unchanged in the second half of the year, and that's down about ¾ percentage point since the last Greenbook.

In terms of the medium-term outlook, 2009-10, we've had important changes in some of the conditioning assumptions that we see as working through so-called conventional channels. As of this afternoon's close, the stock market is down about 20 percent since the September Greenbook. Corporate bond rates are up about 90 basis points, and the dollar is up about 3 percent since the last Greenbook. One good bit of news is that oil prices are down about $13 per barrel since we put the September Greenbook to bed. Of course, financial stress has greatly intensified. Using our usual method, which we described in the box in Part 1 of the Greenbook, we now think that the intensification of financial stress since the September Greenbook would subtract nearly 1 percentage point from real GDP growth in 2009. The stock market has clearly been a moving target for us as we've been trying to put this all together and assess the outlook for next year and 2010. But using this afternoon's close as the starting point, real GDP now is projected to rise only about ½ percent over the four quarters of 2009 and then to pick up to an increase of about 2½ percent in 2010. With that growth rate, we would have the unemployment rate rising to about 7¼ percent by the end of 2009, and we would expect it to remain at about that level through 2010.

In terms of inflation, the recent data on core inflation pushed up our estimate of core PCE price inflation in the third quarter to more than 3 percent. That's about 0.2 percentage point higher than in the September Greenbook, but we expect that to ease back off in the fourth quarter and come down to a rate of about 2½ percent. For the medium term, core inflation is expected to slow over the remainder of the forecast period. We think that the pass-through from import and energy prices will abate, and of course, the additional slack that we now have in the forecast also could relieve some pressure on inflation. In terms of the overall inflation rate, we expect energy and food price increases to taper off, and so we would see PCE price inflation slowing to about the same rate as core inflation. Specifically, we would see inflation at about 2 percent in 2009 and about 1.7 percent in 2010. Nathan now has a few comments he wants to add.

MR. SHEETS. Since the last Greenbook, the economic indicators for the foreign economies have generally surprised us on the downside, notwithstanding the fact that our expectations in the Greenbook for foreign growth were already pretty grim. In the euro area, measures of consumer and business sentiment have continued to retreat. Industrial production has moved down, and retail sales have been soft. Recent data for

the United Kingdom have continued to point to a mild contraction during the second half of this year, and notably house prices there continue to fall. In Japan, industrial production plummeted in August, recording its biggest monthly decline in more than five years, and survey data point to further declines in business and consumer confidence. Finally, in the emerging market economies, industrial production has fallen in a broad set of countries, and exports have softened significantly.

In light of these data, we now see foreign growth in the second half of this year as likely to come in at a little less than 1½ percent, down ½ percentage point from our last forecast, with these markdowns spread about evenly between the advanced economies and the emerging market economies. We have reduced our projections for growth in 2009 almost as much. This weakening outlook for global activity has been largely driven, as Bill has described, by a marked deterioration in financial conditions in both the advanced and the emerging market economies. Since the last FOMC meeting, equity markets have fallen sharply in numerous countries. Risk premiums on many types of assets have risen, and conditions in short-term funding markets have worsened further. These difficult financial conditions threaten the outlook for foreign growth going forward both by weighing on sentiment in financial markets and by potentially limiting the flow of credit to the economy.

If there is any good news for me to report, it's that the softening outlook for global growth has continued to put downward pressure on the price of oil and other commodities. Oil prices have been extraordinarily volatile over the last month, lurching up and down in response to a number of factors, including the effects of the two hurricanes, shifting expectations regarding global growth, and financial turbulence. On net, as Larry mentioned, the price of WTI is down about $13 a barrel since the Greenbook and down over $55 per barrel from its peak in mid-July. Prices for many nonfuel commodities have fallen sharply since the FOMC meeting, including price declines of more than 10 percent for copper, nickel, and rubber, and more than 20 percent for corn and soybeans. Headline inflation remains elevated in the advanced foreign economies. Notably, U.K. inflation in August reached 4¾ percent, a 15-year high. In contrast, the most recent CPI data for the euro area hint at some deceleration, with inflation moving down from over 4 percent in July to 3.6 percent in September. Going forward, there are good reasons to expect inflation in these economies to abate, given the recent sharp decline in commodity prices and emerging slack in their economies. Inflation rates in the emerging market economies appear to be cresting for similar reasons.

In the midst of these events, the dollar has remained quite resilient, rising about 3 percent since the last FOMC meeting. In our view the currency markets earlier this year had priced in expectations that the major foreign economies would remain largely resilient despite U.S. slowing. As the growth prospects for the foreign economies have deteriorated, the relative attractiveness of the dollar has increased. This, along with the sustained demand for dollar funding in global financial markets, seems to have buoyed the dollar of late.

Finally, given the weaker path of foreign activity and the stronger dollar, we now expect export growth to be somewhat less robust than was the case in our previous forecast and, consequently, net exports to be less supportive of U.S. economic growth over the next two years. Nevertheless, net exports are still expected to contribute a positive 0.5 percentage point to growth in the second half of this year and about 0.3 percentage point in 2009. We are happy to take your questions now.

CHAIRMAN BERNANKE. Are there questions for Larry or for Nathan? Governor Kohn.

MR. KOHN. Larry, what were the policy assumptions under your forecast?

MR. SLIFMAN. We maintained the same path as in the September Greenbook.

CHAIRMAN BERNANKE. President Fisher.

MR. FISHER. Mr. Chairman, I just want to add to Nathan's discussion but join it with the credit road. I spent this afternoon with the National Retail Federation. These are CEOs of Home Depot to JCPenney's to Ann Taylor, et cetera. One thing that I've been concerned about has been Chinese pressures in terms of their selling prices. As you know, these were being elevated—for example, in women's wear, 8 percent across the board. What is interesting is that, in the past two weeks, it has completely changed. They will deal only with those they consider to be creditworthy buyers, and they've now negotiated that price all the way back to last year's levels, as long as you are creditworthy. If you're not creditworthy in their opinion, they won't sell to you, period. So these two things are beginning to join, and I think this adds to the points that Nathan made. It's not just a matter of slack. It's a matter of unwillingness to deal with certain opposite parties—a counterparty risk of its own kind, so to speak—and it at least mitigates the concern I've had about the pass-through risk that we've talked about quite a bit. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. Other questions for Nathan or Larry? President Evans.

MR. EVANS. Thank you, Mr. Chairman. I was jotting down some of the figures on the lending facilities and the magnitudes just to see if I had the right ballpark. You know, from the TAF

to the TSLF, the primary dealer credit facility, and on down to today's facility on commercial paper, and then if you throw in the Treasury program, which is not exactly ours, and the swaps as well, I get to something like over $3 trillion that is being put out against collateral and to be lent. Is that the right order of magnitude? I guess the question I have is whether we have any sense that this is likely to get to the point of unlocking the lending capacity that's so important to get the economy going?

CHAIRMAN BERNANKE. Bill, do you want to tackle that?

MR. DUDLEY. Sure. I think those figures are the right order of magnitude. I looked at some figures today that, based on reasonable assumptions, you might expect the balance sheet to grow to a high of $2.5 trillion to $3 trillion by the end of the year. Obviously, it depends on what assumptions you make about the amount of TAF credit that is actually drawn down and the amount of swaps that are actually drawn down. But it could be that order of magnitude, and that would be exceptional. That's why getting interest-on-reserves authority was very, very important. As Brian has said in earlier briefings, interest on reserves is going to start on Thursday, and that's going to place a floor on the federal funds rate. So we think we're in a situation where we have a very important tool that will allow us to expand the balance sheet but maintain control of the federal funds rate. So we're not going to be compromising monetary policy.

CHAIRMAN BERNANKE. Other questions? Vice Chairman Geithner.

VICE CHAIRMAN GEITHNER. Could I just add something, Mr. Chairman, to what Bill said?

CHAIRMAN BERNANKE. Certainly.

VICE CHAIRMAN GEITHNER. I'm not sure this is the right way to think about it, but you could think about the use of our balance sheet as a necessary but not sufficient condition to

achieve Charlie's objective, which is to help stabilize the financial system and make sure that intermediation begins again and that people are willing to start lending again on a scale necessary to support some reasonable outcome for the economy going forward. Our basic judgment—and I think everybody's judgment—is that it is going to require capital from the government in some mix of forms for that to happen. I don't think that any of us believes that the expansion of our balance sheet alone is going to be sufficient to achieve that outcome. That's why—and I think you all know this—the Chairman has been working so closely with the Secretary of the Treasury to make sure that the authority that the Congress passes is used in a way that has the maximum possible benefit in things that are about capital so that the probability of default of the financial system goes down and people feel more comfortable lending at term to financials.

CHAIRMAN BERNANKE. Thank you. Other questions? All right. If not, let me just say a few words. I will be brief. It's more than obvious that we have an extraordinary situation. It is not a single market. It's not like the 1987 stock market crash or the 1970 commercial paper crisis. Virtually all the markets—particularly the credit markets—are not functioning or are in extreme stress. It's really an extraordinary situation, and I think everyone can agree that it's creating enormous risks for the global economy.

What to do about it? The exchange we just had suggests that we may have disagreements about the benefits of liquidity provision. I personally think that it has been helpful. But I think we can agree that it is obviously not a panacea because, as the Vice Chairman points out, it doesn't address the underlying capital issues. That suggests that the right solutions probably have a significant fiscal element to them. However, one feature of the last few days is how striking, how uncoordinated, and how erratic some of the fiscal approaches have been—particularly in Europe, where there has been a remarkable lack of coordination in the European Union. So the fiscal

solutions are coming, but they're not there yet, and it is going to be a while. We need greater clarity on those issues. We had a meeting today on the Treasury's authority, and they are hoping in the next few weeks to begin to provide greater clarity, which will be very helpful. But I think that, if we can find some kind of bridge, it would be helpful, and that's what this meeting is about.

Although the financial markets are the dramatic element of the situation, I think we can make a case for easing policy today on the macro outlook, as given by Larry and Nathan. I won't go into detail. I think it's fairly clear. You look first at inflation, and you see the remarkable decline in commodity prices, the appreciation of the dollar, and the decline in breakevens. The 10-year breakeven this morning was about 1.35. Of course, that could be a noisy indicator, but certainly it's quite low. I would say that, in terms of activity and the relation to inflation, we don't have to rely on any flat Phillips curves here. We have a global slowdown, and the implications for commodity prices are first order for our inflation forecast. It is never safe to declare inflation under complete control, and I certainly don't claim that no risks are there; but clearly the outlook for inflation is not looking nearly so threatening as it may have in the past.

On the economic growth side, what is particularly worrisome to me is that, before this latest upsurge in financial stress, we had already seen deceleration in growth, including the declines, for example, in consumer spending. Everyone I know who has looked at it—outside forecasters and the Greenbook producers here at the Board—believes that the financial stress we are seeing now is going to have a significant additional effect on growth. Larry gave some estimates of unemployment above 7 percent for a couple of years. So even putting aside the extraordinary conditions in financial markets, I think the macro outlook has shifted decisively toward output risks and away from inflation risks, and on that basis, I think that a policy move is justified.

I should say that this comes as a surprise to me. I very much expected that we could stay at 2 percent for a long time, and then when the economy began to recover, we could begin to normalize interest rates. But clearly things have gone off in a direction that is quite worrisome. One could legitimately ask questions about the transmission mechanism under these conditions, and I think those are good questions. But first it seems to me that we can, to some extent, offset costs of credit through our actions, even if spreads are wide. Second, to the extent that the global coordination creates some more optimism about the future of the global economy, we may see some improvements in credit spreads. We may not, but it seems to me that this is the right direction in which to go.

Despite everything that's happening, I might not be bringing this to you at this point, except that we have the opportunity to move jointly with five other major central banks, and I think the coordination and cooperation is a very important element of this proposal. First of all, again, I mentioned before the lurching and the lack of coordination among fiscal authorities and other governments. I think it would be extraordinarily helpful to confidence to show that the world central banks are working closely together, have a similar view of global economic conditions, and are willing to take strong actions to address those conditions. I think that there is a multiplier effect, if you will. Our move, along with these other moves, will have a stronger effect on the global economy and on the U.S. economy than our acting alone. Moving together has other benefits. Just to note one, we can have less concern about the dollar if we're all moving together and less concern about inflation expectations given that all the banks are moving and all see the same problem.

There is a tactical issue. I think the real key to this is actually the European Central Bank. They have had some difficulty coming to the realization that Europe would be under a great deal of stress and was not going to be decoupled from the United States. They made an important

rhetorical step at their last meeting to open the way for a potential cut, but I think that this coordinated action gives them an opportunity to get out of the corner into which they are somewhat painted and their move will have a big impact on global expectations about policy responsiveness. So, again, I think the coordination is a very important part of this.

I want to say once again that I don't think that monetary policy is going to solve this problem. I don't think liquidity policy is going to solve this problem. I think the only way out of this is fiscal and perhaps some regulatory and other related policies. But we don't have that yet. We're working toward that. We are in a very serious situation. So it seems to me that there is a case for moving now in an attempt to provide some reassurance—it may or may not do so—but in any case, to try to do what we can to make a bridge toward the broader approach to the crisis.

So that's my recommendation, that we join the other central banks in a 50 basis point move before markets open tomorrow morning. If we proceed in that direction, there are, as I mentioned, two statements. Brian, do the Presidents have the joint statement?

MR. MADIGAN. They do not.

CHAIRMAN BERNANKE. All right. I'm going to read the joint statement by central banks, which has been negotiated with the other central banks. So we really can't edit this one because of the negotiations that have already taken place. However, you should already have the FOMC statement. So here's the joint statement by central banks:

"Throughout the current financial crisis, central banks have engaged in continuous close consultation and have cooperated in unprecedented joint actions such as the provision of liquidity to reduce strains in financial markets. Inflationary pressures have started to moderate in a number of countries, partly reflecting a marked decline in energy and other commodity prices. Inflation expectations are diminishing and remain anchored to price stability. The recent intensification of

the financial crisis has augmented the downside risks to growth and thus has diminished further the upside risks to price stability. Some easing of global monetary conditions is therefore warranted. Accordingly, the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, Sveriges Riksbank, and the Swiss National Bank are today announcing reductions in policy interest rates. The Bank of Japan expresses its strong support of these policy actions."

So that would be the joint statement. Then we would issue separately on our website the FOMC statement. Let me stop there and open the floor for comments on the action, on the general situation, on the statement, or whatever you would like to talk about. Would anyone like to speak? President Yellen.

MS. YELLEN. Thank you, Mr. Chairman. I strongly support your proposal to cut the federal funds rate by 50 basis points today and the wording of the statement. I'm pleased that the FOMC will take this step as part of a coordinated program with other central banks. In my opinion, a larger action could easily be justified and is ultimately likely to prove necessary. We're witnessing a complete breakdown in the functioning of credit markets, and it is affecting every class of borrowers. The financial developments are dangerous and are having a pronounced impact on the economic outlook. The outlook has deteriorated very sharply, and even so, I still see the risks to the downside. Moreover, recent data on consumer and capital spending and on housing confirm that a sharp contraction in domestic demand is under way. As far as I'm concerned, for the reasons you gave, inflation risks have diminished markedly. Indeed, in a contraction as severe as that which is now on the horizon, I anticipate that inflation will decline noticeably below my own estimate of price stability. I think the Board has taken a wide array of creative and massive actions to provide liquidity to the credit markets. I think these are very appropriate and necessary. I hope we will do

more, but they are not completely a substitute for cutting the federal funds rate. I think that's an important complement to the liquidity actions.

CHAIRMAN BERNANKE. Thank you. Vice Chairman Geithner, you had a two-hander?

VICE CHAIRMAN GEITHNER. I just wanted to point out that I have assembled a historic coalition in New York of hawks on both sides of me today in support of your proposal. They have agreed to join me here in New York as a gesture of support for your proposal.

CHAIRMAN BERNANKE. Somebody send me a photograph.

MR. FISHER. Mr. Chairman, we enjoy visiting Third World countries. [Laughter]

MR. PLOSSER. We just thought we would outflank him, but we haven't succeeded.

CHAIRMAN BERNANKE. I don't know where to go from there. [Laughter] Are there any other comments? President Plosser.

MR. PLOSSER. Thank you, Mr. Chairman. I'd just like to make a couple of observations and perhaps ask a question and make maybe one observation about language. As a general proposition, I do not like intermeeting cuts. I think they signal more panic than they do stability. On the other hand, I think this is an opportunity, given what the other central banks are doing, that might prove to be an exception to that. So I am reluctantly or modestly comfortable with this, however you want to characterize it, because I don't think that anything that we do today—cutting the funds rate 50 basis points or whatever—is going to make the next couple of months in terms of the overall economy any less painful. They won't be felt in the real economy for some time to come. They may provide some solace to the markets. I hope that they will. I wouldn't bet the ranch on that, but I do think that the coordinated effort might be helpful. I like in the statement the stressing of the point that, as you put it, this is based on a deteriorating economic outlook, and I

think it is very important that we continue to emphasize that point as opposed to just volatility in the financial markets. So I feel that's very helpful.

I have one question. President Yellen alluded to this, and I would like your thoughts on this, Mr. Chairman. Obviously, as we have been experiencing over the last year, things have seemed to change very rapidly at times, sometimes in surprising ways and in ways that we couldn't anticipate. But I have stressed in past meetings the importance for us of thinking not just about a funds rate decision on any given day or at any given meeting but about what we think the path should look like. So rather than just considering our action today, we obviously have a scheduled meeting coming up in a few weeks. Do you think that this is the precursor, as President Yellen suggested, to perhaps additional cuts, and where do you think a likely path might take us going forward, given that this is an intermeeting cut?

My last comment has to do with the language, and I'd just like to make an observation about the sentence on inflation. It reads, "Inflation has been high, but the Committee believes that the decline in energy and other commodity prices and the weaker prospects for economic activity have materially reduced the upside risks to inflation." I guess I would make two observations, Mr. Chairman. One, that seems to be a much stronger statement about the reduction in the prospects for inflation than actually you gave in your speech today, where you emphasized that it had been reduced but that there continues to be lots of uncertainty and inflation continues to need monitoring. I would put on the table for discussion that we change the phrase "materially reduced" to these things have "mitigated near-term upside risks to inflation." Clearly commodity and oil prices have both mitigated the expectational channel for inflation in the near term. But I'm not necessarily convinced—and it's very model dependent—as to what inflation might do in the latter part of '09

and so forth. So I think that we should emphasize that the inflation risks for the near term have been mitigated as our rationale there. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. To respond to your question, I am not planning any particular action at the regular meeting at this point or any particular recommendation. Obviously, given how quickly things are changing, the world could be very different then from the way it is now. I think this is a good opportunity to move with the other central banks, as you mentioned.

Thinking about funds rate paths, we all have to be aware that we are, in fact, now at a very low level, and there are serious questions about the functioning of markets and the economy at extraordinary low levels of interest rates. So that constraint is going to be an issue, and it will affect our decision as we think about it. But I feel rather unconfident about predicting the path of rates six months in the future because I'm not quite sure what is going to happen tomorrow at this point. Let me turn to President Stern.

MR. STERN. Thank you, Mr. Chairman. I support reducing the funds rate target 50 basis points and doing it now. I think we ought to take advantage of the situation that has arisen with regard to coordinated action with other central banks. That seems to me to be important and appropriate at this point, given the extraordinary circumstances that we confront.

I'd just make a couple of other comments. Larry Slifman marked down the economic outlook for the next several quarters for sure and I guess longer than that. If I were doing my forecast today, I would mark down the near-term outlook even more. It seems to me that the restraints on the economy together with the nature of the incoming evidence suggest that the near-term outlook at least is not terribly promising—not that we can do very much about that, of course. But I think maybe more important, I have been one who for some time thought that it was likely that inflation would diminish relatively quickly. That apparently isn't going to happen or didn't happen

in the third quarter as measured by core, but the incoming evidence both nationally and globally suggests to me that inflation risks have diminished. I've expected that to be the case. It seems to be unwinding in that fashion. Obviously I didn't anticipate the path of commodity prices and the stress in the financial markets to the degree that it has occurred, but they only reinforce my confidence that inflation, in fact, will run lower from here. Thank you.

CHAIRMAN BERNANKE. Thank you. President Evans.

MR. EVANS. Thank you, Mr. Chairman. I'd like to say that your own commentary touched on almost all the issues that I had in front of me. I can support this action. I'm not sure it's the ideal time, but I can certainly support this. I agree with you that I think inflationary pressures will be coming down. I think that we're looking at significant resource slack. Commodity prices are coming down, and the prospects for growth are not good at all. I think the only thing keeping us from calling this a recession is the official people who are in charge of doing that.

I don't want you to misinterpret my question about our balance sheet and the size of what we're extending to the markets when I asked about $3 trillion when I added in the Treasury proposal. Clearly there is a lot of financial stress out there, and I think that we're facing a very substantial credit crunch of unusual proportions. I agree that these facilities are attempting to unlock the lending capacity, as Vice Chairman Geithner mentioned. I think that's extremely helpful. I just have concerns—these are very, very large, unprecedented actions—and I'm sure that everybody else shares them as well. I'm reasonably confident that there's adequate risk management in terms of the collateral, but this is certainly something that we all should be concerned about.

You also mentioned the transmission mechanism. I normally don't think that timing issues are that important. But when we cut the funds rate tomorrow morning and when the headwinds are

still the predominant factor, I just wonder whether or not the economy will notice. I think that ultimately the liquidity will continue to flow out, and it will have some effect, but I don't know how large it will be, and that is a risk. Nevertheless, the opportunity to take a coordinated action with the foreign central banks that you mentioned is very important, and as President Plosser and you already mentioned, I'm not sure what this means for future actions, but we're not very good at being able to say how the economy is going to go from here. So I can support this action. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. Governor Kohn.

MR. KOHN. Thank you, Mr. Chairman. I support the proposal for all the reasons that others have given. I think the incoming data and the events of the last month or so suggest a major downward revision to expected income and a substantial revision to expected inflation. On the income side, we still have very substantial downside risk. This is a credit crunch. Banks won't lend to each other. It's hard to imagine that they will lend much to households and businesses unless they perceive those households and businesses to be super-safe borrowers. I think there's a real risk of a very sharp downturn in the economy here. It's not my modal forecast, but I think that tail has gotten very fat. So even on a mechanical basis, a Taylor rule or something like that on a forecast basis would justify a 50 basis point cut in the funds rate. But this isn't about mechanics. We're in the middle of a crisis of confidence, really, in the financial markets, and I think part of the dynamic that we're seeing out there is concern about how the financial markets and the economy will interact.

I agree with everyone else that a cut in the federal funds rate is certainly not a panacea. It's not going to restore confidence instantaneously. But I do think the coordinated action by the central banks will have an effect around the edges on interest rates and on the cost of capital, but even more

in confidence that at least some functions here are operating—people are consulting internationally and are willing to take decisive action. It's not going to be sufficient to get us out of where we are, but I think it's a necessary step. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. President Rosengren.

MR. ROSENGREN. Economic and financial conditions have deteriorated significantly. I strongly support a 50 basis point reduction, and I would not change the language. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. President Fisher.

MR. FISHER. Mr. Chairman, I find especially attractive the global coordination that you and others have engineered here. I think it's important that we act in concert with our colleagues. I don't have any problem with the statement. I do worry about whether or not we have any bullets left in our holster on this front, and I think we need to be mindful of that as we go forward. I'm sympathetic to President Plosser's comment about inflation, but I think in this case that the inference is pretty clear—that is, we're accepting the fact that this economic weakness that is driven or exacerbated by the intensification of the financial market turmoil does reduce the risk to inflation—and I think the implication is "for the foreseeable future."

I trust, however, going back to a point that Governor Mishkin made before his departure—it may surprise you that I agree with Governor Mishkin—that we do have to be resolute in our understanding that we will not repeat the mistakes that have been made in the past. Once this condition is under control and the economy begins to repair—and I expect it will be quite a while before that occurs—I hope that we will not be the least bit hesitant to tighten monetary policy if it's required and not make the mistake of the past of waiting too long. Incidentally, markets are rarely

satisfied even with an action such as the one that's about to be taken, and they'll ask for more, and they'll want to take more. But I support the cut, Mr. Chairman. Thank you.

CHAIRMAN BERNANKE. Thank you. President Lockhart.

MR. LOCKHART. Thank you, Mr. Chairman. I also support the policy action and really have nothing to add in terms of its rationale. But in the statement there is really no reference to the coordinated and global nature of the action. I'm sure that's purposeful. It does seem to me that we have an opportunity perhaps to reinforce the psychological power of this by referencing it. So my question is, Why not include some nod to that aspect, which in the minds of so many people seems to be the real power behind this decision? Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. President Lockhart, just again the structure of the announcement. There will be two parts. The first part is joint from all of the central banks and, of course, will focus on the coordinated aspects of this. The second part is specific to each central bank reflecting on its own national situation. So, in fact, the common announcement will begin with an emphasis on the coordination aspects of this move. President Lacker.

MR. LACKER. Thank you, Mr. Chairman. Economic growth has undoubtedly weakened in the past two months, and that was getting me comfortable with a 2 percent funds rate. I don't have any objection to the cut in interest rates at this time. I am sympathetic to President Plosser's suggestion about the language about inflation. It is quite a swing from our previous language to what we have in the draft here, although actually part of me likes the joint statement better. But I can see the need for our own statement.

About use of our balance sheet, it's hard for me to see why it's absolutely necessary for a recovery. A lot of what we've done has been sold to us as insurance against the possibility of runs, fire sales, margin spirals, or various theoretical possibilities that involve some inefficient devolution

of activity separate from fundamentals. If the fundamentals improve, it seems to me likely that lending is going to return whether or not these facilities are in place. More broadly, I'm worried about unwinding these. I'm afraid that it might be as difficult as it would be for the FDIC to reduce their deposit insurance premium back from $250,000 to $100,000 after this. I think it would be worthwhile, as we go on with financial markets in such turmoil, to reflect on whether what we're seeing is genuine fundamental uncertainty about counterparties and whether our lending is the equivalent of pushing on a string, to use another metaphor from the Great Depression.

CHAIRMAN BERNANKE. Quoting Keynes, I see, Jeff. All right. President Pianalto.

MS. PIANALTO. Thank you, Mr. Chairman. I also support your recommendation to reduce our target fed funds rate by 50 basis points. Clearly, as has been noted, economic activity has weakened substantially since our last meeting, and inflation concerns have lessened. For all the reasons you articulated, especially the opportunity to participate in a coordinated effort with other central banks, I think a 50 basis point cut in our fed funds rate target is appropriate today. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. Actually, going back to President Lacker and President Plosser, President Lacker made the point about the joint statement. The joint statement with respect to inflation says "the recent intensification of the financial crisis has augmented the downside risks to growth and thus has diminished further the upside risks to price stability." I would be content if the preference of others is to take out the word "materially" and just say "have reduced the upside risks to inflation." That would be perhaps more consistent, but I'm happy either way. So that's just a suggestion. Let me go on now to Bob Rasche.

MR. RASCHE. Thank you, Mr. Chairman. President Bullard has a prior commitment and was unable to participate in the discussion. He's asked me to present some comments to reflect his views, and with your permission, I'd like to proceed.

CHAIRMAN BERNANKE. Go ahead.

MR. RASCHE. It is not desirable to implement a reduction in the intended funds rate at this time. First, intermeeting actions should be reserved for those few instances in which significant unforeseen developments with predictable consequences for the economy occur. The current situation is highly volatile and unsettled. Clearly financial markets are experiencing great turmoil. However, we have established new risk facilities to address liquidity issues, including new facilities in the past two days.

The outlook for economic activity in the second half of 2008 has deteriorated. It is likely that this period eventually will be labeled a recession. Probably the extent of the weakness is not apparent at this time. The revised forecast from the Board's staff as of last Friday is for real GDP to be essentially flat for the current and final quarter of 2008. The Macro Advisers forecast from last weekend has flat GDP for the third quarter and a 2 percent annual rate of decline in the fourth quarter followed by weak but positive real growth in the first half of 2009. While the uncertainty surrounding these forecasts may be greater than in a typical environment and while a good case can be made that the risk to the forecast is weighted to the downside, there's still a significant probability that any recession will be quite mild. We have acted preemptively, aggressively, and unilaterally since the beginning of the year against the risk of an economic slowdown. We can afford to be patient until we have more information and can better assess the impact of recent financial market events on the real economy.

Second, a rate cut at this time carries downside reputational risk. After the decline in equity prices over the past ten days, an action today could be perceived as an effort to shore up those markets. Whether we like it or believe it, a significant population is convinced that we set policy to provide a "Greenspan put" for the markets. A rate action under current conditions could reinforce that perception. If there is a dramatic market rally before the next scheduled meeting, would we entertain a reversal of any actions taken today? Worse, if equity markets continue to slump between now and the end of the month, would we entertain additional rate cuts solely for that reason? At this point it's too soon to realize any impact of the TARP. The idea of a "Wall Street bailout" is not universally popular, and commentators and pundits are already questioning whether it will succeed. A rate action today carries the risk that the Committee will be perceived as questioning whether the TARP can achieve the desired results.

Finally, an action today could be interpreted as a lack of confidence on the part of the Committee in the efficacy of various liquidity facilities that have been announced or enhanced in the recent past. Thank you.

CHAIRMAN BERNANKE. Thank you. Governor Warsh.

MR. WARSH. Thank you, Mr. Chairman. Let me make three brief points. First, on financial markets, I think Bill described them accurately as a mess. I guess to amplify that comment I'd say that what appears now in financial markets is that the thesis we've been talking about—that this is significantly about housing—seems to some extent overcome by events. I think the best way to view financial markets is to say that what's fundamentally going on is a reassessment of the value of every asset everywhere in the world, and what might have been triggered by housing has certainly gone beyond that. That forces us and market participants alike to think about the mix of policy responses, not principally or not just from the Federal Reserve.

Second, on the economy, I suspect that it will be increasingly hard to find decouplers, and I suspect that the real economic problems in Europe and among the advanced foreign economies are likely to be more real, deeper, and harder for them and their economies to respond to than ours. So as Nathan suggests, that makes the policy decisions they have over the coming months and our ability to count on a global recovery even more suspect.

Third, on the policy front, in thinking about this as a global, synchronized rate cut it strikes me that the first two words of that phrase are far more important than the last two and that the focus on global, synchronized action is an important symbol to markets not just here but abroad—that the world's central banks and policy action are very focused and that all of us will do whatever it takes to try to make sure that the real economy and financial markets respond more positively. So I take your judgment, Mr. Chairman, that this is the right time—to take advantage of the action of a host of central banks; and I'll join the realistic expectations crowd in thinking that we shouldn't oversell what's the likely policy response.

In terms of the statement itself, I would be comfortable with the statement as written but would have a preference to dropping "materially" as you suggest. Thank you.

CHAIRMAN BERNANKE. Governor Kroszner.

MR. KROSZNER. Thank you very much. With the intermeeting move that we had back in January—10 months ago, which now of course seems like 10 years ago—we spoke a lot about the possibility of a regime shift—that there's a growth state and a contraction state and there could be a nonlinear movement between the two. Unfortunately, over the past few weeks we've seen some evidence of that nonlinear shift, both in the real economy and in financial markets. In particular, we're seeing that globally—we are seeing a very, very sharp change internationally in growth prospects, and that's being reflected in the financial markets. One reason that we're seeing some of

the problems in the financial markets, as mentioned by a number of participants, is the concern about insufficient capital. Well, one reason for the concerns about insufficient capital and the heightening of those concerns is what losses are going to be faced. Obviously the real economy has to do with how the housing market is going to evolve, which has to do with wealth, which has to do with unemployment, and I think that's part of what's feeding what's going on. That's why I think a significant move now, especially coordinated internationally, could be helpful in trying to reduce some of that macroeconomic tail risk. We are seeing reasonable evidence that we're shifting into a contraction regime, if you will, rather than a growth regime. I think we were fighting hard against that with our earlier rate cuts and with our liquidity facilities. I think we were able to hold that shift at bay for a while. But now we have some evidence that we've moved into this other regime, and I think that is partly what is feeding the problems in the financial markets. That's why it's extremely important that we make this move and make it in a coordinated, international way.

As others have also mentioned, we're starting to come close to running out of ammunition. So if we are going to take a shot, we had better make it as powerful as possible. Doing it in an internationally coordinated way is to make it as powerful as possible. So I very much support the actions.

CHAIRMAN BERNANKE. Thank you. Governor Duke.

MS. DUKE. Thank you, Mr. Chairman. I don't have an awful lot to add to what has already been said. I'm not optimistic that this will necessarily increase financial institutions' confidence in lending to each other, but I think the coordinated action at least will be something that maybe helps to give some confidence in the certainty of future actions. I think a lot of it has been the unpredictability of what government is going to do. So that may help on that score, and I support the action.

CHAIRMAN BERNANKE. Thank you. Vice Chairman.

VICE CHAIRMAN GEITHNER. Mr. Chairman, I support your recommendation and the statement as drafted and commend you for taking this initiative and bringing together the central banks of the major economies at this time. I would just say that there is substantial risk that this will get substantially worse before it gets better, and we may have to do further escalation on a range of fronts. I'm not saying monetary policy necessarily, but it's good to prepare for that possibility.

CHAIRMAN BERNANKE. Okay. Anyone else? First Vice President Rasdall from Kansas City.

MR. RASDALL. Thank you, Mr. Chairman. Briefly, we support the recommendation and the statement and recognize the significance of the opportunity to move with the other five central banks. Thank you.

CHAIRMAN BERNANKE. Thank you. I didn't hear a clear sense on the word "materially," but if there's not a strong view one way or the other, I guess I would suggest striking it on the grounds that it's a little more continuous with our previous communication and similar to the common statement. Is there anyone who is concerned about that change? President Plosser, did you have a comment?

MR. PLOSSER. I would prefer that. I think it is more consistent with both your speech today and our previous statements and it still conveys the correct message. So I support and would be happy with just leaving out "materially."

CHAIRMAN BERNANKE. Okay. Thank you. Anyone else? If not, Ms. Danker, can you call the roll please?

MS. DANKER. Yes. The vote will encompass both the directive and the policy statement that were distributed earlier today, with the exception of the final sentence in the second paragraph

of the draft policy statement, which says, “Inflation has been high, but the Committee believes that the decline in energy and other commodity prices and the weaker prospects for economic activity have reduced the upside risks to inflation.”

Chairman Bernanke	Yes
Vice Chairman Geithner	Yes
Governor Duke	Yes
President Fisher	Yes
Governor Kohn	Yes
Governor Kroszner	Yes
President Pianalto	Yes
President Plosser	Yes
President Stern	Yes
Governor Warsh	Yes

CHAIRMAN BERNANKE. Thank you. Thank you for a constructive discussion. Again, I believe it is 7:00 a.m. tomorrow for the release of the information. Brian has handed me a note here. We’re going to be considering the request of Boston to reduce the discount rate by 50 basis points. That’s the request that we have. All right. Thank you very much.

END OF MEETING