

Minutes of the Federal Open Market Committee July 31–August 1, 2012

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, July 31, 2012, at 1:00 p.m. and continued on Wednesday, August 1, 2012, at 9:00 a.m.

PRESENT:

Ben Bernanke, Chairman
William C. Dudley, Vice Chairman
Elizabeth Duke
Jeffrey M. Lacker
Dennis P. Lockhart
Sandra Pianalto
Jerome H. Powell
Sarah Bloom Raskin
Jeremy C. Stein
Daniel K. Tarullo
John C. Williams
Janet L. Yellen

James Bullard, Christine Cumming, Charles L. Evans, Esther L. George, and Eric Rosengren, Alternate Members of the Federal Open Market Committee

Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser, Presidents of the Federal Reserve Banks of Dallas, Minneapolis, and Philadelphia, respectively

William B. English, Secretary and Economist
Deborah J. Danker, Deputy Secretary
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
Steven B. Kamin, Economist
David W. Wilcox, Economist

David Altig, Thomas A. Connors, Michael P. Leahy, James J. McAndrews, William Nelson, David Reifschneider, William Wascher, Associate Economists

Simon Potter, Manager, System Open Market Account

Michael S. Gibson, Director, Division of Banking Supervision and Regulation, Board of Governors

Nellie Liang, Director, Office of Financial Stability Policy and Research, Board of Governors

Jon W. Faust and Andrew T. Levin, Special Advisors to the Board, Office of Board Members, 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

Seth B. Carpenter, Senior Associate Director, Division of Monetary Affairs, Board of Governors

Thomas Laubach, Senior Adviser, Division of Research and Statistics, Board of Governors; Joyce K. Zickler, Senior Adviser, Division of Monetary Affairs, Board of Governors

Michael T. Kiley and David E. Lebow, Associate Directors, Division of Research and Statistics, Board of Governors

Karen M. Pence, Assistant Director, Division of Research and Statistics, Board of Governors

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

Elizabeth Klee, Senior Economist, Division of Monetary Affairs, Board of Governors; Robert J. Tetlow, Senior Economist, Division of Research and Statistics, Board of Governors

David A. Saperano, First Vice President, Federal Reserve Bank of St. Louis

Jeff Fuhrer and Daniel G. Sullivan, Executive Vice Presidents, Federal Reserve Banks of Boston and Chicago, respectively

Troy Davig and Christopher J. Waller, Senior Vice Presidents, Federal Reserve Banks of Kansas City and St. Louis, respectively

Reuven Glick, Group Vice President, Federal Reserve Bank of San Francisco

Todd E. Clark, Lorie K. Logan, Keith Sill, and Mark A. Wynne, Vice Presidents, Federal Reserve Banks of Cleveland, New York, Philadelphia, and Dallas, respectively

Robert L. Hetzel and Samuel Schulhofer-Wohl, Senior Economists, Federal Reserve Banks of Richmond and Minneapolis, respectively

Simple Rules for Monetary Policy

A staff presentation summarized research on the efficacy of alternative simple monetary policy rules in fostering the Federal Reserve's monetary policy objectives of maximum employment and price stability. The presentation reviewed the characteristics of a variety of rules and noted a number of reasons why current conditions might warrant deviating from the prescriptions of simple rules designed for more normal times. The presentation also discussed how simple rules might be used as part of a comprehensive policy framework to provide clear and transparent benchmarks for monetary policy decisionmaking and the possibility that such rules could be helpful in communicating the connection between policy choices and the Federal Open Market Committee's (FOMC) objectives.

Meeting participants expressed a range of views regarding the appropriate role of policy rules in monetary policy decisionmaking. A number of participants indicated that such rules have played a useful role in informing the Committee's monetary policy deliberations. However, several participants pointed to specific considerations—including the possible mismeasurement of unobservable variables, such as potential output, and uncertainty about the appropriate economic models to use in estimating the magnitude of those variables—that might limit the usefulness of simple rules both internally and in public communications. Several participants saw value in examining the performance of rules across a range of economic models. Participants discussed the case for making adjustments to the prescriptions of simple policy rules in the current circumstances to take into account various considerations such as the effective lower bound for the federal funds rate, the effects of the Committee's balance sheet policies, and potential shifts in the dynamics of the economy. Some participants noted that adjustment of standard policy rules for balance sheet policies would

tend to push up the federal funds rate prescription, while a number of participants indicated that other factors related to current circumstances may warrant maintaining an accommodative stance of policy for longer than would be prescribed by standard rules. With regard to the latter, some participants suggested that inertial policy rules—that is, rules under which any movements in the stance of policy tend to be fairly persistent—would be most appropriate in the current context.

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

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the FOMC met on June 19–20, 2012. He also reported on System open market operations, including the ongoing reinvestment into agency-guaranteed mortgage-backed securities (MBS) of principal payments received on SOMA holdings of agency debt and agency-guaranteed MBS as well as the operations related to the continuation of the maturity extension program authorized at the June 19–20, 2012, FOMC meeting. His report included a summary of analysis prepared by the staff on the potential implications of the size and composition of the Federal Reserve's securities portfolio for private-sector holdings of Treasury securities and agency MBS and for trading conditions in markets related to these securities. The Manager also reported on recent developments in European money markets and implications for the yields on the euro-denominated assets that the Federal Reserve holds in its foreign exchange reserves. By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

Staff Review of the Economic Situation

The information reviewed at the July 31–August 1 meeting indicated that economic activity increased at a slower pace in the second quarter than earlier in the year and that labor market conditions had improved little in recent months. In addition, revised data for 2009 through 2011 from the Bureau of Economic Analysis indicated that the recession had been slightly less deep and the early part of the subsequent recovery had been a bit more gradual than previously thought, leaving the level of real gross domestic product (GDP) at the end of last year essentially the same as estimated earlier. In the second quarter, consumer price inflation was markedly lower than in the first quarter, mostly

reflecting substantial declines in consumer energy prices, while measures of longer-run inflation expectations remained stable.

Private nonfarm employment expanded in June at about the same modest pace as in the second quarter as a whole, and government employment decreased slightly. The unemployment rate was 8.2 percent in June, the same as its average during the first half of the year. The rate of long-duration unemployment stayed elevated, and the share of workers employed part time for economic reasons was still high. Indicators of job openings and firms' hiring plans were generally subdued. While initial claims for unemployment insurance trended down a bit over the intermeeting period, they remained at a level consistent with continued modest increases in employment in the coming months.

Manufacturing production decelerated significantly in the second quarter following a large gain in the first quarter, while the rate of manufacturing capacity utilization was unchanged on balance. The production of motor vehicles and parts increased considerably last quarter, but factory output outside of the motor vehicle sector was essentially flat. Automakers' schedules indicated that the pace of motor vehicle assemblies in the third quarter would be about the same as in the second quarter. Broader indicators of manufacturing output, such as the diffusion indexes of new orders from the national and regional manufacturing surveys, declined in recent months and were at levels consistent with only muted increases in production in the near term.

Real personal consumption expenditures increased at a slower rate in the second quarter than in the first quarter, primarily reflecting a decrease in spending for motor vehicles. Meanwhile, real disposable personal income rose at a faster pace than consumer spending in both the first and second quarters, boosted in part in recent months by lower energy prices. Consumer sentiment as measured by the Thomson Reuters/University of Michigan Surveys of Consumers (Michigan Survey) was more downbeat in June and July than earlier in the year.

Conditions in the housing market generally improved further in recent months, but activity remained at a low level against the backdrop of the large inventory of foreclosed and distressed properties and tight underwriting standards for mortgage loans. Both starts and permits of new single-family homes increased in the second quarter. Starts of new multifamily units were about the same last quarter as in the previous quarter, but permits rose, which pointed to higher multifamily

construction in the coming months. Home prices increased in May for the fifth consecutive month. Sales of new homes in the second quarter were moderately higher than in the first quarter, but existing home sales decreased slightly.

Real business expenditures on equipment and software rose in the second quarter at a faster pace than in the first quarter. However, new orders for nondefense capital goods excluding aircraft decreased last quarter, and the backlog of unfilled orders decelerated sharply. Other recent forward-looking indicators, such as surveys of business conditions and capital spending plans, also suggested that increases in outlays for business equipment would slow in coming months. Real business spending for nonresidential construction increased somewhat in the second quarter but remained at a relatively low level. Meanwhile, business inventories generally appeared to be relatively well aligned with sales.

Real federal government purchases decreased a little in the second quarter, following a much sharper decline in the previous three quarters, as the continued contraction in defense spending eased. Real state and local government purchases continued to contract at a moderate rate last quarter.

The U.S. international trade deficit narrowed in May, as exports edged up and imports declined. The increase in exports primarily reflected higher exports of services and agricultural products. The decrease in imports was the result of a decline in oil imports, as both the price and the quantity of oil imports fell. Imports of consumer goods and industrial supplies also moved down, but imports of capital goods and automotive products increased. Based on an estimate of the trade data for June, the advance release of the national income and product accounts showed that real net exports of goods and services made a small negative arithmetic contribution to the increase in U.S. real GDP in the second quarter.

Overall U.S. consumer prices increased at a slower pace in the second quarter than in the first. Consumer energy prices declined significantly last quarter, and survey data indicated that gasoline prices fell somewhat further in the first few weeks of July. Meanwhile, consumer food prices posted only a small increase last quarter, but the recent sizable run-up in spot and futures prices of farm commodities, reflecting the effects of the drought and hot weather in the midwestern part of the United States, pointed to some temporary upward pressures on retail food prices later this year. Consumer prices excluding food and energy increased more mod-

erately in the second quarter than in the first. Near-term inflation expectations from the Michigan Survey rose a little in June and July, while longer-term inflation expectations in the survey continued to be stable.

Available measures of labor compensation indicated that nominal wage gains remained restrained. The employment cost index rose at a modest pace again in the second quarter. Average hourly earnings for all employees also increased at a relatively slow rate last quarter.

Foreign economic growth continued to be subdued, as fiscal retrenchment and financial stresses in the euro area continued to weigh on economic activity in Europe and elsewhere. Recent indicators of production and confidence in the euro area remained weak, and the preliminary second-quarter estimate of real GDP in the United Kingdom showed a contraction. Real GDP in China accelerated somewhat in the second quarter following a relatively weak expansion in the first quarter, and recent monthly data suggested some further improvement. However, data for other emerging market economies generally pointed to a deceleration in economic activity last quarter. Foreign inflation eased in the second quarter and remains well contained, as earlier declines in the prices of energy and other commodities passed through to the retail level.

Staff Review of the Financial Situation

Several factors influenced developments in financial markets since the time of the June FOMC meeting. Generally weaker-than-expected economic data in the United States, concerns about the fiscal and banking situation in the euro area, and the outlook for global economic growth weighed on investor sentiment. However, the effects of these factors were offset to some extent by actual and expected easing of monetary policy in the United States and abroad and by better-than-anticipated profits at some S&P 500 firms.

Interest rates generally moved down, on net, over the intermeeting period. The yield on nominal 10-year Treasury securities declined to a historically low level, partly due to a lower expected path of the federal funds rate, the continuation of the maturity extension program announced at the June FOMC meeting, and perceptions of an increased likelihood that the Federal Reserve will ease monetary policy further. In addition, persistent concerns about euro-area developments were reportedly associated with increased safe-haven demands that contributed to the decline in Treasury yields. Anecdotal reports suggested that the decrease in shorter-term yields may also have reflected somewhat

increased expectations that the Federal Reserve would reduce the interest rate paid on reserve balances in coming months. Near-term indicators of inflation expectations derived from nominal and inflation-protected Treasury securities fell modestly despite an increase in some commodity prices; such indicators changed little at longer horizons. The expected path for the federal funds rate derived from money market futures quotes shifted down.

Conditions in short-term unsecured dollar funding markets remained stable over the intermeeting period, although most peripheral euro-area institutions continued to have little, if any, access to such markets. In secured funding markets, Treasury general collateral repurchase agreement rates rose slightly on balance.

Broad indexes of U.S. equity prices rose somewhat, on net, over the intermeeting period, with significant gains prompted in part by comments from European officials that apparently raised investor expectations for near-term European policy actions. Option-implied volatility on the S&P 500 index rose slightly. Stock prices for the large domestic bank holding companies posted mixed changes over the period, and credit default swap (CDS) spreads for those firms generally moved lower on net.

Yields on investment- and speculative-grade corporate bonds fell further over the intermeeting period, approaching record lows. Their spreads relative to comparable-maturity Treasury securities narrowed but were still above their average levels prior to the financial crisis. Nonfinancial firms continued to issue debt at a strong pace over the period. Gross investment-grade corporate bond issuance remained robust in June and July, while the volume of nonfinancial commercial paper outstanding rose early in the second quarter but decreased slightly in June. Commercial and industrial (C&I) loans advanced further over the intermeeting period. Issuance in the syndicated leveraged loan market remained solid in the second quarter; terms and structures of new leveraged loan deals reportedly loosened modestly on the margin. Gross public equity issuance by nonfinancial firms was anemic in June and July.

Financial conditions in the commercial real estate market remained somewhat strained against a backdrop of weak fundamentals and still-tight underwriting. That said, issuance of commercial mortgage-backed securities picked up in the second quarter.

Despite new historical lows for residential mortgage rates over the intermeeting period, refinancing activity remained relatively muted. Evidence from the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) conducted in July indicated that mortgage underwriting standards at banks generally have not eased much from their tightest post-crisis levels. Consumer credit expanded further in May as a result of rapid increases in student loans and, to a lesser extent, auto loans. Delinquency rates for consumer credit remained low, likely in part because of a compositional shift of credit supply over the past few years toward the least-risky borrowers.

Gross issuance of long-term municipal bonds was robust in June and July. Net issuance of long-term bonds turned positive in the second quarter after staying in negative territory for much of the past year. Yields on long-term general obligation municipal bonds generally followed Treasury yields lower, while default rates remained very low and CDS spreads for states were roughly unchanged on net.

Bank credit and total loans continued to expand modestly in the second quarter, largely because of the further robust increase in C&I loans. The gradual expansion in total loans was broadly consistent with the July SLOOS, in which domestic banks generally indicated that demand strengthened for many types of loans in the second quarter and that lending standards eased somewhat, on balance, across most major loan categories.

The staff's broad nominal index for the foreign exchange value of the dollar changed little, on net, over the intermeeting period, although the dollar appreciated against the euro. Financial markets in the euro area were volatile, as a deterioration in market sentiment gave way to periods of optimism following the euro-area summit in late June, the decision by the European Central Bank (ECB) to ease policy in early July, and indications from the ECB later in July that the central bank might take further steps to support the monetary union. On net, European stock markets finished the period higher. Yield spreads on Spanish and Italian 10-year bonds over their German equivalents, which rose sharply over most of July, fell back from their intermeeting peaks but remained elevated.

Several foreign central banks eased monetary policy over the intermeeting period. The ECB cut its benchmark policy rate by 25 basis points and reduced the rate on its overnight deposit facility to zero. The Bank of England increased the size of its asset purchase pro-

gram and announced details on its new program designed to boost bank lending to the nonfinancial sector. The central banks of Brazil, China, and South Korea all reduced official rates as well. Amid policy easing in the euro area and United Kingdom, yields on German and U.K. sovereign bonds declined, with two-year German sovereign bonds trading at yields below zero.

Staff Economic Outlook

In the economic forecast prepared by the staff for the July 31–August 1 FOMC meeting, the near-term projection for real GDP growth was revised down somewhat. The revision primarily reflected a slower pace of consumer spending than the staff expected at the time of the previous projection, along with a deterioration in some forward-looking indicators. However, the staff's medium-term forecast for real GDP growth was little changed, as the slightly weaker underlying pace of economic activity suggested by the recent data was roughly offset by the anticipated effects of the continuation of the maturity extension program announced following the June FOMC meeting, which had not been incorporated in the previous projection. With the restraint from fiscal policy assumed to increase next year, the staff projected that increases in real GDP would not significantly exceed the growth rate of potential output in 2013. Thereafter, economic activity was expected to accelerate gradually, supported by an eventual easing in fiscal policy restraint, gains in consumer and business sentiment, further improvements in credit conditions, and continued accommodative monetary policy. The expansion in economic activity was anticipated to reduce the substantial margin of slack in labor and product markets only slowly over the projection period, and the unemployment rate was expected to remain elevated at the end of 2014.

The staff's forecast for inflation was little changed from the projection prepared for the June FOMC meeting. With crude oil prices expected to decline a bit from their current levels, the boost to retail food prices from the current drought in the Midwest anticipated to be only temporary and relatively small, longer-run inflation expectations remaining stable, and substantial resource slack persisting over the forecast period, the staff continued to project that inflation would be subdued through 2014.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and the outlook, meeting participants agreed that the information received since the Committee met in June sug-

gested that economic activity had decelerated in recent months to a slower pace than they had anticipated. Although business investment had continued to advance, consumer spending had slowed considerably since earlier in the year. Conditions in the housing sector appeared to have improved somewhat, but from a very low level. Indicators of manufacturing activity had softened. Recent monthly gains in payroll employment had continued to be small, and the unemployment rate in June remained at an elevated level. Consumer price inflation had been low in recent months, as declines in the costs of crude oil were passed through to retail energy prices. Longer-term inflation expectations had remained stable.

Regarding the economic outlook, most participants agreed that economic growth was likely to remain moderate over coming quarters and then pick up gradually. However, some participants indicated that they had lowered their near-term forecasts for economic growth in light of the weaker-than-expected increases in consumer spending and employment in recent months. In addition, some participants expressed concern about the persistent headwinds restraining the pace of the recovery, including the weak housing sector, still-tight borrowing conditions for some households and firms, and fiscal restraint at all levels of government. Many participants judged that a high level of uncertainty about possible spillovers from the fiscal and banking strains in the euro area and about the outlook for U.S. fiscal or regulatory policies was holding back household and business spending. And they saw the possibilities of an intensification of strains in the euro area and of a sharper-than-anticipated U.S. fiscal consolidation as significant downside risks to the economic outlook. Although participants generally agreed that improvements in recent years in the capital and liquidity of financial institutions and in the strength of household and business balance sheets have increased the resilience of the economy, some were concerned that at its current pace, the recovery was still vulnerable to adverse shocks. Given participants' forecasts of economic activity, they generally anticipated that the unemployment rate would decline only slowly toward levels that participants judge to be consistent with the Committee's mandate. Participants' assessments of the outlook for inflation were largely unchanged from those reported in June. Smoothing through the effects of fluctuations in food and energy prices, participants anticipated that inflation over the medium term would remain at or below the Committee's 2 percent longer-run objective.

Meeting participants again exchanged views on the extent of slack in labor and product markets. A number of participants expressed the view that structural changes in the labor market were not sufficient to explain the high level of unemployment. Those participants saw substantial slack in resource utilization and hence continued to judge that inflation was likely to remain subdued over the medium term as the economy continued to recover. However, several other participants interpreted the moderate pace of the recovery as pointing to a more substantial markdown in the trajectory of potential output. In particular, a couple of participants noted that they would have expected inflation to have fallen more in recent years if the output gap had been as substantial as some measures suggested. One participant posited that the sharp decline in net worth and reduced credit availability in recent years not only weighed on aggregate demand, but also reduced aggregate supply by hampering new business formation and product innovation; another participant cited evidence that structural unemployment was elevated as a result of mismatches between the skills demanded by employers and those of the long-duration unemployed.

In discussing developments in the household sector, many participants noted the recent deceleration in overall consumer spending, although a couple cited new autos and tourism as areas of relative strength. Participants saw several factors as likely contributing to slower consumer spending, including the weakness in earned income and a high level of uncertainty among households about the economic outlook. Several pointed out that while households had made considerable progress in reducing their debt and rebuilding their savings, the deleveraging process was still ongoing, the level of housing debt remained high, and a significant number of mortgage borrowers continued to be underwater on their loans. Home sales and construction were generally viewed as gradually improving, supported in part by historically low mortgage interest rates. Many participants reported that house prices in their Districts were rising or had bottomed out, and several noted that their contacts saw signs of progress in reducing the overhang of unsold properties. However, it was noted that the reduction in inventories should be viewed cautiously because owners who are underwater on their mortgages may be withholding their homes from the market, implying a substantial "shadow" inventory.

Regarding the business sector, many participants reported that, with the exception of motor vehicle production, manufacturing activity in their Districts was

slow or had declined in recent months. Nonetheless, forward-looking surveys of orders and manufacturing production in a couple of Districts were more positive. Energy-related activity continued to expand, and investment projects in that sector were reported to be moving forward. However, contacts in several Districts indicated that export demand had weakened as a result of the slowdown in economic activity in Europe; Asia; and some emerging market countries, including China. More generally, some participants reported that their business contacts regarded the economic outlook to be highly uncertain, in part due to unresolved fiscal and regulatory matters. Although several participants noted that the uncertainty had not led businesses in their Districts to reduce payrolls or cut back spending, others cited reports of shortfalls from business plans that could lead to cost-cutting, of restructuring to position firms for leaner operations, or even of postponed investment and hiring. Two participants provided an update on the situation in the agricultural sector in light of the drought in the Midwest: With crop yields projected to be down markedly and prices rising, livestock producers appeared likely to suffer losses as a result of higher input costs while crop producers would need to rely on higher prices and crop insurance to stabilize their income.

The incoming information on inflation over the intermeeting period was largely in line with participants' expectations. Consumer prices had decelerated as a result of the pass-through of lower crude oil costs to retail prices of gasoline and fuel oil. Crude oil prices had turned up again more recently, but one participant noted that global inventories of oil were elevated and, with world demand easing, prices should be restrained going forward. Participants acknowledged that the drought would likely result in a temporary run-up in consumer food prices later this year. Nonetheless, inflation was expected to remain subdued, on balance, over coming quarters. In explaining that outlook, participants cited the lack of upward pressure from labor costs and prices of imported commodities as well as the stability of inflation expectations. A couple of participants referred to information from business contacts suggesting that inflation was unlikely to decline further, and a few expressed concerns that maintaining a highly accommodative stance of monetary policy for an extended period could erode the stability of inflation expectations over time and hence posed upside risks to the inflation outlook.

Financial markets remained sensitive to ongoing developments related to the sovereign debt and banking sit-

uation in the euro area, and participants continued to view the possibility of an intensification of strains in global financial markets as a significant downside risk to the domestic economic outlook. Several participants indicated that recent trends in euro-area equity indexes and sovereign debt yields had not been encouraging, and some noted that the uncertainty prevailing in global financial markets was showing through in a cautious posture of investors. Nonetheless, participants generally agreed that conditions in domestic credit markets remained more favorable than they were a year ago. One participant pointed out that credit risk spreads—while still above pre-recession norms—may have been boosted by safe-haven demands for Treasury securities and indicated that broader financial market conditions seemed reasonably accommodative. Banks were reported to be seeing an increase in their residential mortgage business along with a continued rise in C&I lending, especially to large firms; consumer credit was also increasing.

Participants discussed a number of policy tools that the Committee might employ if it decided to provide additional monetary accommodation to support a stronger economic recovery in a context of price stability. One of the policy options discussed was an extension of the period over which the Committee expected to maintain its target range for the federal funds rate at 0 to ¼ percent. It was noted that such an extension might be particularly effective if done in conjunction with a statement indicating that a highly accommodative stance of monetary policy was likely to be maintained even as the recovery progressed. Given the uncertainty attending the economic outlook, a few participants questioned whether the conditionality of the forward guidance was sufficiently clear, and they suggested that the Committee should consider replacing the calendar date with guidance that was linked more directly to the economic factors that the Committee would consider in deciding to raise its target for the federal funds rate, or omit the forward guidance language entirely.

Participants also exchanged views on the likely benefits and costs of a new large-scale asset purchase program. Many participants expected that such a program could provide additional support for the economic recovery both by putting downward pressure on longer-term interest rates and by contributing to easier financial conditions more broadly. In addition, some participants noted that a new program might boost business and consumer confidence and reinforce the Committee's commitment to making sustained progress toward its mandated objectives. Participants also discussed the

merits of purchases of Treasury securities relative to agency MBS. However, others questioned the possible efficacy of such a program under present circumstances, and a couple suggested that the effects on economic activity might be transitory. In reviewing the costs that such a program might entail, some participants expressed concerns about the effects of additional asset purchases on trading conditions in markets related to Treasury securities and agency MBS, but others agreed with the staff's analysis showing substantial capacity for additional purchases without disrupting market functioning. Several worried that additional purchases might alter the process of normalizing the Federal Reserve's balance sheet when the time came to begin removing accommodation. A few participants were concerned that an extended period of accommodation or an additional large-scale asset purchase program could increase the risks to financial stability or lead to a rise in longer-term inflation expectations. Many participants indicated that any new purchase program should be sufficiently flexible to allow adjustments, as needed, in response to economic developments or to changes in the Committee's assessment of the efficacy and costs of the program.

Some participants commented on other possible tools for adding policy accommodation, including a reduction in the interest rate paid on required and excess reserve balances. While a couple of participants favored such a reduction, several others raised concerns about possible adverse effects on money markets. It was noted that the ECB's recent cut in its deposit rate to zero provided an opportunity to learn more about the possible consequences for market functioning of such a move. In light of the Bank of England's Funding for Lending Scheme, a couple of participants expressed interest in exploring possible programs aimed at encouraging bank lending to households and firms, although the importance of institutional differences between the two countries was noted.

Committee Policy Action

The information received over the intermeeting period indicated that economic activity had decelerated in recent months, with a notable slowing in consumer spending. Employment gains continued to be modest, and the unemployment rate was unchanged at a level that almost all members saw as elevated relative to levels consistent with the Committee's mandate. Inflation had declined from its rate earlier in the year, mainly reflecting lower prices of crude oil and gasoline, and inflation expectations had been stable. Members generally expected that economic growth would be moder-

ate over coming quarters and then would pick up very gradually. While most members did not view the medium-run economic outlook as having changed significantly since the June meeting, several noted that they had lowered their expectations for economic growth over coming quarters. Furthermore, members generally attached an unusually high level of uncertainty to their assessments of the economic outlook and continued to judge that the risks to economic growth were tilted to the downside because of strains in financial markets stemming from the sovereign debt and banking situation in Europe as well as the potential for a significant slowdown in global economic growth and for a sharper-than-anticipated fiscal contraction in the United States. A number of members noted that if the recent modest rate of economic growth were to persist, the economy would be less able to weather a material adverse shock without slipping back into recession. Most members continued to anticipate that, with longer-term inflation expectations stable and the existing slack in resource utilization being taken up very gradually, inflation would run over the medium term at a rate at or below the Committee's objective of 2 percent. In contrast, one member thought that the economy may be operating near its current potential and, thus, that maintaining the Committee's current highly accommodative policy stance well into 2014 would pose upside risks to the inflation outlook.

The Committee had provided additional accommodation at its previous meeting by announcing the continuation of the maturity extension program through the end of the year, and more time was seen as necessary to evaluate the effects of that decision. Nonetheless, many members expected that at the end of 2014, the unemployment rate would still be well above their estimates of its longer-term normal rate and that inflation would be at or below the Committee's longer-run objective of 2 percent. A number of them indicated that additional accommodation could help foster a more rapid improvement in labor market conditions in an environment in which price pressures were likely to be subdued. Many members judged that additional monetary accommodation would likely be warranted fairly soon unless incoming information pointed to a substantial and sustainable strengthening in the pace of the economic recovery. Several members noted the benefits of accumulating further information that could help clarify the contours of the outlook for economic activity and inflation as well as the need for further policy action. One member judged that additional accommodation would likely not be effective in improving the

economic outlook and viewed the potential costs associated with such action as unacceptably high. At the conclusion of the discussion, members agreed that they would closely monitor economic and financial developments and carefully weigh the potential benefits and costs of various tools in assessing whether additional policy action would be warranted.

With respect to the statement to be released following the meeting, members agreed that it should acknowledge the deceleration in economic activity, the small gains in employment, and the slowing in inflation reflected in the economic data over the intermeeting period. Because most saw no significant changes in the medium-run outlook, they agreed to continue to indicate that the Committee anticipates a very gradual pickup in economic activity over time and a slow decline in unemployment, with inflation at or below the rate that it judges most consistent with its dual mandate. Many members expressed support for extending the Committee's forward guidance, but they agreed to defer a decision on this matter until the September meeting in order to consider such an adjustment in the context of updates to participants' individual economic projections and the Committee's further consideration of its policy options. The statement also reiterated the Committee's intention to extend the average maturity of its securities holdings as announced in June. Consistent with the concerns expressed by many members about the slow pace of the economic recovery, the downside risks to economic growth, and the considerable slack in resource utilization, the Committee decided that the statement should conclude by indicating that it will provide additional accommodation as needed to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.

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 $\frac{1}{4}$ percent. The Committee directs the Desk to continue the maturity extension program it announced in

June to purchase Treasury securities with remaining maturities of 6 years to 30 years with a total face value of about \$267 billion by the end of December 2012, and to sell or redeem Treasury securities with remaining maturities of approximately 3 years or less with a total face value of about \$267 billion. For the duration of this program, the Committee directs the Desk to suspend its current policy of rolling over maturing Treasury securities into new issues. The Committee directs the Desk to maintain its existing policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in the System Open Market Account in agency mortgage-backed securities. These actions should maintain the total face value of domestic securities at approximately \$2.6 trillion. 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 June suggests that economic activity decelerated somewhat over the first half of this year. Growth in employment has been slow in recent months, and the unemployment rate remains elevated. Business fixed investment has continued to advance. Household spending has been rising at a somewhat slower pace than earlier in the year. Despite some further signs of improvement, the housing sector remains depressed. Inflation has declined since earlier this year, mainly reflecting lower prices of crude oil and gasoline, and longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects economic growth to remain moder-

ate over coming quarters and then to pick up very gradually. Consequently, the Committee anticipates that the unemployment rate will decline only slowly toward levels that it judges to be consistent with its dual mandate. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook. The Committee anticipates that inflation over the medium term will run at or below the rate that it judges most consistent with its dual mandate.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee expects to maintain a highly accommodative stance for monetary policy. In particular, the Committee decided today to keep the target range for the federal funds rate at 0 to $\frac{1}{4}$ percent and currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.

The Committee also decided to continue through the end of the year its program to extend the average maturity of its holdings of securities as announced in June, and it is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The Committee will closely monitor incoming information on economic and financial developments and will provide additional accommodation as needed to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.”

Voting for this action: Ben Bernanke, William C. Dudley, Elizabeth Duke, Dennis P. Lockhart, Sandra Pianalto, Jerome H. Powell, Sarah Bloom Raskin, Jere-

my C. Stein, Daniel K. Tarullo, John C. Williams, and Janet L. Yellen.

Voting against this action: Jeffrey M. Lacker.

Mr. Lacker dissented because he did not believe that exceptionally low levels for the federal funds rate were likely to be warranted for the length of time specified in the Committee’s statement. In his view, significant uncertainty regarding the evolution of economic conditions over the next few years made the future path of interest rates difficult to forecast, and the Committee’s statement implied more confidence on this score than justified by the current outlook.

Consensus Forecast Experiment

In light of the discussion at the previous FOMC meeting, the subcommittee on communications developed an initial experimental exercise intended to shed light on the feasibility and desirability of constructing an FOMC consensus forecast. At this meeting, participants discussed various aspects of the exercise, such as the possible monetary policy assumptions on which to condition an FOMC consensus forecast, the measurement of the degree of uncertainty surrounding each of the projected variables in the forecast, and the potential for communications benefits. In conclusion, participants generally expressed support for a second exercise to be undertaken in conjunction with the September FOMC meeting.

It was agreed that the next meeting of the Committee would be held on Wednesday–Thursday, September 12–13, 2012. The meeting adjourned at 2:15 p.m. on August 1, 2012.

Notation Vote

By notation vote completed on July 10, 2012, the Committee unanimously approved the minutes of the FOMC meeting held on June 19–20, 2012.

William B. English
Secretary