

## Minutes of the Federal Open Market Committee March 17-18, 2009

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, March 17, 2009, at 2:00 p.m. and continued on Wednesday, March 18, 2009, at 9:00 a.m.

### PRESENT:

Mr. Bernanke, Chairman  
Mr. Dudley, Vice Chairman  
Ms. Duke  
Mr. Evans  
Mr. Kohn  
Mr. Lacker  
Mr. Lockhart  
Mr. Tarullo  
Mr. Warsh  
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

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

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Sullivan, Weinberg, Wilcox, and Williams, Associate Economists

Ms. Mosser, Temporary Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson, Deputy Secretary, Office of the Secretary, Board of Governors

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

Ms. Bailey and Mr. English, Deputy Directors, Divisions of Banking Supervision and Regulation and Monetary Affairs, respectively, Board of Governors

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

Messrs. Leahy, Nelson, Reifschneider, and Wascher,<sup>1</sup> Associate Directors, Divisions of International Finance, Monetary Affairs, Research and Statistics, and Research and Statistics, respectively, Board of Governors

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

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Lewis, Economist, Division of Monetary Affairs, Board of Governors

Ms. Beattie,<sup>1</sup> Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Williams, Records Management Analyst, Division of Monetary Affairs, Board of Governors

Mr. Sapenaro, First Vice President, Federal Reserve Bank of St. Louis

Messrs. Fuhrer and Rosenblum, Executive Vice Presidents, Federal Reserve Banks of Boston and Dallas, respectively

Messrs. Hilton and Schweitzer, Senior Vice Presidents, Federal Reserve Banks of New York and Cleveland, respectively

---

<sup>1</sup> Attended Tuesday's session only.

Messrs. Clark, Gavin, Klitgaard, and Yi, Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, New York, and Philadelphia, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

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

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities and in agency debt and agency mortgage-backed securities (MBS) during the period since the Committee's January 27-28 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the period since the Committee's January 27-28 meeting.

Staff reported on recent developments in System liquidity programs and on changes in the System's balance sheet. As of March 12, the System's total assets and liabilities were about \$2 trillion, close to the level of that just before the January 27-28 meeting. Holdings of agency debt and agency MBS had increased, while foreign central bank drawings on reciprocal currency arrangements had declined. Credit extended by the Commercial Paper Funding Facility also had declined, as 90-day paper purchased in the early weeks of the program matured and a large portion was not renewed through the facility. Primary credit extended by the Federal Reserve was about unchanged, and credit outstanding under the Term Auction Facility increased somewhat over the period as the February auctions experienced higher demand than previous auctions. In contrast, credit extended under the Primary Dealer Credit Facility declined somewhat over the intermeeting period, and credit extended under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility edged down.

Most meeting participants interpreted the evidence as indicating that credit markets still were not working well, and that the Federal Reserve's lending programs, asset purchases, and currency swaps were providing much-needed support to economic activity by reducing dislocations in financial markets, lowering the cost of credit, and facilitating the flow of credit to businesses

and households. Participants discussed the prospective further increase in the Federal Reserve's balance sheet, with a focus on the Term Asset-Backed Securities Loan Facility (TALF) and open market purchases of longer-term assets.

The launch of the TALF was announced on March 3. In the initial phase of the program, the Federal Reserve offered to provide up to \$200 billion of three-year loans, on a nonrecourse basis, against AAA-rated asset-backed securities (ABS) backed by newly and recently originated auto loans, credit card loans, student loans, loans guaranteed by the Small Business Administration, and, potentially, certain other closely related types of ABS. The Federal Reserve and the Treasury had previously announced their expectation that the program would be expanded to accept other types of ABS. The demand for TALF funding appeared likely to be modest initially, and some participants saw a risk that private firms might be reluctant to borrow from the TALF out of concern about potential future changes in government policies that could affect TALF borrowers. However, other participants anticipated that TALF loans would increase over time as financial market institutions became more familiar with the program. Most participants supported the expansion of the lending capacity of the TALF, subject to receiving additional capital from the Treasury, and the inclusion of additional categories of recently issued, highly rated ABS as acceptable collateral. However, some participants expressed concern about the risks that might arise from the possible extension of the TALF to include older and lower-quality assets, noting, in particular, the greater uncertainty over the value of such assets.

The Federal Reserve's programs to buy direct debt obligations of the federal housing agencies and agency-guaranteed MBS were on track to reach their initial targets of \$100 billion and \$500 billion, respectively, by the end of June. Participants agreed that the asset purchase programs were helping to reduce mortgage interest rates and improve market functioning, thereby providing support to economic activity. Some participants stated a preference for communicating the Committee's intention regarding such purchases in terms of the growth rate of Federal Reserve holdings rather than a dollar target for total purchases. However, others noted that the pace of MBS issuance was likely to be especially brisk over the next few months, in part because of the Administration's new Making Home Affordable program, and observed that it could be advantageous to be able to front-load purchases to accommodate the pattern of mortgage refinancing. Partici-

pants also discussed the relative merits of increasing the Federal Reserve's purchases of agency MBS versus initiating purchases of longer-term Treasury securities. Some participants remarked that experience suggested that purchases of Treasury securities would have effects across a variety of long-term debt markets and should ease financial conditions generally while minimizing the Federal Reserve's influence on the allocation of credit. However, purchases of agency securities could have a more direct effect on mortgage rates, thus providing greater benefits to the housing sector, and on private borrowing rates more generally. Also, some participants were concerned that Federal Reserve purchases of longer-term Treasury securities might be seen as an indication that the Federal Reserve was responding to a fiscal objective rather than its statutory mandate, thus reducing the Federal Reserve's credibility regarding long-run price stability. Most participants, however, saw this risk as low so long as the Federal Reserve was clear about the importance of its long-term price stability objective and demonstrated a commitment to take the necessary steps in the future to achieve its objectives.

In light of the economic and financial conditions, meeting participants viewed the expansion of the Federal Reserve's balance sheet that might be associated with these and other programs as appropriate in order to foster the dual objectives of maximum employment and price stability. It was noted that the Treasury and the Federal Reserve will seek legislation to give the Federal Reserve tools in addition to interest on reserves to manage the federal funds rate while providing the funding necessary for the TALF and other key credit-easing programs.

The Committee also took up a proposal to augment the existing network of central bank liquidity swap lines by adding several temporary swap lines that could provide foreign currency liquidity to U.S. institutions, analogous to the arrangements that currently provide U.S. dollar liquidity abroad. There was no evidence that these institutions were encountering difficulty in meeting foreign currency obligations at this time, but these facilities would be available should pressures develop in the future. The Committee unanimously approved the following resolution:

“The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to enter into additional temporary reciprocal currency arrangements (swap lines) with the Bank of England, the European Central Bank

(ECB), the Bank of Japan, and the Swiss National Bank to support the provision of liquidity in British pounds, euros, Japanese yen, and Swiss francs. The swap arrangements with each foreign central bank shall be subject to the following limits: an aggregate amount of up to £30 billion with the Bank of England; an aggregate amount of up to €80 billion with the ECB; an aggregate amount of up to ¥10 trillion with the Bank of Japan; and an aggregate amount of up to SwF 40 billion with the Swiss National Bank. These arrangements shall terminate no later than October 30, 2009, unless extended by mutual agreement of the Committee and the respective foreign central banks. The Committee also authorizes the Federal Reserve Bank of New York to provide the foreign currencies obtained under the arrangements to U.S. financial institutions by means of swap transactions to assist such institutions in meeting short-term liquidity needs in their foreign operations. Requests for drawings on the central bank swap lines and distribution of the foreign currency proceeds to U.S. financial institutions shall be initiated by the appropriate Reserve Bank and approved by the Foreign Currency Subcommittee.”

#### **Staff Review of the Economic and Financial Situation**

The information reviewed at the March 17-18 meeting indicated that economic activity had fallen sharply in recent months. The contraction was reflected in widespread declines in payroll employment and industrial production. Consumer spending appeared to remain at a low level after changing little, on balance, in recent months. The housing market weakened further, and nonresidential construction fell. Business spending on equipment and software continued to fall across a broad range of categories. Despite the cutbacks in production, inventory overhangs appeared to worsen in a number of areas. Both headline and core consumer prices edged up in January and February.

Labor market conditions continued to deteriorate. Private payroll employment dropped considerably over the three months ending in February. Employment losses remained widespread across industries, with the notable exception of health care. Meanwhile, the average workweek of production and nonsupervisory workers on private payrolls continued to be low in February, and the number of aggregate hours worked for this group was markedly below the fourth-quarter aver-

age. The civilian unemployment rate climbed  $\frac{1}{2}$  percentage point in February, to 8.1 percent. The labor force participation rate declined in January and February, on balance, likely in response to weakened labor demand. The four-week moving average of initial claims for unemployment insurance continued to move up through early March, and the level of insured unemployed rose further.

Industrial production fell in January and February, with cutbacks again widespread, and capacity utilization in manufacturing declined to a very low level. Although production of light motor vehicles turned up in February, it remained well below the pace of the fourth quarter as manufacturers responded to the significant deterioration in demand over the past few months. The output of high-tech products declined as production of computers and semiconductors extended the sharp declines that began in the fourth quarter of 2008. The production of other consumer durables and business equipment weakened further, and broad indicators of near-term manufacturing activity suggested that factory output would continue to contract over the next few months.

The available data suggested that real consumer spending held steady, on balance, in the first two months of this year after having fallen sharply over the second half of last year. Real spending on goods excluding motor vehicles was estimated to have edged up, on balance, in January and February. In contrast, real outlays on motor vehicles contracted further in February after a decline in January. The financial strain on households intensified over the previous several months; by the end of the fourth quarter, household net worth for the first time since 1995 had fallen to less than five times disposable income, and substantial declines in equity and house prices continued early this year. Consumer sentiment declined further in February as households voiced greater concerns about income and job prospects. The Reuters/University of Michigan index in early March stood only slightly above its 29-year low reached in November, and the Conference Board index, which includes questions about employment conditions, fell in February to a new low.

Housing activity continued to be subdued. Single-family starts ticked up in February, and adjusted permit issuance in this sector moved up to a level slightly above starts. Multifamily starts jumped in February from the very low level in January, and the level of multifamily starts was close to where it had been at the end of the third quarter of 2008. Housing demand re-

mained very weak, however. Although the stock of unsold new single-family homes fell in January to its lowest level since 2003, inventories continued to move up relative to the slow pace of sales. Sales of existing single-family homes fell in January, reversing the uptick seen in December. Over the previous 12 months, the pace of existing home sales declined much less than that of new home sales, reflecting in part increases in foreclosure-related and other distressed sales. The weakness in home sales persisted despite historically low mortgage rates for borrowers eligible for conforming loans. After having fallen significantly late last year, rates for conforming 30-year fixed-rate mortgages fluctuated in a relatively narrow range during the intermeeting period. In contrast, the market for nonconforming loans remained severely impaired. House prices continued to decline.

Business spending on transportation equipment continued to fall from already low levels, and demand both for high-tech equipment and software and for equipment other than high-tech and transportation dropped sharply in the fourth quarter. In January, nominal shipments of nondefense capital goods excluding aircraft declined, and new orders fell significantly further. The fundamental determinants of equipment and software spending worsened appreciably: Business output dropped, and rising corporate bond yields boosted the user cost of capital in the fourth quarter. After holding up surprisingly well through most of last year, outlays on nonresidential structures began to show declines consistent with the weak fundamentals for this sector. In real terms, investment declined for most types of buildings over the previous few months. Census data on book-value inventory investment for January suggested that firms had further pared their stocks; however, sales continued to fall more quickly than inventories, apparently exacerbating the overhangs that developed in the second half of 2008.

The U.S. international trade deficit narrowed in December and January, as a steep fall in imports more than offset a decline in exports. All major categories of exports decreased, especially sales of industrial supplies, machinery, and automotive products. All major categories of imports decreased as well, with large declines in imports of oil, automotive products, and industrial supplies. The drop in the value of oil imports reflected a lower price. Imports of automotive products declined as automakers made significant production cutbacks throughout North America.

Output in the advanced foreign economies contracted in the fourth quarter, with large reductions in real gross domestic product (GDP) in all the major economies and a double-digit rate of decline in Japan. Trade and investment in those countries were particularly weak. Indicators of economic activity, especially industrial production, suggested that the pace of contraction accelerated late in the fourth quarter and into the first quarter. Economic activity in emerging market economies also weakened significantly in the fourth quarter. Exports, industrial production, and confidence indicators dropped notably in both Latin America and emerging Asia. Incoming data for January and February suggested a further significant decline in the first quarter.

In the United States, overall consumer prices increased in January and February, led by an increase in energy prices, after posting sizable declines late last year. Excluding the categories of food and energy, consumer prices edged higher in January and February after three months of no change. The producer price index for core intermediate materials dropped for a fifth month in February, reflecting, in part, weaker global demand and steep declines in the prices of a wide variety of energy-intensive goods, such as chemicals and plastics. Low readings on overall and core consumer price inflation in recent months, as well as the weakened economic outlook, kept near-term inflation expectations reported in surveys well below their high levels in mid-2008. In contrast, measures of longer-term expectations remained close to their averages over the past couple of years. Hourly earnings continued to increase at a moderate rate in February.

The Federal Open Market Committee's decision at the January meeting to leave the target range for the federal funds rate unchanged was widely anticipated by investors and had little impact on short-term money markets. Over the intermeeting period, the path for the federal funds rate implied by futures rates shifted down somewhat, on net, mostly on incoming news about the financial sector and the economic outlook. Yields on nominal Treasury coupon securities increased over the period, reportedly because market participants had assigned some probability to the possibility that the Federal Reserve would establish a purchase program for longer-term Treasury securities that was not, in fact, forthcoming; yields were also reported to have responded to concerns over the federal deficit and the growing supply of Treasury securities. Yields on longer-term inflation-indexed Treasury securities increased more than those on their nominal counterparts, leaving longer-term inflation compensation lower over the pe-

riod, and inflation compensation at shorter horizons was little changed. Poor liquidity in the market for Treasury inflation-protected securities continued to make these readings difficult to interpret.

Conditions in short-term funding markets were mixed over the intermeeting period. In unsecured interbank funding markets, spreads of dollar London interbank offered rates (Libor) over comparable-maturity overnight index swap rates trended higher, on net, especially at longer maturities, and forward spreads increased, evidently on renewed concerns about the financial condition of some large banks. Conditions in the commercial paper (CP) market continued to improve, on balance, over the intermeeting period. Spreads on 30-day A2/P2-rated CP trended down further, and those on AA-rated asset-backed commercial paper remained at the lower end of the range recorded over the past year. Conditions in repurchase agreement markets for most collateral types improved over the period, but volumes remained low.

Trading conditions in the secondary market for nominal Treasury coupon securities showed some limited signs of improvement. Average bid-asked spreads for on-the-run nominal Treasury notes were relatively stable near their pre-crisis levels. Daily trading volumes for on-the-run securities, however, inched lower, and spreads between the yields of on- and off-the-run 10-year Treasury notes remained very high.

Broad equity price indexes dropped significantly, on balance, over the intermeeting period amid continued concerns about the health of the financial sector, uncertainty regarding the efficacy of government support to the sector, and a further weakening of the economic outlook. Bank stock prices were particularly hard hit, and the credit default swap (CDS) spreads of many banks rose above the peaks recorded last fall on anxieties about the financial conditions of the largest banking firms. Stock prices of insurance companies dropped sharply over the period, reflecting concerns about the adequacy of their capital positions. On March 2, American International Group, Inc. (AIG), reported losses of more than \$60 billion for the fourth quarter of last year, and the Treasury and the Federal Reserve announced a restructuring of the government assistance to AIG to enhance the company's capital and liquidity to facilitate the orderly completion of its global divestiture program.

Measures of liquidity in the secondary market for speculative-grade corporate bonds worsened somewhat over the period but remained significantly better than

in the fall of 2008. Spreads of yields on both BBB-rated and speculative-grade bonds relative to those on comparable-maturity Treasury securities were little changed on net. The investment- and speculative-grade CDS indexes widened significantly, on net, over the intermeeting period. Gross bond issuance by non-financial firms was very strong in January and February, as investment-grade issuance more than doubled from its already solid pace in the fourth quarter; speculative-grade issuance, however, remained sluggish. Trading conditions in the leveraged syndicated loan market improved slightly, but issuance continued to be very weak. The market for commercial mortgage-backed securities (CMBS) also remained under heavy stress. Indexes of CDS spreads on AAA-rated CMBS widened to record levels, as Moody's downgraded a large portion of the 2006 and 2007 vintages after a reevaluation of its rating criteria.

The debt of the domestic private nonfinancial sector, which was about unchanged in the fourth quarter of last year, was estimated to have remained about flat in the first quarter. Household debt appeared to have contracted in the first quarter for the second quarter in a row, primarily as a result of declines in both consumer and home mortgage debt. Declines in consumer and mortgage debt stemmed, in turn, from very weak household spending, the continued drop in house prices, and tighter terms and standards for loans. Business debt was projected to expand at a moderate pace in the first quarter, largely because of a burst of corporate bond issuance. Reflecting heavy borrowing by the Treasury, total debt of the domestic nonfinancial sector was projected to have continued to expand in the first quarter, but at a pace below that recorded in the fourth quarter of last year.

The rise in M2 slowed in February from the rapid pace recorded over the previous few months. Liquid deposits, while decelerating, continued to expand briskly. Savings deposits increased while demand deposits decreased. Retail money funds fell in February, reflecting sizable outflows from Treasury-only funds, which generally provided low yields. Small time deposits also contracted, as the institutions that had been bidding aggressively for these retail funds stopped doing so. The expansion in currency remained robust.

Bank credit continued to decline in January and February, and commercial and industrial (C&I) loans decreased over these months. The February Survey of Terms of Business Lending indicated that C&I loan rate spreads over comparable-maturity market instru-

ments rose modestly overall from the November survey. Commercial real estate loans outstanding also declined over the first part of 2009. In contrast, consumer loans on banks' books jumped over the first two months of the year because of sizable increases at a few banks that purchased loans from their affiliated finance companies. In addition, some banks brought consumer loans that had previously been securitized back onto their books. After 12 consecutive months of contraction, residential mortgage loans on banks' books increased in February, likely a result of the pickup in refinancing activity. In contrast, the rise in home equity loans slowed noticeably in January and February.

Among the advanced foreign economies, headline equity price indexes generally fell significantly over the period, with the sharpest drops in the banking sector. In particular, European bank shares fell steeply as earnings reports for the fourth quarter came in weaker than expected and fears about the exposure of many western European banks to emerging Europe increased. The major currencies index of the dollar rose, on net, over the intermeeting period; foremost among the contributors to the rise was a significant appreciation of the dollar against the yen. Financial conditions in emerging markets also worsened, with their exchange rates and equity prices generally falling and CDS premiums rising a bit on balance.

Several foreign governments and central banks took further steps to support their financial markets and economies. The Bank of England announced its intention to purchase substantial quantities of government and corporate bonds through its Asset Purchase Facility, after which yields on long-term British gilts fell significantly. In addition, the British government launched its Asset Protection Scheme, which insured assets placed in the scheme by the Royal Bank of Scotland and Lloyds Bank. The Bank of Japan stated that it would resume purchases of equities held on banks' balance sheets, announced plans to purchase corporate bonds, and began its previously announced purchases of commercial paper. The Swiss National Bank announced that it would purchase both domestic corporate debt and foreign currency to increase liquidity.

#### **Staff Economic Outlook**

In the forecast prepared for the meeting, the staff revised down its outlook for economic activity. The deterioration in labor market conditions was rapid in recent months, with steep job losses across nearly all sectors. Industrial production continued to contract rapidly as firms responded to the falloff in demand and

the buildup of some inventory overhangs. The incoming data on business spending suggested that business investment in equipment and structures continued to decline. Single-family housing starts had fallen to a post-World War II low in January, and demand for new homes remained weak. Both exports and imports retreated significantly in the fourth quarter of last year and appeared headed for comparable declines this quarter. Consumer outlays showed some signs of stabilizing at a low level, with real outlays for goods outside of motor vehicles recording gains in January and February. Financial conditions overall were even less supportive of economic activity, with broad equity indexes down significantly amid continued concerns about the health of the financial sector, the dollar stronger, and long-term interest rates higher. The staff's projections for real GDP in the second half of 2009 and in 2010 were revised down, with real GDP expected to flatten out gradually over the second half of this year and then to expand slowly next year as the stresses in financial markets ease, the effects of fiscal stimulus take hold, inventory adjustments are worked through, and the correction in housing activity comes to an end. The weaker trajectory of real output resulted in the projected path of the unemployment rate rising more steeply into early next year before flattening out at a high level over the rest of the year. The staff forecast for overall and core personal consumption expenditures (PCE) inflation over the next two years was revised down slightly. Both core and overall PCE price inflation were expected to be damped by low rates of resource utilization, falling import prices, and easing cost pressures as a result of the sharp net declines in oil and other raw materials prices since last summer.

#### **Meeting Participants' Views and Committee Policy Action**

In the discussion of the economic situation and outlook, nearly all meeting participants said that conditions had deteriorated relative to their expectations at the time of the January meeting. The slowdown was widespread across sectors. Large declines in equity prices, a further drop in house prices, and mounting job losses threatened to further depress consumer spending, despite some firming in the recent retail sales data and forthcoming tax reductions. Business capital spending was weakening in an environment of uncertainty and low business confidence. Of particular note was the apparent sharp fall in foreign economic activity, which was having a negative effect on U.S. exports. Credit conditions remained very tight, and financial markets

remained fragile and unsettled, with pressures on financial institutions generally intensifying this year. Overall, participants expressed concern about downside risks to an outlook for activity that was already weak. With regard to the outlook for inflation, all participants agreed that inflation pressures were likely to remain subdued, and several expressed the view that inflation was likely to persist below desirable levels.

District business contacts indicated that production and sales were declining steeply. Some industries that previously were less affected, such as agriculture and energy, had begun to suffer the effects of the slowdown. Businesses reported that bank financing was becoming more expensive and more difficult to obtain. Expenditures were being cut substantially for a wide range of capital equipment, and spending on nonresidential structures had recently turned down. Inventory liquidation was continuing, but inventory-sales ratios remained elevated as sales slowed. Against this backdrop, participants anticipated further employment cutbacks over coming months, though perhaps at a gradually diminishing rate.

Several participants said that the degree and pervasiveness of the decline in foreign economic activity was one of the most notable developments since the January meeting. In light of this development, it was widely agreed that exports were not likely to be a source of support for U.S. economic activity in the near term.

Participants did not interpret the uptick in housing starts in February as the beginning of a new trend, but some noted that there was only limited scope for housing activity to fall further. Nonetheless, large inventories of unsold homes relative to sales and the prospect of a continued high level of distressed sales would continue to hold down residential investment in the near term. Several participants noted the tentative signs of stabilization in consumer spending in January and February. However, others suggested that strains on household balance sheets from falling equity and house prices, reduced credit availability, and the fear of unemployment could well lead to further increases in the saving rate that would damp consumption growth in the near term.

Overall, most participants viewed downside risks as predominating in the near term, mainly owing to potential adverse feedback effects as reduced employment and production weighed on consumer spending and investment, and as the weakening economy boosted the prospective losses of financial institutions, leading to a further tightening of credit conditions.

Looking beyond the very near term, a number of market forces and policies now in place were seen as eventually leading to economic recovery. Notably, the low level of mortgage interest rates, reduced house prices, and the Administration's new programs to encourage mortgage refinancing and mitigate foreclosures ultimately could bring about a lower cost of homeownership, a sustained increase in home sales, and a stabilization of house prices. The household saving rate, which had already risen considerably, would eventually level out and cease to hold back consumption growth. Business inventories would come into line with even a low level of sales, and the pressure on production from inventory drawdowns would diminish. Fiscal and monetary policies were likely to contribute significantly to aggregate demand in coming quarters. Participants expressed a variety of views about the strength and timing of the recovery, however. Some believed that the natural resilience of market forces would become evident later this year. Others, who saw recovery as delayed and potentially weak, were concerned about a possible further rise in the saving rate and a very slow improvement in financial conditions. Some participants also cautioned that, because of the poor functioning of the financial system, capital and labor were not being allocated to their most productive uses, and this failure threatened to damp the recovery and reduce the potential growth of the economy over the medium term.

Participants saw little chance of a pickup in inflation over the near term, as rising unemployment and falling capacity utilization were holding down wages and prices and inflation expectations appeared subdued. Several expressed concern that inflation was likely to persist below desired levels, with a few pointing to the risk of deflation. Even without a continuation of outright price declines, falling expectations of inflation would raise the real rate of interest and thus increase the burden of debt and further restrain the economy.

Some indicators, including share prices and CDS spreads of financial institutions, suggested a worsening of financial market strains since January. However, for the most part, participants viewed conditions in financial markets as little changed but remaining extraordinarily stressed. The large volume of issuance of investment-grade corporate bonds in recent weeks was a notable bright spot. Participants shared comments received from financial industry contacts on their experiences with and concerns about recent government programs to stabilize the financial system. These contacts feared that uncertainties about future actions the

government might take and future regulations it might impose were making it more difficult to plan and were discouraging participation in government efforts to stabilize the financial system. Participants agreed that a credible and widely understood program to deal with the troubles of the banking system could help restore business and consumer confidence. Many viewed the strengthening of the banking system as essential for a sustained and robust recovery.

In the discussion of monetary policy for the intermeeting period, Committee members agreed that substantial additional purchases of longer-term assets eligible for open market operations would be appropriate. Such purchases would provide further monetary stimulus to help address the very weak economic outlook and reduce the risk that inflation could persist for a time below rates that best foster longer-term economic growth and price stability. One member preferred to focus additional purchases on longer-term Treasury securities, whereas another member preferred to focus on agency MBS. However, both could support expanded purchases across a range of assets, and several members noted that working across a range of assets and instruments was appropriate when the effects of any one tactic were uncertain. Members agreed that the monetary base was likely to grow significantly as a consequence of additional asset purchases; one, in particular, stressed that sustained increases in the monetary base were important to ensure that policy was consistently expansionary. Members expressed a range of views as to the preferred size of the increase in purchases. Several members felt that the significant deterioration in the economic outlook merited a very substantial increase in purchases of longer-term assets. In contrast, the potential for a large increase over time in the size of the balance sheet from the TALF program was seen as supporting a more modest, though still substantial, increase in asset purchases. Ultimately, members agreed to undertake additional purchases of agency MBS of up to \$750 billion and of agency debt of up to \$100 billion, and they also agreed to purchase up to \$300 billion of longer-term Treasury securities. The Committee believed that purchases of these amounts would help to promote a return to economic growth and price stability. The period for conducting the agency debt and MBS purchases was extended from the next three months to the next nine months; members agreed to allow the Desk flexibility within this horizon to respond to market conditions. Treasury purchases were to be conducted over the next six months. Members also noted the recent launch of the TALF,



and they agreed to include in the Committee's statement an indication that the range of assets accepted as eligible collateral for the TALF was likely to be expanded. Committee members decided to keep the target range for the federal funds rate at 0 to ¼ percent and to communicate to the public the Committee's view that the federal funds rate was likely to remain exceptionally low for an extended period.

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

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase GSE debt, GSE-guaranteed MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Committee anticipates that the combination of outright purchases and various liquidity facilities outstanding will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The Desk is expected to purchase up to \$200 billion in housing-related GSE debt by the end of this year. The Desk is expected to purchase at least \$500 billion in GSE-guaranteed MBS by the end of the second quarter of this year and is expected to purchase up to \$1.25 trillion of these securities by the end of this year. The Committee also directs the Desk to purchase longer-term Treasury securities during the intermeeting period. Over the next six months, the Desk is expected to purchase up to \$300 billion of longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's

objectives of maximum employment and price stability."

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

"Information received since the Federal Open Market Committee met in January indicates that the economy continues to contract. Job losses, declining equity and housing wealth, and tight credit conditions have weighed on consumer sentiment and spending. Weaker sales prospects and difficulties in obtaining credit have led businesses to cut back on inventories and fixed investment. U.S. exports have slumped as a number of major trading partners have also fallen into recession. Although the near-term economic outlook is weak, the Committee anticipates that policy actions to stabilize financial markets and institutions, together with fiscal and monetary stimulus, will contribute to a gradual resumption of sustainable economic growth.

In light of increasing economic slack here and abroad, the Committee expects that inflation will remain subdued. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide greater support to mortgage lending and housing markets, the Committee decided today to increase the size of the Federal Reserve's balance sheet further by purchasing up to an additional \$750 billion of agency mortgage-backed securities, bringing its total purchases of these securities to up to \$1.25 trillion this year, and to increase its purchases of agency debt this year by up to \$100 billion to a total of up to \$200 billion. Moreover, to help improve conditions in private credit markets, the Committee decided to purchase up to \$300 billion of longer-term Treasury securities over the next six months.

The Federal Reserve has launched the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses and anticipates that the range of eligible collateral for this facility is likely to be expanded to include other financial assets. The Committee will continue to carefully monitor the size and composition of the Federal Reserve's balance sheet in light of evolving financial and economic developments.”

**Voting for this action:** Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.

**Voting against this action:** None.

It was agreed that the next meeting of the Committee would be held on Tuesday-Wednesday, April 28-29, 2009. The meeting adjourned at 1:35 p.m. on March 18, 2009.

#### **Conference Call**

On February 7, 2009, the Committee met by conference call in a joint session with the Board of Governors to discuss the potential role of the Federal Reserve in the Treasury's forthcoming financial stabilization plan. After hearing an overview of the version of the plan envisioned at the time of the meeting, meeting participants discussed its principal elements and shared a range of perspectives on its implications for financial markets and institutions. The Federal Reserve's primary direct role in the plan would be through an expansion of the previously announced TALF, which would be supported by additional funds from the Troubled Asset Relief Program (TARP). In the current envi-

ronment, it was anticipated that such an expansion would provide additional assistance to financial markets and institutions in meeting the credit needs of households and businesses and thus would support overall economic activity. While several participants expressed some concern that the expansion of the TALF program could increase the Federal Reserve's exposure to credit risk, the program's requirements for highly rated collateral that would exceed the value of the related loans, in combination with the added TARP funds as a backstop against losses, were generally seen as providing the Federal Reserve with adequate protection. Participants also discussed the implications of the expanded TALF program for the Federal Reserve's balance sheet over time. Participants agreed it would be important to work with the Treasury to obtain tools to ensure that any reserves added to the banking system through this program could be removed at the appropriate time.

#### **Notation Vote**

By notation vote completed on February 17, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on January 27-28, 2009.

---

**Brian F. Madigan**  
Secretary