

Minutes of the Federal Open Market Committee September 20–21, 2011

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, September 20, 2011, at 10:30 a.m., and continued on Wednesday, September 21, 2011, at 9:00 a.m.

PRESENT:

Ben Bernanke, Chairman
William C. Dudley, Vice Chairman
Elizabeth Duke
Charles L. Evans
Richard W. Fisher
Narayana Kocherlakota
Charles I. Plosser
Sarah Bloom Raskin
Daniel K. Tarullo
Janet L. Yellen

Christine Cumming, Jeffrey M. Lacker, Dennis P. Lockhart, Sandra Pianalto, and John C. Williams, Alternate Members of the Federal Open Market Committee

James Bullard and Eric Rosengren, Presidents of the Federal Reserve Banks of St. Louis and Boston, respectively

Esther L. George, First Vice President, Federal Reserve Bank of Kansas City

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

James A. Clouse, Thomas A. Connors, Steven B. Kamin, Loretta J. Mester, Simon Potter, David Reifschneider, Harvey Rosenblum, and David W. Wilcox, Associate Economists

Brian Sack, Manager, System Open Market Account

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

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

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

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

William Nelson, Deputy Director, Division of Monetary Affairs, Board of Governors

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

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

Seth B. Carpenter, Senior Associate Director, Division of Monetary Affairs, Board of Governors; Michael P. Leahy, Senior Associate Director, Division of International Finance, Board of Governors; Lawrence Slifman and William Wascher, Senior Associate Directors, Division of Research and Statistics, Board of Governors

Andrew T. Levin, Senior Adviser, Office of Board Members, Board of Governors; Stephen A. Meyer and Joyce K. Zickler, Senior Advisers, Division of Monetary Affairs, Board of Governors

Daniel M. Covitz and David E. Lebow, Associate Directors, Division of Research and Statistics, Board of Governors

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

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

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

Jeff Fuhrer, Executive Vice President, Federal Reserve Bank of Boston

David Altig, Alan D. Barkema, Spencer Krane, Mark E. Schweitzer, Christopher J. Waller, and John A. Weinberg, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Kansas City, Chicago, Cleveland, St. Louis, and Richmond, respectively

Julie Ann Remache, Assistant Vice President, Federal Reserve Bank of New York

Eric T. Swanson, Senior Research Advisor, Federal Reserve Bank of San Francisco

Jonathan Heathcote, Senior Economist, Federal Reserve Bank of Minneapolis

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

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Federal Open Market Committee (FOMC) met on August 9, 2011. He also reported on System open market operations, including the continuing reinvestment into longer-term Treasury securities of principal payments received on SOMA holdings of agency debt and agency-guaranteed mortgage-backed securities (MBS). By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period.

Staff Presentation on Policy Tools

The staff gave a presentation on several tools that could be used, within the Committee's current policy framework, to provide additional monetary policy accommodation to support the economic recovery. The presentation first reviewed three options for managing the size and composition of the SOMA portfolio: a reinvestment maturity extension program, a SOMA portfolio maturity extension program, and a large-scale asset purchase program. Under the first of these options, the Federal Reserve would reinvest the principal payments it receives on its holdings of agency securities exclusively in long-term Treasury securities. Under the second option, the Committee would purchase long-term Treasury securities and sell the same amount of

shorter-term Treasury securities; these transactions would significantly increase the average maturity of the SOMA portfolio, but the size of the Federal Reserve's balance sheet and the level of reserve balances would be largely unaffected in the near term. Under the third option, the Committee would purchase longer-term Treasury securities, increasing the size of its balance sheet and the supply of reserve balances. The staff also summarized a set of options for clarifying, for the public, the Committee's longer-run objectives under its dual mandate as well as the Committee's forward guidance about the likely future stance of monetary policy. The options focused on ways to elucidate the economic conditions that could warrant raising the level of short-term interest rates. Finally, the staff presentation summarized the potential implications of reducing the interest rate that the Federal Reserve pays on reserve balances that depository institutions hold in accounts at the Federal Reserve Banks (the IOR rate).

Meeting participants expressed a range of views on the potential efficacy of policy tools tied to the size and composition of the Federal Reserve's balance sheet. Many judged that these policies could provide additional monetary policy accommodation by lowering longer-term interest rates and easing financial conditions at a time when further reductions in the federal funds rate are infeasible. However, a number saw the potential effects on real economic activity as limited or only transitory, particularly in the current environment of balance sheet deleveraging, credit constraints, and household and business uncertainty about the economic outlook. Participants noted that a SOMA maturity extension program would not expand the Federal Reserve's balance sheet or the level of reserve balances, and that the scale of such a program was necessarily limited by the size of the Federal Reserve's holdings of shorter-term securities so that it could not be repeated to provide further stimulus. A number of participants saw large-scale asset purchases as potentially a more potent tool that should be retained as an option in the event that further policy action to support a stronger economic recovery was warranted. Some judged that large-scale asset purchases and the resulting expansion of the Federal Reserve's balance sheet would be more likely to raise inflation and inflation expectations than to stimulate economic activity and argued that such tools should be reserved for circumstances in which the risk of deflation was elevated. In commenting on the implications of a maturity extension program or another large-scale asset purchase program, several participants noted that the System should avoid holding a

very large proportion of the outstanding stock of longer-term Treasury securities in its portfolio because the result could be a deterioration in market functioning. A number of participants suggested directing some purchases or reinvestments into agency MBS; however, a couple of participants saw such actions as unlikely to have benefits, or as a form of credit allocation.

Most participants indicated that they favored taking steps to increase further the transparency of monetary policy, including providing more information about the Committee's longer-run policy objectives and about the factors that influence the Committee's policy decisions. Participants generally agreed that a clear statement of the Committee's longer-run policy objectives could be helpful; some noted that it would also be useful to clarify the linkage between these longer-run objectives and the Committee's approach to setting the stance of monetary policy in the short and medium run. That said, a number of participants expressed concerns about the conceptual issues associated with establishing and communicating explicit longer-run objectives for the unemployment rate or other measures of labor market conditions, inasmuch as the long-run equilibrium levels of such measures are influenced importantly by nonmonetary factors, are subject to change over time, and are estimated with considerable uncertainty. In contrast, participants noted that the long-run level of inflation is determined primarily by monetary policy. Accordingly, many felt that if the Committee were to reach a consensus on more explicit statements of its longer-run objectives, it would need to provide an in-depth explanation to the public of how those objectives were determined and how they fit into the policymaking framework. Participants generally saw the Committee's post-meeting statements as not well suited to communicate fully the Committee's thinking about its objectives and its policy framework, and agreed that the Committee would need to use other means to communicate that information or to supplement information in the statement.

Most participants also indicated that they saw advantages in being more transparent about the conditionality in the Committee's forward guidance by providing more information about the economic conditions to which the guidance refers. They judged that such a step could make the Committee's forward guidance more effective and increase the likelihood that financial markets would respond to incoming economic information in ways that would help monetary policy achieve its goals. However, several participants saw a risk that any explicit statement of economic conditions

specified in the Committee's forward guidance could be mistaken for a statement of its longer-run objectives. Others thought this risk of misinterpretation could be managed through careful communications. A number of participants suggested that the Committee's periodic Summary of Economic Projections could be used to provide more information about their views on the longer-run objectives and the likely evolution of monetary policy.

Participants discussed whether to reduce the IOR rate, weighing potential benefits and costs. A number of participants judged that a reduction would result in at least marginally lower money market rates and could help stimulate bank lending. Several noted that reducing the IOR rate could help signal the Committee's intention to keep the federal funds rate low. Some participants observed that keeping the IOR rate noticeably above the market rate on other safe, short-term instruments could be perceived as subsidizing some banking institutions. However, some others noted that a recent change in deposit insurance assessments had the effect of significantly reducing the net return that many banks receive from holding reserve balances. Moreover, many participants voiced concerns that reducing the IOR rate risked costly disruptions to money markets and to the intermediation of credit, and that the magnitude of such effects would be difficult to predict in advance. In addition, the federal funds market could contract as a result and the effective federal funds rate could become less reliably linked to other short-term interest rates. Participants generally agreed that they needed more information on the likely effects of a reduction in the IOR rate in order to judge its usefulness as a policy tool in the current environment.

Staff Review of the Economic Situation

The information reviewed at the September 20–21 meeting indicated that economic activity continued to expand at a slow pace and that labor market conditions remained weak. Consumer price inflation appeared to have moderated since earlier in the year, and measures of long-run inflation expectations remained stable.

Private nonfarm employment rose only slightly in August, and job gains were weak even after adjusting for the effects of a strike by communications workers during the month. Meanwhile, employment at state and local governments declined further, reflecting their tight budget conditions. The unemployment rate remained at 9.1 percent in August, and both long-duration unemployment and the share of workers employed part time for economic reasons were still ele-

vated. Initial claims for unemployment insurance edged up, on net, over the previous few weeks, and many indicators of firms' hiring plans deteriorated somewhat in recent months.

Industrial production expanded solidly but unevenly in July and August, and the manufacturing capacity utilization rate moved up. Output increased markedly at both motor vehicle manufacturers and their upstream suppliers as the supply chain disruptions associated with the earthquake in Japan eased. In contrast, the pace of factory production softened among industries unlikely to have been affected by the supply disruptions. Motor vehicle assemblies were scheduled to rise noticeably in September and then increase further in the fourth quarter, but broader indicators of near-term manufacturing activity, such as the diffusion indexes of new orders from the national and regional manufacturing surveys, remained at levels consistent with only meager gains in output in the coming months.

Real consumer spending posted a solid gain in July, in part reflecting a rebound in motor vehicle purchases from their low level in the spring when the availability of some models was limited. However, nominal retail sales, excluding purchases at motor vehicles and parts outlets, only inched up in August, and sales of new light motor vehicles ticked down. Real disposable income edged lower in July, as gains in nominal income were offset by the rise in consumer prices. Consumer sentiment deteriorated significantly further in August and stayed downbeat in early September.

Activity in the housing market continued to be depressed by weak demand, uncertainty about future home prices, tight credit conditions for mortgages and construction loans, and a substantial inventory of foreclosed and distressed properties. Starts and permits for new single-family homes in July and August stayed near the very low levels seen since the middle of last year. Sales of new and existing homes remained subdued in recent months, and home prices edged down further.

Real business spending on equipment and software appeared to expand further. Nominal shipments of nondefense capital goods increased in July, and business purchases of new motor vehicles trended higher. New orders of nondefense capital goods continued to run ahead of shipments in July, and the expanding backlog of unfilled orders pointed toward further gains in outlays for business equipment in subsequent months. In contrast, survey measures of business conditions and sentiment remained at muted levels in August and September. Real business expenditures for

office and commercial buildings moved up in recent months, but outlays were still at a very low level and continued to be restrained by high vacancy rates and tight credit conditions for construction loans. Meanwhile, spending for drilling and mining structures increased further. Businesses seemed to be adding to inventories at a more modest pace in July, as the restocking of motor vehicle inventories depleted by the earlier production disruptions was offset by slowing accumulation in other sectors. In most industries, inventories looked to be reasonably well aligned with sales.

Real federal government purchases appeared to increase in recent months as defense expenditures continued to rise from unusually low levels early in the year. At the state and local level, real government purchases seemed set to decline further as payrolls were reduced and construction spending decreased.

The nominal U.S. international trade deficit widened in June but narrowed significantly in July. Exports rose briskly in July, particularly in industrial supplies and capital goods, after having decreased in June. Imports moved down in both months, as declines in petroleum products—reflecting both lower prices and decreased volumes—more than offset large gains in automotive products following the easing of supply chain disruptions in Japan. Trade data for July suggested that net exports continued to boost U.S. real gross domestic product (GDP) growth in the third quarter.

Monthly U.S. consumer price inflation picked up in July and August after slowing in May and June, but remained a bit lower than earlier in the year. Consumer energy prices stepped up in July and August but only partially retraced their decline over the previous two months, and the increases in food prices were somewhat below the pace seen early in the year. The consumer price index excluding food and energy rose at about the same average monthly rate in July and August as in the second quarter. Near-term inflation expectations from the Thomson Reuters/University of Michigan Surveys of Consumers in August and September stayed well below the elevated level seen in the spring, and longer-term inflation expectations remained stable.

Available measures of labor compensation indicated that wage increases continued to be restrained by the large margin of slack in the labor market. Average hourly earnings for all employees posted a small gain, on net, over July and August, and their rate of increase from 12 months earlier remained subdued.

Foreign economic growth declined in the second quarter. Growth slowed notably in Europe; economic activity also decelerated in the emerging market economies. Real GDP contracted in Canada due to a large decline in exports. Output also fell in Japan, reflecting the dislocations caused by the March earthquake. Part of the downshift in global economic growth appeared to have been driven by temporary supply chain disruptions caused by Japan's earthquake. Although the waning of these disruptions seemed to be supporting a rebound in foreign GDP growth in the third quarter, recent indicators suggested only sluggish gains in underlying economic activity. With the intensification of fiscal and financial stress in the euro area, measures of consumer and business confidence declined in August, and indicators of manufacturing activity in the region deteriorated. For many emerging market economies, the recent slowing in growth of economic activity was most evident in exports, industrial production, and other indicators of manufacturing activity. Inflation abroad eased in the second quarter as the effects of earlier increases in food and energy prices began to fade. More recently, however, increases in domestic food prices appeared to be pushing up consumer price inflation in some economies.

Staff Review of the Financial Situation

Financial markets were volatile over the intermeeting period as investors responded to mostly downbeat news on economic activity in the United States and abroad. Fluctuations in investors' level of concern about European fiscal and financial prospects also contributed to market volatility.

The expected path of the federal funds rate moved down appreciably over the intermeeting period. Investors initially focused on the firmer forward guidance in the August FOMC statement indicating that the Committee anticipated that economic conditions were likely to warrant exceptionally low levels of the federal funds rate at least through mid-2013. Over subsequent weeks, weak economic data contributed to rising expectations of additional monetary accommodation; those expectations and increasing concerns about the financial situation in Europe led to an appreciable decline in intermediate- and longer-term nominal Treasury yields. Partly in reaction to the softer economic outlook, measures of inflation compensation for the next 5 years as well as 5 to 10 years ahead derived from nominal and inflation-protected Treasury securities each fell to the low end of their ranges for this year.

Since early August, the equity prices of large U.S. financial institutions fell and their credit default swap (CDS) spreads widened. More-pronounced declines in equity prices and larger increases in CDS spreads occurred for some European financial institutions. Though many large European banks found it increasingly difficult, in recent weeks, to get unsecured dollar funding beyond the very short term, the conditions faced by U.S. financial institutions in these markets were little changed. In secured funding markets, term financing reportedly remained readily available for both domestic and European financial institutions through repurchase agreements backed by Treasury and agency collateral. However, some strains emerged late in the intermeeting period in the market for repurchase agreements backed by lower-quality, nontraditional collateral. In response to dollar funding pressures abroad, the Bank of England, the European Central Bank (ECB), and the Swiss National Bank announced that they would offer banks in their jurisdictions dollar loans for periods of approximately three months as well as continue to offer dollar loans for one-week periods; the Bank of Japan added to its previously announced program of three-month and seven-day dollar loans.

Broad stock price indexes were volatile but increased, on net, since the August FOMC meeting, following sharp declines in the days just preceding that meeting. Gross public equity issuance by nonfinancial firms weakened substantially in recent weeks, and a large number of planned initial public offerings were shelved amid the heightened market volatility.

Spreads of yields on investment- and speculative-grade corporate bonds over those on comparable-maturity Treasury securities rose significantly over the intermeeting period, reaching levels last registered in late 2009, and average bid prices in the secondary market for syndicated leveraged loans declined. Credit flows in August offered additional evidence that debt markets had become less hospitable to lower-rated nonfinancial firms. Bond issuance by speculative-grade firms nearly came to a halt, and the volume of new leveraged loans financed by institutional investors appeared to drop sharply after having moved down in July. However, net bond issuance by investment-grade companies remained robust in August despite wider spreads, and nonfinancial commercial paper outstanding increased slightly.

In the September 2011 Senior Credit Officer Opinion Survey on Dealer Financing Terms, dealers reported only small changes in credit terms across major classes

of counterparties over the past three months. Respondents noted that the use of financial leverage by hedge funds decreased somewhat over the same period. Dealers also indicated that their clients' willingness to bear risk generally had declined somewhat; that was particularly true of hedge funds.

Financing conditions for commercial real estate remained weak. Issuance of commercial mortgage-backed securities (CMBS) slowed further in July and August, and investors appeared to demand greater compensation for risk. Prices of most types of commercial properties remained depressed despite a slight decline in vacancy rates in the second quarter. Delinquency rates on loans that back existing CMBS hovered at an elevated level in August, but delinquency rates on commercial real estate loans held by banks decreased in the second quarter.

Residential MBS yields and residential mortgage interest rates declined, on net, over the intermeeting period to historically low levels, but their spreads to yields on long-term Treasury securities increased. However, low mortgage rates spurred little refinancing activity, in part because of tight underwriting standards and low levels of home equity for many households. Residential mortgage debt contracted further in the second quarter, and the volume of mortgage applications to purchase homes moved down so far in the third quarter. Rates of serious mortgage delinquency continued to moderate but remained high, while the rate at which prime mortgages moved into delinquency stepped up, on balance, in recent months.

Consumer credit increased at a solid pace in July, as a sizable increase in nonrevolving credit—driven by a surge in federally funded student loans—more than offset a decrease in revolving credit. Issuance of consumer asset-backed securities moved down in August, but spreads on these securities remained low. Delinquency rates for several categories of consumer loans moved down further in recent months, with some reaching levels not seen since the 2008–09 recession began.

Core commercial bank loans—the sum of commercial and industrial (C&I), real estate, and consumer loans—expanded slightly in July and August. C&I loans grew strongly, consumer loans showed tepid growth, and real estate loans continued to decline. The upturn in lending was concentrated at large domestic and foreign institutions; at smaller banks, core loans declined in July and August at about the same pace as in recent quarters.

M2 surged in July and August, as investors and asset managers sought the relative safety and liquidity of bank deposits and other assets that make up the M2 aggregate. Notably, institutional investors, concerned about exposures of money funds to European financial institutions, shifted from prime money funds to bank deposits, and money fund managers accumulated sizable bank deposits in anticipation of potentially large redemptions by investors. In addition, retail investors evidently placed redemptions from equity and bond mutual funds into bank deposits and retail money market funds.

The foreign exchange value of the dollar increased over the intermeeting period, reflecting a flight to safety that also contributed to lower benchmark sovereign yields in Germany, the United Kingdom, and Canada. In contrast, the yield on two-year Greek sovereign bonds rose sharply as market participants became increasingly concerned that Greece might default on its sovereign debt. Equity prices in the euro area decreased over the intermeeting period, following sharp declines in early August. After falling steeply before the August FOMC meeting, emerging market equity prices were little changed, on net, over the period.

The European Central Bank continued to purchase, in the secondary market, sovereign debt of euro-area countries. Yields on Italian and Spanish debt, which declined following reported ECB purchases in early August, drifted higher during the intermeeting period. Prices of money market futures contracts indicated that monetary policy was expected to become more accommodative in both the euro area and the United Kingdom. The Swiss National Bank took several steps to ease monetary policy, including intervening in the foreign exchange market to counter further appreciation of its currency and eventually announcing that it is prepared to buy unlimited quantities of foreign currency to prevent the Swiss franc from trading in the foreign exchange market at a rate below 1.2 Swiss francs per euro. Citing concerns over the global economic outlook, the central bank of Brazil reduced its policy rate after having raised it several times earlier this year. In contrast, China continued to tighten its monetary policy, extending reserve requirements to a wider range of bank liabilities as it attempted to rein in off-balance-sheet lending by its banks.

Staff Economic Outlook

In the economic forecast prepared for the September FOMC meeting, the staff lowered its projection for the increase in real GDP in the second half of 2011 and in

the medium term. The incoming data on household and business spending were about as expected, on balance, but labor market conditions and indicators of near-term economic activity, such as consumer and business sentiment, were weaker than anticipated. In addition, financial conditions deteriorated since the time of the previous forecast as investors pulled back from riskier assets. Nevertheless, the staff continued to forecast that economic activity would increase more rapidly in the second half of this year than over the first half, as supply chain disruptions in the motor vehicle sector eased. In the medium term, the staff still projected real GDP to accelerate gradually, supported by accommodative monetary policy, further increases in credit availability, and improvements in consumer and business confidence from their current low levels. The increase in real GDP was expected to be sufficient to reduce the unemployment rate only slowly over the projection period, and the jobless rate was anticipated to remain elevated at the end of 2013.

The staff's projection for inflation was little changed from its forecast at the time of the August FOMC meeting. The upward pressure on consumer prices from increases in import and commodity prices earlier in the year, along with the temporary boost to motor vehicle prices from low inventories, were expected to recede further in the coming quarters. With stable long-run inflation expectations and considerable slack in labor and product markets anticipated to persist over the forecast period, the staff continued to project that inflation would be subdued in 2012 and 2013.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants agreed that the information received during the intermeeting period indicated that economic growth remained slow but did not suggest a contraction in activity. Temporary factors that had contributed to slower growth during the first half of the year had partly reversed, contributing to some rebound in final sales and production, particularly in the manufacturing sector where progress had been made in resolving supply chain disruptions. But stresses in global financial markets, sluggish growth in households' real incomes, and heightened uncertainty about economic prospects seemed to have contributed to lower consumer and business sentiment and to be weighing on economic growth. Recent indicators pointed to continuing weakness in overall labor market conditions, and the unemployment rate remained elevated. Inflation appeared to have moderated since earlier in the

year as prices of energy and some commodities declined from their peaks, but inflation had not yet come down as much as participants had expected earlier this year. Labor costs remained subdued.

Looking ahead, participants continued to expect some pickup in the pace of recovery over coming quarters but anticipated that the unemployment rate would decline only gradually. They generally judged that risks to the growth outlook, including strains in global financial markets, were significant and tilted to the downside; moreover, slow growth left the recovery more vulnerable to negative shocks. With longer-term inflation expectations remaining stable and the effects of past increases in energy and commodity prices continuing to dissipate, most participants saw both core and headline inflation as likely to settle, over coming quarters, at or below the levels they see as most consistent with their dual mandate. Participants continued to see the outlook for growth and inflation as more uncertain than usual.

Participants noted modest growth in consumer spending on average in recent months, with some rebound in purchases of new motor vehicles as manufacturers made progress in resolving supply chain disruptions and increased the availability of popular models. Surveys suggested that households were pessimistic about their future incomes, and consumer confidence had dropped to historically low levels. Low confidence, continuing efforts to repair balance sheets, and heightened caution in the face of an uncertain economic environment were seen as factors likely to weigh on household spending. Several participants pointed to depressed home prices and financial constraints, including still-tight credit conditions for many households, as also likely to restrain consumer spending for a time. However, household debt-service burdens had declined, indicating that there had been further progress in repairing household balance sheets.

Business sentiment had worsened, seemingly in response to weaker economic prospects and increased downside risks to the outlook for U.S. and global growth. Contacts at communications, technology, and transportation firms indicated that growth had slowed in those sectors; surveys also indicated that growth in the manufacturing sector had weakened during the summer. One participant suggested that hurricanes and subsequent flooding had contributed to the slowing in some parts of the country. In contrast, business contacts reported that commodity-related sectors such as energy, agriculture, and mining continued to show

strong gains; tourism also appeared to be doing well. Exports remained a bright spot for U.S. manufacturers and commodity producers. Business investment in equipment and software had continued to expand in recent months, but some contacts expressed concern that firms would cut capital spending if their sales slowed further.

The housing sector remained depressed, with construction at very low levels and seen as likely to remain so given the weakness in new home sales and the continuing flow of foreclosed properties into the market. Though mortgage rates were very low, spreads between mortgage rates and yields on Treasury securities were unusually wide. Moreover, still-tight credit standards meant that many households were unable to qualify for loans to buy a home, and the drop in house prices in recent years left others unable to refinance an existing higher-rate mortgage. Nonresidential construction generally remained weak, apart from investment in extractive industries, and forward-looking indicators of nonresidential construction had dropped.

Meeting participants generally noted that overall labor market conditions had shown no improvement or had deteriorated in recent months and the unemployment rate remained elevated. Even after adjusting for the effects of strikes on reported payrolls, the employment report for August showed weak job gains. Moreover, both the average workweek and aggregate hours worked declined. Contacts reported that slower growth, depressed business confidence, and uncertainty about the economic outlook were restraining hiring as well as capital investment; many also cited uncertainty about regulatory and tax policies as contributing to businesses' reluctance to spend. Some business contacts reported that their firms had made contingency plans to reduce output and employment if demand for their products were to turn down. Participants generally agreed that sluggish job growth and the elevated unemployment rate reflected both weak demand for goods and services and a mismatch between the characteristics of the unemployed and the needs of the employers that currently have jobs available, but they had varying views about the relative importance of these two factors. Many participants judged that weak demand was of most importance, while a few argued that structural and geographic mismatches were key. A few commented that business contacts reported receiving large numbers of applications for relatively low-skilled positions but having difficulty finding and hiring candidates for some highly skilled positions. Several participants again noted that the exceptionally high level of

long-duration unemployment could lead to permanent negative effects on the skills and employment prospects of those affected and so reduce the economy's longer-run productive potential.

Participants noted that financial markets were volatile over the intermeeting period and that financial conditions were strained at times, as investors reacted to the incoming economic data and to news about European fiscal and financial developments. Several participants argued that broader financial conditions had become less accommodative over the intermeeting period: Risk spreads had widened appreciably, likely reflecting a reduced willingness of investors to bear risk, a weaker outlook for growth in the United States and globally, and greater uncertainty about economic prospects. On the positive side, some participants noted that the reduction in leverage and increase in financial firms' liquidity cushions since the height of the financial crisis likely had attenuated the adverse effects of heightened risk aversion. Contacts in the banking sector reported that U.S. banks remained willing to lend to qualified customers, but that loan demand was weak. While noting that conditions in bank funding markets had tightened, particularly for European banks, participants observed that the capital and liquidity positions of U.S. banks had strengthened in recent quarters and that the credit quality of both business and household loans had continued to improve. Nonetheless, some large U.S. banks had seen further pressure on their stock prices and CDS spreads. Participants agreed that, if European policymakers did not respond effectively, European sovereign debt and banking problems could intensify, with potentially serious spillovers to the U.S. economy. However, it was noted that the ECB was providing ample liquidity to European banks, and that it had substantial capacity to provide additional liquidity through its lending facilities if necessary.

Most participants agreed that inflation appeared to have moderated in recent months compared with earlier in the year as prices of energy and some commodities declined from their peaks, though the moderation was not as substantial as many participants had expected. Longer-term inflation expectations had remained stable. Most participants anticipated that, with stable inflation expectations, significant slack in labor and product markets, slow wage growth, and little evidence of pricing power among firms, inflation was likely to decline moderately over time. Several suggested that slowing growth in the United States and abroad made a new surge in commodity prices unlikely. However, some noted that core as well as headline inflation

had moved up, on balance, since last fall. A few suggested that the juxtaposition of higher core inflation and somewhat lower unemployment could mean that the degree of slack in labor markets and the level of potential output were lower than the Committee had thought. Some argued that the rise in core inflation from very low levels reflected the accommodative stance of monetary policy and indicated that the large-scale asset purchases the Committee undertook from November through June had been a successful response to the deflation risks of a year ago. Many participants judged that the risks to the outlook for inflation were roughly balanced. Some saw medium-run inflation risks as tilted to the downside, in light of persistent resource slack; some others argued that the accommodative stance of monetary policy and the upward trend in measures of core inflation this year suggested inflation risks were tilted to the upside. Participants generally judged that there was relatively little risk of deflation. One commented that surveys showed that forecasters saw a low likelihood of deflation; a second, however, noted that a measure of the probability of deflation calculated from prices of Treasury inflation-protected securities (TIPS) had declined as the Federal Reserve conducted its second large-scale asset purchase program but more recently had been rising.

Participants saw considerable uncertainty surrounding the outlook for a gradual pickup in economic growth. It was again noted that the cyclical impetus to economic expansion appeared to be weaker than in past recoveries, but that the reasons for the weakness were unclear, contributing to greater uncertainty about the economic outlook. Several commented that, with households and businesses seeking to reduce leverage rather than to borrow and with housing markets in distress, some of the normal mechanisms through which monetary policy actions are transmitted to the real economy appeared to be attenuated. Many participants saw significant downside risks to economic growth. While they did not anticipate a downturn in economic activity, several remarked that, with growth slow, the recovery was more vulnerable to adverse shocks. Risks included the possibility of more pronounced or more protracted deleveraging by households, the chance of a larger-than-expected near-term fiscal tightening, and potential spillovers to the United States if the financial situation in Europe were to worsen appreciably. Participants agreed to consider further how best to use their monetary policy and liquidity tools to deal with such shocks if they were to occur.

Committee Policy Action

In the discussion of monetary policy for the period ahead, most members agreed that the revisions to the economic outlook warranted some additional monetary policy accommodation to support a stronger recovery and to help ensure that inflation, over time, was at a level consistent with the Committee's dual mandate. While they recognized that monetary policy alone could not completely address the economy's ills, most members judged that additional accommodation could contribute importantly to better outcomes in terms of the Committee's dual mandate of maximum employment and price stability. Those viewing greater policy accommodation as appropriate at this meeting generally supported a maturity extension program that would combine asset purchases and sales to extend the average maturity of securities held in the SOMA without generating a substantial expansion of the Federal Reserve's balance sheet or reserve balances. Specifically, those members supported a program under which the Committee would announce its intention to purchase, by the end of June 2012, \$400 billion of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less. They expected this program to put downward pressure on longer-term interest rates and to help make broader financial conditions more accommodative. While the scale of such a maturity extension program was necessarily limited by the amount of shorter-term securities in the SOMA portfolio, most members judged the action as appropriate, given economic conditions and the outlook. Two members said that current conditions and the outlook could justify stronger policy action, but they supported undertaking the maturity extension program at this meeting as it did not rule out additional steps at future meetings. Three members concluded that additional accommodation was not appropriate at this time. The Committee discussed whether to specify the parameters of the maturity extension program by stating its intention to complete the full set of transactions by June 2012 or by stating that it would undertake these transactions at a specified monthly pace. Members saw benefits to both approaches: The former would provide the public greater clarity about the likely scale of the program and the latter might allow the Committee greater flexibility to adjust the scale of the program in response to unexpected economic developments. A majority favored the first approach. Members noted, however, that the Committee will continue to regularly review the size and composition of its securities hold-

ings and that it is prepared to adjust those holdings as appropriate.

Most members also supported a change in the Committee's reinvestment policy. To help support conditions in mortgage markets, the Committee decided to reinvest principal received from its holdings of agency debt and agency MBS in agency MBS rather than continuing to reinvest in longer-term Treasury securities as had been the Committee's practice for more than a year. The effect of this change will be to keep the SOMA's holdings of agency securities at an approximately constant level; under the previous practice, those holdings were declining on an ongoing basis. This change in reinvestment policy was expected to help reduce the spread between yields on mortgage-backed securities and those on comparable-maturity Treasury securities seen this year and so contribute to lower mortgage rates. Members also noted that the change in reinvestment policy could help prevent the shares of outstanding longer-term Treasury securities held by the Federal Reserve from reaching levels high enough to result in a deterioration in Treasury market functioning. One member who opposed the maturity extension program also opposed the change in reinvestment policy because he judged that it would not benefit housing markets. At the same time, the Committee decided to maintain its existing policy of rolling over maturing Treasury securities at auction.

The Committee also decided to keep the target range for the federal funds rate at 0 to ¼ percent and to reaffirm its anticipation 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 mid-2013. A couple of members noted that they would prefer to change the Committee's forward guidance to provide greater clarity about the economic conditions that would be likely to warrant maintaining exceptionally low levels of the target federal funds rate, but no decision was taken on this point.

The Committee agreed that it was important to acknowledge, in the statement to be released following the meeting, that economic growth remained slow and that indicators pointed to continuing weakness in overall labor market conditions. It also agreed to note that inflation appeared to have moderated since earlier in the year as prices of energy and some commodities had declined from their recent peaks, and that longer-term inflation expectations remained stable. Members gen-

erally continued to expect some pickup in the pace of the economic recovery over coming quarters but anticipated that the unemployment rate would decline only gradually and agreed that there were significant downside risks to the economic outlook, including strains in global financial markets. The Committee again anticipated that inflation would settle, over coming quarters, at levels at or below those consistent with the Committee's mandate as the effects of past energy and commodity price increases dissipate further.

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, by the end of June 2012, Treasury securities with remaining maturities of approximately 6 years to 30 years with a total face value of \$400 billion, and to sell Treasury securities with remaining maturities of 3 years or less with a total face value of \$400 billion. The Committee also directs the Desk to maintain its existing policy of rolling over maturing Treasury securities into new issues and to reinvest principal payments on all agency debt and agency mortgage-backed securities in the System Open Market Account in agency mortgage-backed securities in order to 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 August indicates that economic growth remains slow. Recent indicators point to continuing weakness in overall labor market conditions, and the unemployment rate remains elevated. Household spending has been increasing at only a modest pace in recent months despite some recovery in sales of motor vehicles as supply-chain disruptions eased. Investment in nonresidential structures is still weak, and the housing sector remains depressed. However, business investment in equipment and software continues to expand. Inflation appears to have moderated since earlier in the year as prices of energy and some commodities have declined from their peaks. Longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee continues to expect some pickup in the pace of recovery over coming quarters but anticipates that the unemployment rate will decline only gradually toward levels that the Committee judges to be consistent with its dual mandate. Moreover, there are significant downside risks to the economic outlook, including strains in global financial markets. The Committee also anticipates that inflation will settle, over coming quarters, at levels at or below those consistent with the Committee’s dual mandate as the effects of past energy and other commodity price increases dissipate further. However, the Committee will continue to pay close attention to the evolution of inflation and inflation expectations.

To support a stronger economic recovery and to help ensure that inflation, over time, is at levels consistent with the dual mandate, the Committee decided today to extend the average maturity of its holdings of securities. The Committee intends to purchase, by the end of June 2012, \$400 billion of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less. This program should put downward pressure on longer-

term interest rates and help make broader financial conditions more accommodative. The Committee will regularly review the size and composition of its securities holdings and is prepared to adjust those holdings as appropriate.

To help support conditions in mortgage markets, the Committee will now reinvest principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. In addition, the Committee will maintain its existing policy of rolling over maturing Treasury securities at auction.

The Committee also decided 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 mid-2013.

The Committee discussed the range of policy tools available to promote a stronger economic recovery in a context of price stability. It will continue to assess the economic outlook in light of incoming information and is prepared to employ its tools as appropriate.”

Voting for this action: Ben Bernanke, William C. Dudley, Elizabeth Duke, Charles L. Evans, Sarah Bloom Raskin, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser.

Messrs. Fisher, Kocherlakota, and Plosser dissented because they did not support additional policy accommodation at this time. Mr. Fisher saw a maturity extension program as providing few, if any, benefits in support of job creation or economic growth, while it could potentially constrain or complicate the timely removal of policy accommodation. In his view, any reduction in long-term Treasury rates resulting from this policy action would likely lead to further hoarding by savers, with counterproductive results on business and consumer confidence and spending behaviors. He felt that policymakers should instead focus their attention on improving the monetary policy transmission mechanism, particularly with regard to the activity of community banks, which are vital to small business lending and job creation. Mr. Kocherlakota’s perspective on

the policy decision was again shaped by his view that in November 2010, the Committee had chosen a level of accommodation that was well calibrated for the condition of the economy. Since November, inflation, and the one-year-ahead forecast for inflation, had risen, while unemployment, and the one-year-ahead forecast for unemployment, had fallen. He did not believe that providing more monetary accommodation was the appropriate response to those changes in the economy, given the current policy framework. Mr. Plosser felt that a maturity extension program would do little to improve near-term growth or employment, in light of the ongoing structural adjustments and fiscal challenges both in the United States and abroad. Moreover, in his view, with inflation continuing to run above earlier forecasts, such a program could risk adding unwanted inflationary pressures and complicate the eventual exit from the period of extraordinarily accommodative monetary policy.

Following the policy vote, the Manager of the System Open Market Account summarized how the Desk would implement the Committee's decisions. To implement the maturity extension program, the Desk would distribute purchases about evenly across nominal Treasury securities with 6 to 8 years to maturity, with 8 to 10 years to maturity, and with 10 to 30 years to maturity; the Desk would also buy a small amount of TIPS with remaining maturities of 6 to 30 years. This distribution would allocate a much larger share of purchases

to longer maturities than was the case in the Committee's previous asset purchase programs. At the same time, the Desk would sell, from the SOMA portfolio, Treasury securities with remaining maturities of 3 months to 3 years. All Treasury purchases and sales would be conducted using competitive auctions. With respect to the MBS reinvestment program, the Desk would concentrate purchases in newly issued agency-backed MBS and would conduct purchases through a competitive bidding process.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, November 1–2, 2011. The meeting adjourned at 12:30 p.m. on September 21, 2011.

Secretary's Note: The following information regarding the June 21–22, 2011 FOMC meeting was inadvertently omitted from previous minutes. By unanimous vote at that meeting, the Committee ratified the Desk's domestic transactions since the April 26–27, 2011 meeting, and by notation vote completed on July 11, 2011, the Committee unanimously approved the minutes of the June 21–22 FOMC meeting.

William B. English
Secretary