Fed Maintains Stimulus Commitment as Economic Outlook Dims

Jerome Powell reiterates pledge to support eventual recovery, says vigilance in combating coronavirus is key

‘The path of the economy is going to depend to a very high extent on the course of the virus, on the measures that we take to keep it in check,’ Fed Chair Jerome Powell said at a virtual news conference on Wednesday.
Photo: Andrew Harrer/Bloomberg News

By
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Federal Reserve Chairman Jerome Powell said on Wednesday the U.S. economy faces a long road to recovery that will require greater public vigilance to prevent the spread of the coronavirus pandemic and more spending from Congress and the White House.

Fed officials didn’t announce new policy steps at the conclusion of their two-day meeting Wednesday and reiterated their pledge to maintain aggressive measures to support the economy.

“The path of the economy is going to depend to a very high extent on the course of the virus, on the measures that we take to keep it in check,” Mr. Powell said at a news conference. “We can’t say it enough.”

The economic backdrop has weakened somewhat since the Fed's rate-setting committee last met seven weeks ago. After surprising rebounds in employment in May and June, many states have seen significant increases in virus infections, leading to renewed curbs on certain commercial activities and a dampening of consumer confidence.

Mr. Powell said various data sources the Fed monitors suggested hiring and consumer spending had slowed recently.

He encouraged greater adoption of measures to contain the virus by disputing the idea of a trade off between virus suppression and a resumption of commercial activity.

"Social distancing measures and fast reopening of the economy actually go together," Mr. Powell said. "They're not in competition with each other."

Fed officials have been weighing how to provide more support to the economy after moving quickly this spring to cut interest rates to near zero, to ramp up purchases of government debt and to establish an array of emergency lending programs to stabilize funding and credit markets.

But Mr. Powell suggested spending and taxation decisions by Congress and the White House are more urgent now that the Fed has pinned short-term rates pinned near zero while long-term rates hovering at all-time lows.

Leaders of both parties began deliberations this week on a new round of stimulus with key provisions of a $2.2 trillion relief bill in March set to expire this month, but some Republicans are wary about additional government spending.

"Fiscal policy can address things we can't address," said Mr. Powell, a Republican who was named to his current post by President Trump. The measures Congress has approved so far are "really helping now," he said.

Mr. Powell warned that even if the reopening of the economy later this year goes well and millions of people return to work, millions of others employed in industries that depend on large gatherings or close proximity indoors could be out of work for a long time.

All of this could create challenges for the Fed, which has far less room to stimulate the economy than after the 2008 financial crisis because investors already expect the central bank to keep interest rates very low for years.

"They are pushing up against the limits of the ways in which they can provide additional stimulus, and that's a reflection of how they quite appropriately threw the kitchen sink at the problem in March," said Lewis Alexander, chief U.S. economist at Nomura Securities.

"They never want to be in a place of saying, 'There's nothing more we can do.' That is a really bad place for them to be," said Mr. Alexander. "But if you're confronted with a set of circumstances where your response is, 'We're doing everything we can,' how does it not put you in that place?"

Fed officials face three related deliberations over how to provide more stimulus. The first concerns describing how long they will keep rates near zero and buy Treasurys and mortgage bonds, sometimes called forward guidance. The second centers on whether to commit to an open-ended stimulus program with those purchases, as officials did after the 2008 financial crisis. The third entails concluding a yearlong review of the Fed's long-run policy-setting strategy.

Mr. Powell said Wednesday officials had resumed discussions on the last item at their meeting this week and that they would wrap up those deliberations soon. "That will inform everything we do going forward," he said.

Before the pandemic hit, officials were close to agreeing on an important change to their formal statement of long-run goals. The change would effectively abandon the Fed's longtime strategy of always raising rates pre-emptively to prevent inflation from rising above its 2% target.

Instead, officials would allow inflation to average 2% over time. This means periods of inflation below that level would be followed by periods in which they allow inflation to exceed it. The Fed currently doesn't take past performance of inflation into account.

"It is a powerful change," said Priya Misra, head of interest-rate strategy at TD Securities.

The Fed has been seeking more clarity about the economic outlook before rolling out more detailed guidance. Mr. Powell was noncommittal about the timing of those moves Wednesday and suggested they might follow the conclusion of the framework review.

"We're ready to do that when we think it's appropriate," he said. Officials want to wait until "we think it would help."

The Fed already has provided a measure of forward guidance with projections last month that showed most officials don't anticipate lifting rates for years—and bond investors appear to be on the same page for now.

"We're very far away from any kind of tantrum about Fed policy," said Jan Hatzius of Goldman Sachs. "That's the reason why they seem to have decided to take it a little more slowly than they anticipated a couple of months ago."

Steven Blitz of research firm TS Lombard compared the current policy environment as akin to driving a car with a brake pedal but no gas pedal. "Being off the brake isn't going to help the car go. What you need is actual government spending," said Mr. Blitz. "All the Fed can do is get out of the way in terms of being a brake on growth."