Richard H Clarida: US economic outlook and monetary policy

Speech (via webcast) by Mr Richard H Clarida, Vice Chair of the Board of Governors of the Federal Reserve System, at the New York Association for Business Economics, New York City, 21 May 2020.

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It is my pleasure to meet virtually with you today at the New York Association for Business Economics.[1] I have been looking forward to this session, and I am sorry that I cannot join you in person, as I always value my opportunities for dialogue with business and market economists. Since mid-March, along with my Federal Open Market Committee (FOMC) colleagues, I have been working from home. While I certainly miss the opportunities for face-to-face interactions along the corridors of the Board's Eccles Building, I am grateful to be able to work from home and want to convey my deep gratitude to all of those on the frontlines of the crisis, who are working outside the comfort of their homes in hospitals, emergency services, and care facilities.

Current Economic Situation and Outlook

While the coronavirus (COVID-19) pandemic has taken a tragic human toll measured in terms of lives lost and suffering inflicted, as a direct result of the necessary public health policies put in place to mitigate and control the spread of the virus, the pandemic has also inflicted a heavy toll on the levels of activity and employment in the U.S. economy. Real gross domestic product (GDP) declined at a 4.8 percent annual rate in the first quarter of the year and will almost surely continue to contract at an unprecedented pace in the second quarter. The unemployment rate, which was at a 50‑year low of 3.5 percent as recently as February, surged in April by more than 10 percentage points to 14.7 percent, an 80-year high, and it is likely to rise further in May. To put the numbers in some context, more jobs were lost in March and April of this year than had been created in the previous nine years.

But while the economic news has been unremittingly awful in recent weeks, financial conditions since the middle of March have eased—and considerably so in many markets. I believe—and most outside observers agree—that this easing of financial conditions is, at least in part, a direct consequence of the actions the Federal Reserve took at our March 15 meeting, the subsequent announcements over the following days of the creation of nine new credit facilities to support the flow of credit to households and companies, the robust expansion of our existing foreign exchange swap arrangements with major foreign central banks, and the establishment of a new FIMA (Foreign and International Monetary Authorities) Repo Facility with potential eligibility for a broad range of countries.[2] While this easing of financial conditions is, of course, welcome, whether it proves to be durable will depend importantly on the course that the coronavirus contagion takes and the duration of the downturn that it causes. At a minimum, the easing of financial conditions is buying some time until the economy can begin to recover, growth resumes, and unemployment begins to fall.

As I speak to you today, there is extraordinary uncertainty about both the depth and the duration of the economic downturn. Because the course of the economy will depend on the course of the virus and the public health policies put in place to mitigate and contain it, there is an unusually wide range of scenarios for the evolution of the economy that could plausibly play out over the next several years. In my baseline view, while I do believe it will likely take some time for economic activity and the labor market to fully recover from the pandemic shock, I do project right now that the economy will begin to grow and that the unemployment rate will begin to decline starting in the second half of this year. In terms of inflation, my projection is for the COVID-19 contagion shock to be disinflationary, not inflationary, and the data we are seeing so far are consistent with this projection. For example, core CPI (consumer price inflation) prices fell 0.45 percent in April, the largest monthly decrease since the beginning of the series in 1957.

While the COVID-19 shock is disrupting both aggregate demand and supply, the net effect, I believe, will be for aggregate demand to decline relative to aggregate supply, both in the near term and over the medium term. If so, this decrease will put downward pressure on core inflation, which was already running somewhat below our 2 percent objective when the downturn began in March. Moreover, as I have indicated previously, I judge that measures of longer-term inflation expectations were, when the downturn began, at the low end of a range that I consider consistent with our 2 percent inflation objective.

The Policy Response

At the Federal Reserve, we take our dual-mandate obligations of maximum employment and price stability very seriously, and, since March 3, we have deployed our entire toolkit to provide critical support to the economy during this challenging time. In two unscheduled meetings, we voted on March 3 and 15 to cut the target range for the federal funds rate by a total of 150 basis points to its current range of 0 to 25 basis points. In our FOMC statements, we have indicated we expect to maintain the target range at this level until we are confident that the economy has weathered recent events and is on track to achieve our maximum-employment and price-stability goals.

On March 16, we launched a program to purchase Treasury securities and agency mortgage-backed securities in whatever amounts needed to support smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions. To date, these purchases have totaled more than $2 trillion, and, as we indicated following our April FOMC meeting, they are continuing but at a reduced pace, reflecting the substantial improvement in market functioning that has occurred since the program was launched two months ago.

Since March 17, the Federal Reserve Board has announced the establishment of no fewer than nine new facilities to support the flow of credit to households and businesses. These programs are authorized under emergency lending powers granted to the Fed under section 13(3) of the Federal Reserve Act and are available only in "unusual and exigent" circumstances and with the consent of the Secretary of Treasury.[3] I think you will agree that today we face circumstances that are both exigent and unusual. These facilities are supported with money invested by the Department of the Treasury, drawing on appropriations of more than $450 billion authorized by the Congress in the Cares Act (Coronavirus Aid, Relief, and Economic Security Act) for the specific purpose of investing in Fed programs to sustain the flow of credit to households, firms, and communities during the coronavirus pandemic.

With these facilities, we are providing a bridge by stepping in and supporting lending throughout the economy until the recovery takes hold. These programs are designed to offer backstop sources of funding to the private sector, and just the announcement that these backstop facilities would soon be launched appears to have bolstered confidence in capital markets, allowing many companies to finance themselves privately even before the facilities were up and running. But importantly, these are, after all, emergency facilities, and someday—hopefully soon—the emergency will pass. When that day comes and we are confident the economy is solidly on the road to recovery, we will wind down these lending facilities at such time as we determine the circumstances we confront are no longer unusual or exigent.

Not only is the Federal Reserve using its full range of tools to support the economy through this challenging time, but our policies will also help ensure that the rebound in activity when it commences will be as robust as possible. That said, it is important to note that the Fed's statutory authority grants us *lending* powers, not *spending* powers. The Fed is not authorized to grant money to particular beneficiaries, to meet the payroll expenses of small businesses, or to underwrite the unemployment benefits of displaced workers. Programs to support such worthy goals reside squarely in the domain of fiscal policy. The Fed can only make loans to solvent entities with the expectation the loans will be paid back. Direct fiscal support for the economy is thus also essential to sustain economic activity and complement what monetary policy cannot accomplish on its own. Direct fiscal support can make a critical difference, not just in helping families and businesses stay afloat in a time of need, but also in sustaining the productive capacity of the economy after we emerge from this downturn.

Fortunately, the fiscal policy response in the United States to the coronavirus shock has been both robust and timely. In four pieces of legislation passed in just over two months, the Congress has voted $2.9 trillion in coronavirus relief, about 14 percent of GDP. This total includes nearly $700 billion for the Paycheck Protection Program to support worker retention at small companies and more than $450 billion for the U.S. Treasury to provide first-loss equity funding for the Fed credit facilities that I discussed earlier. While the scale, scope, and timing of the monetary and fiscal policy responses to the coronavirus pandemic are unprecedented and will certainly cushion the blow the shock inflicts on the economy, the shock is severe. Depending on the course the virus takes and the depth and duration of the downturn it causes, additional support from both monetary and fiscal policies may be called for.

Concluding Remarks

The coronavirus pandemic poses the most serious threat to maximum employment and, potentially, to price stability that the United States has faced in our lifetimes. There is much that policymakers—and epidemiologists—simply do not know right now about the potential course that the virus, and thus the economy, will take. But there is one thing that I am certain about: The Federal Reserve will continue to act forcefully, proactively, and aggressively as we deploy our toolkit—including our balance sheet, forward guidance, and lending facilities—to provide critical support to the economy during this challenging time and to do all we can to make sure that the recovery from this downturn, once it commences, is as robust as possible.

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[1] These remarks represent my own views, which do not necessarily represent those of the Federal Reserve Board or the Federal Open Market Committee. I am grateful to Chiara Scotti of the Federal Reserve Board staff for her assistance in preparing this text.

[2] For additional information on the Federal Reserve actions taken at the March 15 FOMC meeting, see the meeting statement, which is available (along with statements from other FOMC meetings) on the Board's website at www.federalreserve.gov/monetarypolicy/fomccalendars.htm. More details about the new credit facilities, the expansion of foreign exchange swap arrangements, and the FIMA Repo Facility, as well as other regulatory actions, can be found on the Board's website at www.federalreserve.gov/covid-19.htm.

[3] See Federal Reserve Act, 12 U.S.C. § 343 (1932), quoted text in paragraph 3.A.