Conference Call of the Federal Open Market Committee on August 1, 2011

A joint conference call of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held on Tuesday, August 1, 2011, at 2:00 p.m. Those present were the following:

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, 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 and Dale Roskom, First Vice Presidents, Federal Reserve Banks of Kansas City and Cleveland, respectively

William B. English, Secretary and Economist
Deborah J. Danker, Deputy Secretary
Matthew M. Luecke, Assistant Secretary
Michelle A. Smith, Assistant Secretary
Scott G. Alvarez, General Counsel
Thomas C. Baxter, Deputy General Counsel

Thomas A. Connors, Steven B. Kamin, Loretta J. Mester, David Reifschneider, Daniel G. Sullivan, David W. Wilcox, and Kei-Mu Yi, Associate Economists

Brian Sack, Manager, System Open Market Account

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

Louise L. Roseman, Director, Division of Reserve Bank Operations and Payment Systems, 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

Seth B. Carpenter, Senior Associate Director, Division of Monetary Affairs, Board of Governors; Michael Foley and Mark Van Der Weide, Senior Associate Directors, Division of Banking Supervision and Regulation, Board of Governors; Michael P. Leahy, Senior Associate Director, Division of International Finance, Board of Governors; William Wascher, Senior Associate Director, Division of Research and Statistics, Board of Governors

Andrew T. Levin, Senior Adviser, Office of Board Members, Board of Governors

Brian J. Gross, Special Assistant to the Board, Office of Board Members, Board of Governors

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

Valerie Hinojosa and Randall A. Williams, Records Management Analysts, Division of Monetary Affairs, Board of Governors

Marie Gooding, Sarah G. Green, and Blake Prichard, First Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, and Philadelphia, respectively

Jeff Fuhrer, Robert D. Hankins, Jamie J. McAndrews, and Mark S. Sniderman, Executive Vice Presidents, Federal Reserve Banks of Boston, Dallas, New York, and Cleveland, respectively

David Altig, Alan D. Barkema, Ron Feldman, Craig S. Hakkio, Stephen H. Jenkins, Spencer Krane, Julie L. Stackhouse, Geoffrey Tootell, Christopher J. Waller, and John A. Weinberg, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Kansas City, Minneapolis, Kansas City, Cleveland, Chicago, St. Louis, Boston, St. Louis, and Richmond, respectively

Evan F. Koenig and Lorie K. Logan, Vice Presidents, Federal Reserve Banks of Dallas and New York, respectively

Fred Furlong and David M. Wright, Group Vice Presidents, Federal Reserve Bank of San Francisco

Joshua L. Frost, Assistant Vice President, Federal Reserve Bank of New York

Transcript of the Federal Open Market Committee Conference Call on August 1, 2011

CHAIRMAN BERNANKE. Thank you, everyone, for joining us. This is a joint FOMC–Board meeting, so I need a motion to close the meeting. Governor Duke?

MS. DUKE. So moved, because Governor Yellen is in San Francisco.

CHAIRMAN BERNANKE. Thank you very much. As you know, it's been difficult to schedule this meeting, given the vagaries of politics and of markets. Today could have been, of course, a high-stress day. I hope it's less stressful than that. Nevertheless, I think there are some useful things we can do today.

Let me propose a program, and if anyone has any suggestions, please let me know. I thought what we might do first is get some briefings. We can start, in a moment, with Linda Robertson on the recent developments and the prospects for congressional approval. Brian Gross is here also to provide backup on that.

Second, we'll turn to Brian Sack, who will tell us a bit about both recent and current market developments. That's in preparation for the discussion of potential Federal Reserve actions, if they were to become necessary. Also, I hope Brian will talk a bit about the possibility of a downgrade. Even if there's no default, the downgrade still seems to be a large possibility, and we'd like to know what implications that might have.

Third, Louise Roseman is here. Louise worked hard with the Treasury and with your staffs to develop a system for handling government payments when we thought they would be prioritized or at least not fully paid. I'm going to ask Louise to briefly tell you about that, but I think the issue here, because this is not effective at this point, is to get from you any issues or questions for the future that were raised by this process or any concerns you have about the system that was devised.

Then I'll turn briefly to Mike Foley to update us on banking developments and any questions we've been getting on supervisory issues.

Those are some preliminary briefings to update everybody. Questions will be allowed, of course, at any stage. After the briefings we'll turn to Bill English, who, with the assistance of Brian Sack, will discuss some of the issues raised by their joint memo of a few weeks ago about potential actions that the Federal Reserve could take. Noting that everything is not signed, sealed, and delivered and noting that there are certainly many stresses in financial markets, I think it would still be useful for us to get at least a little bit of input about what kinds of actions the Fed might consider taking under certain contingencies. Particularly given that we have no immediate action proposed, I don't plan to ask for any votes today. But again, your input is useful to help think about what we might bring to this Committee in the future.

So that's my proposal. Are there any suggestions or concerns about what else we might talk about? [No response] All right. Seeing none, let me begin our briefing process and turn to Linda Robertson to give us a brief update on yesterday's negotiations and on where it goes from here. Linda.

MS. ROBERTSON. Great. I think it's appropriate to start exactly where the President started last night. That is, although there's an agreement in principle and legislative language now embodies that framework, there are still some critical votes to take place before any of the celebration or a sigh of relief is fully realized.

I'll come back to the floor situations in a minute. Where I'd like to start is with the framework, and in particular, the mechanics of this agreement, for which there are several important milestones that I think are going to be important in terms of overall thought about where things are heading on fiscal policy. As far as the mechanics goes, I did want to take note briefly about how the various leaders were portraying this. In the document that the speaker put out last night, he basically outlined three accomplishments from his standpoint: (1) it cuts government spending more than it increases the debt limit, (2) it implements spending caps to restrain future spending, and (3) it advances the cause of a balanced budget amendment. Meanwhile, Majority Leader Reid put out a remarkably similar document today, but his touchstones were (1) it extended the debt ceiling up to 2013, removing the cloud of uncertainty over our economy, and (2) it makes a nearly $1 trillion down payment on deficit reductions. So that's how they're framing this deliberation today—and hopefully it will be concluded today.

Let me take a minute to explain the mechanics. It's a couple-stage process, with some interesting hallmarks; for those of you who know the budget battles of the 1980s and into the 1990s, you'll see some familiar mechanisms. For stage 1, there is an immediate-upon-passage $920 billion, roughly, deficit achievement embodied in caps on the discretionary spending accounts, and there are a couple of important components to that. In terms of the overall framework, it's split between nondefense discretionary and defense. There is a specific firewall between those two in FY2012 and FY2013 and then the firewall between those two comes down for the remainder of the 10-year period. What does this mean in terms of overall fiscal reduction in 2012 and '13? Roughly $10 billion in spending cuts over that two-year period—$7 billion and then $3 billion. Of that, $5 billion comes from defense and what they're calling security-related accounts, and the remainder from the nondefense discretionary.

With this first phase, which is automatic upon passage and is focused on the discretionary spending accounts, what happens in terms of the debt ceiling? A two-step process there. Immediately, the Treasury gets a $400 billion bump-up in the debt ceiling, which takes them into September of this year. The President then—although I don't know this for sure—would probably send a certification to the Congress, before they go out in August, attesting to certain levels of debt ceiling within their estimates for the end of the year. The Congress then has, I believe, 50 days to disapprove of that certification. And he has a veto. And with that, the President then achieves another $500 billion on the debt ceiling. In other words, the way they're thinking about this first phase is that roughly $900 billion in debt ceiling is pretty much automatic.

What happens from there? This is where we come to stage 2 and what one thinks about in terms of the overall components of this package. When you look at the totals, you've got roughly $900 billion and change in the first phase—how do you get to the roughly $2.1 trillion to $2.3 trillion that everyone's talking about? That's where stage 2 comes in. A special committee is established, which would be composed of 12 members of Congress, evenly split between parties and evenly split between the chambers. They have until Thanksgiving, November 23, to report back to the leadership on an overall deficit reduction package of $1.5 trillion. Then there's a whole set of fast-track procedures in the Congress if, indeed, this super-special committee does achieve a majority—and it's a majority vote only—on a package. The Congress then has fast-track procedures in which they can vote on this by December 23.