BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

JEROME H. POWELL
CHAIR

April 8, 2021

The Honorable Rick Scott
United States Senate
Washington, D.C. 20510

Dear Senator:

Thank you for your recent letter in which you raised a number of important questions regarding the economic outlook and Federal Reserve policy actions. As Chair of the Federal Open Market Committee (FOMC), I am responding on behalf of the FOMC. In responding to your specific questions, it is important to bear in mind the economic and policy developments over the last year.

With the onset of the pandemic, the United States and global economy experienced the most severe economic shock since the Great Depression. In response to that shock, Congress provided by far the fastest and largest response to any postwar economic downturn, offering fiscal support for households, businesses, health-care providers, and state and local governments.

As the virus arrived in force, the Federal Reserve's immediate challenge was to limit the severity and duration of the fallout to avoid longer-run damage to the economy. In doing so, we also acted with unprecedented speed and force, using the full range of policy tools at our disposal. Our actions included reducing the target range for the federal funds rate to 0 to ¼ percent, purchasing large amounts of Treasury and agency securities to address the severe dysfunction in financial markets, establishing a broad range of emergency lending programs with the approval of the Secretary of the Treasury, and taking many other steps to support economic recovery. By staving off severe financial-market stress, our actions, taken together, helped unlock more than $2 trillion in funding from private sources to support businesses large and small, nonprofits, and state and local governments between April and December. This support, in turn, has helped keep organizations from shuttering and put employers in both a better position to keep many workers employed and to re-hire others as the recovery continues.

Today the economic situation is much improved. The recovery has progressed more quickly than generally expected and looks to be strengthening. This is due in significant part to the unprecedented fiscal and monetary policy actions implemented over the past year, which provided essential support to households, businesses, and communities. However, the sectors of the economy most adversely affected by the virus, and by social distancing, remain weak. Indeed, the unemployment rate—still elevated at 6 percent—underestimates the shortfall in jobs, as labor market participation remains notably below pre-pandemic levels.

As we have emphasized throughout the pandemic, the path of the economy continues to depend on the course of the virus. Although new cases of COVID-19 are far below their January level, the number has turned back up, which is cause for concern. Still, ongoing vaccinations offer hope for a return to more normal conditions later this year.

In addition to responding to the economic and financial crisis associated with the pandemic, we also were working in 2020 to complete the first public review of our monetary policy strategy, tools, and communication practices. That effort culminated in the release of our revised Statement on Longer-Run Goals and Monetary Policy Strategy (consensus statement).[1] This important document describes the key principles that have guided our monetary policy actions over the past year and will continue to serve as the foundation for our policy actions going forward. This new consensus statement conveys our continued strong commitment to achieving the goals given to us by Congress and our willingness to deploy our tools as appropriate to achieve those goals.

As I discussed last August, our new consensus statement addresses head-on a key challenge faced by central banks all over the world in recent years—the global trend toward lower interest rates and the limitations that trend implies for the effectiveness of traditional monetary policy tools.[2] In particular, the trend toward lower interest rates has made it more challenging for central banks to provide the accommodation necessary to address adverse economic shocks and counter disinflationary forces. In the United States, inflation has run below 2 percent on average for more than a decade. The new consensus statement conveys our determination to use our full range of tools to achieve our objectives and to avoid the experience in some countries in which central bank policy rates are pinned near zero with subpar economic performance and the associated downward pressure on inflation and inflation expectations. In conducting monetary policy, we will remain focused on fostering as strong a labor market as possible for the benefit of all Americans, while seeking to achieve an average 2 percent inflation rate over time.

After the release of the new consensus statement, the FOMC acted at subsequent meetings to provide guidance for the future path of the target range for the federal funds rate and for asset purchases that were consistent with the new strategy. In particular, the FOMC indicated that it expects to maintain the current target range until (i) labor market conditions have reached levels consistent with the FOMC's assessments of maximum employment; (ii) inflation has risen to 2 percent; and, (iii) inflation is on track to moderately exceed 2 percent for some time. In following this policy, the FOMC seeks to achieve inflation that averages 2 percent over time and thereby keep inflation expectations firmly anchored at 2 percent. Last December, the FOMC also provided guidance about its program of asset purchases, indicating that it would continue to increase its holdings of Treasury securities and agency mortgage backed securities (MBS) at least at the current pace of $80 billion per month and $40 billion per month, respectively, until

---

[1] https://www.federalreserve.gov/newsevents/pressreleases/monetary20200827a.htm.
[2] https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm.

there is substantial further progress toward the FOMC's maximum employment and price stability goals. Our asset purchases help to foster accommodative financial conditions, thereby supporting lower borrowing rates for households and businesses and promoting our congressionally mandated objectives.

Of course, the outlook for the economy and policy remains highly uncertain. With the passage of the *Consolidated Appropriations Act* last year and the *American Rescue Plan Act* this year, significant further fiscal expansion is now in train. Based on that change in the fiscal outlook and on the progress in vaccinations and other factors, FOMC participants along with private sector analysts have significantly marked up their economic forecasts. In the Summary of Economic Projections (SEP) prepared for the March meeting, FOMC participants projected the unemployment rate to continue to decline, with a median projection of 4.5 percent at the end of this year and 3.5 percent by the end of 2023.[3]

Overall inflation remains below our 2 percent longer-run objective. Over the next few months, 12-month measures of inflation will likely move up as the very low readings from March and April of last year fall out of the calculation. Beyond these base effects, we could also see upward pressure on prices if spending rebounds quickly as the economy continues to reopen, particularly if supply bottlenecks limit how quickly production can respond in the near term. However, these increases in prices are likely to be transitory, and I would not expect them to have persistent effects on inflation. In our March SEP projections, the median inflation projection of FOMC participants was 2.4 percent for this year, 2 percent for next year, and a little higher than 2 percent by the end of 2023.

I would emphasize that the SEP is a summary of the individual views of FOMC participants, not an FOMC consensus forecast. Moreover, these are just projections, and the economy could evolve in many ways. In light of that uncertainty, the FOMC has provided its guidance for the federal funds rate and asset purchases in the form of outcome-based criteria for the labor market and inflation. That means that our future policy actions will be based on actual progress toward our objectives. If progress towards our employment and inflation objectives slows, we will maintain a highly accommodative stance for longer. Conversely, if progress turns out to be more rapid, adjustments to the stance of policy would likely occur sooner. As always, we are fully committed to both legs of the dual mandate, and we will set monetary policy as appropriate to achieve our maximum employment and price stability goals.

The future path for many of our other policy actions taken last spring is more clear cut. With one exception, all of the emergency lending programs established under section 13(3) of the Federal Reserve Act (FRA) have been closed. We recently extended the Paycheck Protection Program Liquidity Facility (PPPLF) for another quarter to continue to support the Paycheck Protection Program (PPP), consistent with the recent action of Congress to extend the PPP program through May.

The background above is intended to provide perspective on your specific questions. Your first two questions focus on the potential for rising inflation risks and the threat that high and rising inflation could pose for families and businesses. As noted above, we do expect that

[3] https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20210317.pdf.

overall inflation will move a little higher this year, in part reflecting transitory factors as the economy strengthens. Moreover, the potential for temporary supply constraints in selected sectors could result in increases in the prices for particular goods and services. But as discussed above, inflation has been low in the United States and around the world for more than a decade, and inflation that is too low harms American families and businesses; inflation that runs persistently below our 2 percent objective limits the extent of policy accommodation that can be provided through our traditional policy tools and raises the risks of more adverse economic downturns in the event of economic shocks. Following the persistent shortfall of inflation from 2 percent over recent years, and to achieve inflation that averages 2 percent over time, we are now aiming for inflation moderately above 2 percent for some time. This policy strategy should help keep longer-term inflation expectations well anchored at 2 percent. We do not seek inflation that substantially exceeds 2 percent, nor do we seek inflation above 2 percent for a prolonged period. I would emphasize, though, that we are fully committed to both legs of our dual mandate—maximum employment and stable prices. We understand well the lessons of the high inflation experience in the 1960s and 1970s, and the burdens that experience created for all Americans. We do not anticipate inflation pressures of that type, but we have the tools to address such pressures if they do arise.

Your third and fourth questions focus on the FOMC's purchases of Treasury securities and agency MBS. As noted above, the FOMC is increasing its holdings of these securities to foster accommodative financial conditions, support the flow of credit to households and businesses, and promote economic recovery. We believe these programs have been effective in keeping borrowing rates low for households and businesses and in supporting the economy through this difficult period. As noted above, we plan to continue increasing our holdings of Treasury and agency securities at least at the current pace until we see substantial further progress toward our maximum employment and price stability goals. We have also indicated that we would proceed gradually in eventually winding down our purchases and would provide notice well in advance of the beginning of that process. Once our purchases are completed, our holdings of securities will continue to provide substantial policy accommodation to support a strong economy and inflation consistent with our 2 percent longer-run objective. As in the period following earlier large-scale asset purchases, there will ultimately be a period over which the balance sheet and reserves in the banking system are returned to more normal levels, but that time is likely well into the future.

With regard to whether the Federal Reserve's asset purchases are providing financing for fiscal deficits, as noted above, our purchases of securities are aimed at fostering accommodative financial conditions and sustaining smooth market functioning. Since June of last year, we have purchased securities at a steady pace unrelated to the magnitude of fiscal deficits. Moreover, we do not increase our holdings of Treasury securities by purchasing securities at Treasury auctions. The Federal Reserve purchases only previously-issued Treasury securities in the secondary market through open market operations conducted in an open and competitive process. The Treasury Department issues new securities through auctions directly to private investors. The low yields on Treasury securities attests to the continued strong global demand for Treasury securities as the safest and most liquid asset in the world.

Your fifth question focuses on the payment of interest on reserves. In 2008, Congress authorized the Federal Reserve to begin paying interest on balances maintained by depository institutions at the Federal Reserve. The interest rate paid on reserves is the key tool, together with the offered rate on Overnight Reverse Repurchase Agreement (ON RRP) operations, that allows the Federal Reserve to keep the federal funds rate and other short-term rates at the level necessary to achieve our statutory objectives of maximum employment and stable prices. In early 2019, the FOMC released a statement indicating that it intended to implement monetary policy in an ample reserves regime.[4] In that regime, the Federal Reserve supplies a substantial quantity of reserves sufficient to keep the federal funds rate at or close to the interest on reserves rate and within the target range established by the FOMC. This operating regime has many advantages over the operating regime in place prior to 2007, which involved a complicated and burdensome system of reserve requirements and an equally complicated system for closely managing the supply of reserves on a day-to-day basis. Moreover, banks have substantial demands for high quality liquid assets as part of their liquidity risk management, and reserves play an important role in meeting this demand.

Your sixth question focuses on whether the Federal Reserve's actions have undermined the role of the dollar in global financial markets. As noted above, all of our actions in response to the crisis have been taken to promote our congressional mandates of maximum employment and price stability and to foster financial stability. Securing these outcomes is critical to ensuring that the dollar continues to play a central role in the global economy. Today, the dollar continues to play an essential function in global currency markets, and Treasury securities and other dollar-denominated assets remain in strong demand around the world.

Your last question focuses on when the Federal Reserve will begin to wind down many of the actions taken over the last twelve months. As noted above, some of our policy actions have already expired. With one exception, all the emergency lending programs established under section 13(3) of the FRA are now closed for new lending. The one exception is the PPPLF, which was extended until the middle of this year to help continue to support new lending to small businesses under the PPP program. Similarly, many of the regulatory actions taken a year ago have expired. As noted above, the process and timeline for normalization of the stance of monetary policy will be guided by our statutory mandate and in keeping with our outcome-based guidance.

Thank you for your interest in these important issues. I want to assure you that everything we do is aimed at achieving the goals that Congress has directed us to pursue to benefit all Americans.

Sincerely,

Jerome H. Powell

---

[4] https://www.federalreserve.gov/newsevents/pressreleases/monetary20190130c.htm.