ECONOMIC ADVISORY PANEL MEETING

Federal Reserve Bank of New York
33 Liberty Street, New York, New York

Friday, November 16th, 2012

AGENDA

10:00 a.m. Coffee, Benjamin Strong Room, 10th floor

10:30 a.m. Fiscal Policy Discussion
- Presentations by Austan Goolsbee and Glenn Hubbard
- Discussion based on their presentations, led off by Greg Mankiw and Alan Blinder.

11:45 a.m. Monetary Policy Discussion
- Discussion based on attached "Discussion Questions on Monetary Policy, Forward Guidance, and Risks."

12:30 p.m. Luncheon, 10th floor

Part I: Issues related to the "Fiscal Cliff" and medium-term fiscal policy

As the December 31st deadline for the expiration of various tax and spending programs and the implementation of the spending sequester, as outlined in the Budget Control Act of 2011, draws near, several important issues come into focus. Will the Congress and the President enact policies to avoid the automatic tax increases and spending cuts assumed in the full fiscal cliff? What policies should they adopt? What are some of the consequences for the medium term fiscal and economic outlook in the U.S.? To discuss these issues, Glenn Hubbard and Austan Goolsbee will make short presentations on these issues. Alan Blinder and Greg Mankiw will lead off the subsequent discussion.

As background, we provide a few charts on the size of the programs involved in the fiscal cliff, estimates of spending and tax multipliers, and on the stance of fiscal policy.

Overview of Impact of Fiscal Cliff

- "Full fiscal cliff": wide range of changes in fiscal policy prescribed by current law.
- "Baseline" provisions: narrower set of provisions widely assumed in forecasts for 2013. ("*NABE Outlook*", National Association for Business Economics, Oct. 2012)
- Corresponding fiscal contraction (Table 1):
  - Baseline provisions: 1.9% of projected GDP .
  - Full fiscal cliff: 4.7% of projected GDP.
- Alternative estimates of the resulting drag on GDP for 2013 (Table 2).
  - Two alternative sets of multipliers.
    - Conventional: based on FRB-US with no monetary accommodation.
    - Alternative: derived from a class of widely used DSGE models, assuming the FFR at the zero lower bound (ZLB) in 2013 and 2014. *("Effects of Fiscal Stimulus in Structural Models," Coenen et al., AEJ: Macroeconomics 2012 4(1): 22-68.)*
  - Estimated fiscal drag (percent of GDP)
    - Baseline provisions: -0.7% under conventional multipliers; -1.2% under DSGE multipliers.
    - Full fiscal cliff: -1.7% under conventional multipliers; -2.95% under DSGE multipliers.
- According to the Congressional Budget Office, the full fiscal cliff would represent the largest fiscal contraction of the entire period since 1962. (see Chart)

Table 1: Tax and Spending Provisions of the "Fiscal Cliff"

	Impact on Calendar 2013 Deficit	
Baseline Provisions	**Billions of Dollars**	**% of GDP**
Payroll Tax Cut	-127	0.8
Affordable Care Act Taxes	-24	0.1
Emergency Unemployment Benefits	-35	0.2
Partial Expensing	-87	0.5
Discretionary Spending		
Budget Control Act caps	-29	0.2
Overseas defense drawdown	-15	0.1
Subtotal	**-317**	**1.9**
Additional Provisions of Full Fiscal Cliff		
2001-2003 tax cuts and AMT	-295	1.8
Medicare "Doc fix"	-15	0.1
Regular Tax extenders (ie, R&D credit)	-47	0.3
Full Sequester (additional amount)	-87	0.5
Subtotal	**-444**	**2.7**
Total	**-761**	**4.7**

Source: Congressional Budget Office. Provisions incorporated in consensus baseline from National Association for Business Economics, October 2012.

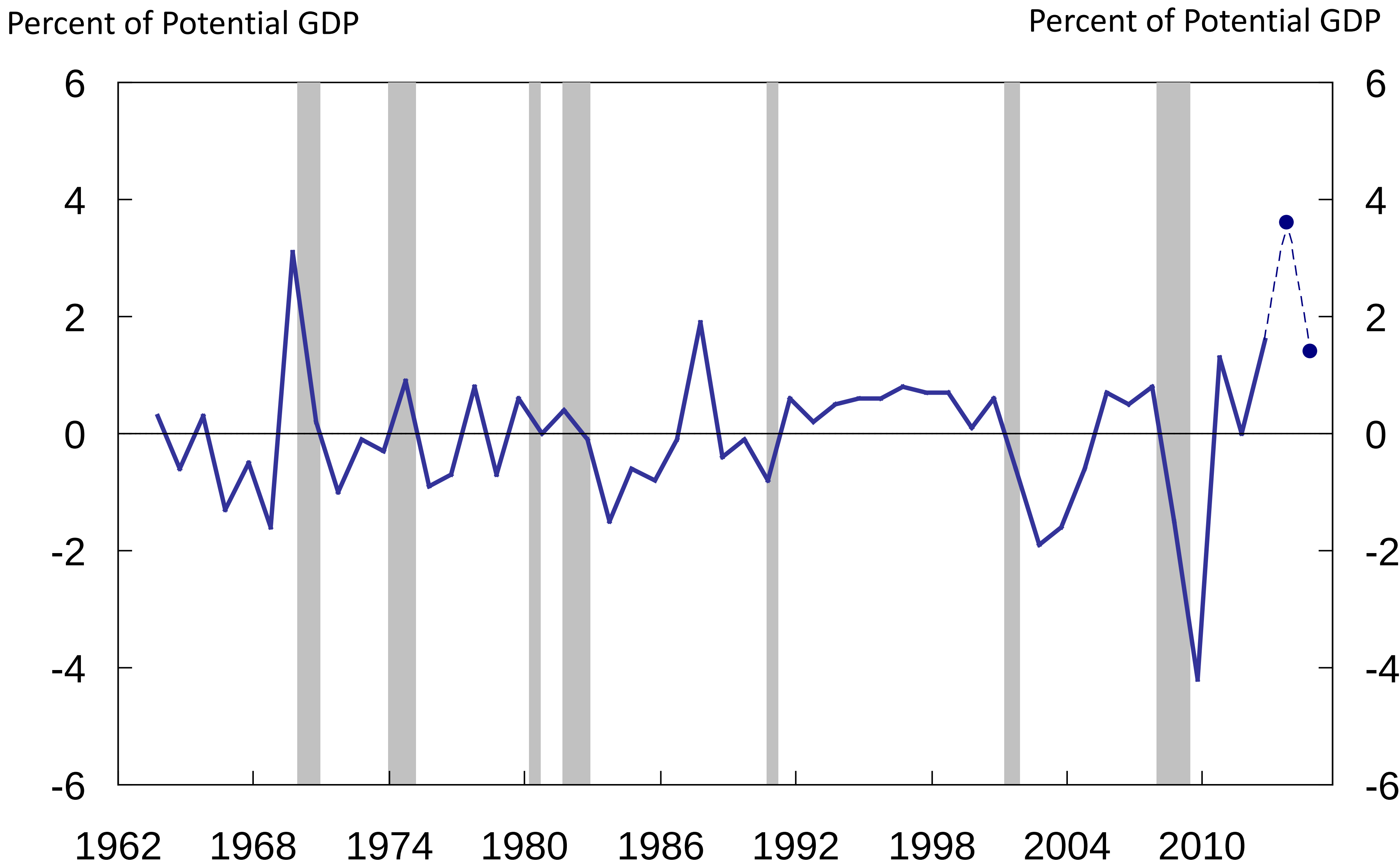
Table 2: Fiscal Drag in 2013 with Alternative Multipliers

	Provisions (% of GDP)	Multipliers: Conventional	Multipliers: DSGE 2y@ ZLB	Fiscal Drag: % of GDP: Conventional	Fiscal Drag: % of GDP: DSGE 2y@ ZLB
Baseline Provisions					
Labor Income Taxes	0.8	0.25	0.35	-0.23	-0.32
Targeted Transfers	0.3	0.80	1.25	-0.17	-0.27
Corporate Taxes	0.5	0.10	0.25	-0.05	-0.13
Government Consumption	0.3	0.90	1.75	-0.29	-0.48
Subtotal	**1.9**			**-0.70**	**-1.2**
Additional Provisions of Full Fiscal Cliff					
Labor Income Taxes	1.8	0.25	0.35	-0.45	-0.63
Targeted Transfers	0.1	0.80	1.25	-0.07	-0.11
Corporate Taxes	0.3	0.10	0.25	-0.03	-0.07
Government Consumption	0.5	0.90	1.75	-0.48	-0.93
Subtotal	**2.7**			**-1.03**	**-1.75**
Combined Total	**4.7**			**-1.73**	**-2.95**

Note: Multipliers and corresponding fiscal drag estimates are year end medians.

Stance of Fiscal Policy

Change in Full Employment Budget Balance as a Percent of Potential GDP



Source: Congressional Budget Office

Part II: Monetary Policy Discussion

At the September meeting, the FOMC decided to undertake additional accommodation through a new open-ended asset purchase program, extension of the forward guidance on the federal funds rate target, and significant changes in its communications; the FOMC reaffirmed these actions at the October meeting. Overall, the September and October statements are more explicit on the state-conditional nature of the policy accommodation.

Notable elements of the September and October FOMC statement:

- The planned new asset purchases consist of agency MBS at a pace of $40 billion per month. In addition, the FOMC continued the MEP (about $45 billion per month of purchases of long-term Treasuries and sales of short-term Treasuries) and its reinvestment policy of agency debt and MBS. The FOMC announced its actions as an open-ended program, explicitly linked to achievement of objectives:

  > "If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases, and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability."

- The FOMC also extended its guidance on the federal funds rate target to mid-2015. That guidance was stated more in terms of the FOMC's objectives rather than reflecting a weak economic outlook:

  > "To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Committee also decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015."

Discussion Items

➢ Outstanding Issues With This Policy Stance

▪ Asset purchases: benefits and costs

Research suggests that long-term asset purchases can be effective, but their efficacy may be limited if lower rates on the purchased securities are not effectively transmitted to borrowers through lower rates and more access to credit. The transmission mechanism may be limited in the current environment of low long-term interest rates and restrictions in credit supply to customers with less-than-perfect credit records.

- Do you think that MBS purchases can provide a significant boost to the housing market and the economy more broadly?
- What are the options to improve the transmission of lower rates on the secondary market MBS into the primary mortgage rates?
- What are the potential problems of an open-ended program?

➢ The Road to Greater Transparency

▪ Enhancement of the forward guidance

As we noted above, the statement says that the Committee anticipates it will maintain a highly accommodative stance even after the recovery strengthens. At the same time, it maintains a calendar time reference for the future path of the policy rate.

- Would using explicit thresholds for the unemployment rate and inflation, as suggested on several occasions by Chicago Fed President Evans, facilitate communication of the expected policy path and make accommodation more effective?

  > "I think the Fed should make it clear that the federal funds rate will not be increased until the unemployment rate falls below 7 percent. Knowing that rates would stay low until significant progress is made in reducing unemployment would reassure markets and the public that the Fed would not prematurely reduce its accommodation." [President Evans' August 27, 2012 speech]

The statement also has language that links future balance sheet actions to the achievement of objectives.

- Should the FOMC provide other benchmarks to gauge "substantial improvement" in the labor market, such as the monthly increase in payroll employment, the employment to population ratio, or flow measures such as the job finding rate?