Discussion at NY Fed

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November 2013
Three Questions

1. When to exit?
2. How to exit?
3. What problems might you encounter while exiting?
What is the natural rate of unemployment?

• Recent Fed paper by Reifschneider, Wascher, and Wilcox say the 95 percent confidence interval is about 4.5 to 7 percent.

• And they point out that even that is too small.

• Consistent with older work of Stock & Watson.
Median Duration of Unemployment (UEMPMED)

Shaded areas indicate US recessions.
2013 research.stlouisfed.org
Short-term unemployment rate: Unemployed less than 5 weeks as percent of adjusted labor force (employed + short-term unemployed)
Phillips relationships which are defined in terms of unsatisfied demand variables appear to be somewhat more stable than those using unemployment rates.

-- Katherine Abraham and James Medoff, 1981
How has the Phillips curve changed?

- Smaller coefficient on slack?
- Inflation expectations are more anchored?
- Remember the Great Moderation!
Making a Graceful Exit

• Reverse open market operations?
• Increasing interest on reserves
   “The principal tool that we contemplate is the interest rate paid on excess reserves.”
   - Ben Bernanke, April 2013
• Will this work?
What is the right sequence?

• Reverse course?
• Or not?

“The Fed can start by raising short-term interest rates, currently near zero, while leaving QE3 on hold.”

- Ronald McKinnon, WSJ, 10/27/2013
Problems you might encounter

• Raising interest rates is never popular.

• “So, Ms. Yellen, are you telling me that the Federal Reserve is using taxpayer money to pay banks *not* to make loans to the American people.”