We likely live in a new era of low interest rates

Core CPI
(12-mo % change)

Laubach-Williams R* estimates

One-Sided Estimate R*
Some consequences for monetary policy
1. The FOMC will no longer be able to cut the funds rate by 250-600 bps to fight recessions.
2. With the funds rate near zero more often, the FOMC will have to get more creative—and maybe boastful.

- No central bank likes to admit being powerless.
- But might this endanger the Fed’s credibility?
- A possible “solution”: Peg a different rate.
3. Do super-low interest rates foment asset-price bubbles?

- Seems so, e.g., reaching for yield.
- But what if very low rates get to seem (and are) “normal?”
- Let’s not forget that low discount rates raise fundamental values.
4. Distributional effects of monetary policy may become more salient.

The very low interest rates to fight recessions will:

- Raise asset values—benefitting the rich
- Impoverish people (e.g., retirees) living on interest income—the not-very rich
- Make it very difficult to save for retirement
5. Will a flatter yield curve (greatly) damage bank profitability, as widely assumed?

\[ \rho = 0.17 \ (1984-2016) \]
6. A research question: Is there a major slope discontinuity at $i=0$?

- We used to think there was a ZLB. That's been proven wrong.
- But does pushing the funds rate from, say, 1% to -1% pack (much) less punch than moving it from, say, 3% to 1%?