MONETARY POLICY ADVISORY PANEL

Luncheon Meeting, September 9, 2016

AGENDA

Monetary Policy in a Low Interest Rate Environment

Background

When this Panel last met in March, we discussed the post-liftoff landscape, and tried to put in perspective how the tightening in financial conditions at the beginning of 2016, global economic developments, and heightened uncertainty around the outlook had flattened the paths of market-implied expectations and of SEP projections for the policy rate from those in December.

At this juncture, even though real GDP growth was sluggish in the first half of the year, the U.S. economy appears to be on firmer ground and a number of FOMC participants have stated publicly that recent developments have strengthened the case for an increase in the policy rate. In parallel, the declines in estimates of potential growth and real equilibrium rates raise the issue of how constrained monetary policy has become to respond appropriately to adverse shocks.

Against this backdrop, as stated in the July FOMC meeting minutes, the Federal Reserve is engaged in “an ongoing long-term effort begun in July 2015 to evaluate potential long-run frameworks for monetary policy implementation.” [Emphasis added.] Chair Yellen dedicated her remarks at Jackson Hole to a discussion of the post-crisis monetary policy toolkit. At the same time, there has been considerable commentary about whether the monetary policy strategy needs to be rethought in light of fundamental changes in the economic environment.

At this meeting we would like to hear your view on the following interrelated topics:

- Implications of the low interest rate environment
- The effectiveness of the Fed’s current toolkit
- Possible adjustments to the FOMC’s policy strategy
- Monetary and fiscal policy interaction
Questions for Discussion

On the low interest rate environment

- What are your views on the implications of longer-term shifts in the global economy, including the widespread fall in equilibrium real rates, for U.S. monetary policy?
- How should U.S. monetary policy address the possibility of transmission of “secular stagnation” across economies?

On the effectiveness of the policy framework

- Is the Fed’s toolkit discussed in Chair Yellen’s Jackson Hole speech sufficient in your view to provide appropriate countercyclical support in an environment with a greater likelihood of zero lower bound episodes?
- Given the changes in the economic and financial environment over the past several years, what do you see as an appropriate configuration of the balance sheet in the long-run operating framework?

On possible adjustments to the monetary policy strategy

- Do you believe that any of the following would be a more effective way to reformulate the objectives from the dual mandate: expressing the Federal Reserve’s longer-run inflation objective in a way that more explicitly allows short-term overshoots, targeting a price level trajectory, or targeting a nominal GDP path?
- Would a more explicit explanation of how policymakers would respond to alternative outlook scenarios help to clarify the FOMC policy reaction function?

On fiscal and monetary policy interaction

- The fiscal theory of the price level implies that, given the constraints of the consolidated government balance sheet, fiscal and monetary policies are interdependent. In your view, how important in the current environment is coordination between monetary and fiscal policy to achieve the FOMC’s longer-term objectives?
- Are there specific fiscal actions that would support the increase of inflation to the FOMC objective and also be consistent with the medium- and longer-term objectives for fiscal policy?
Figure 1 – FFR Target Reduction in Recession and Current Projected Paths

Reduction in Federal Funds Rate During Recessions

Federal Fund Rate Projections: June 2016 SEP

Market-Implied Path of FFR vs. SEP Dots

DSGE Model FFR and ‘Natural’ FFR Paths

Source: FRED, Reifsneider (2016)

Source: FRBNY and Federal Reserve Board
Figure 2 – An assessment of FOMC’s ability to respond to future shocks

Figure 3 – Inflation Indicators

PCE Deflator
12 Month % Change

Signal Component (SiCo) model for core PCE

CPI Inflation: Core Goods and Core Services
12 Month % Change

CPI Inflation: 12-Month Change and UIG Measures

Source: Bureau of Economic Analysis, via Haver Analytics
Note: Shading shows NBER recessions.

Source: FRBNY
Note: The gray area represents 90% bands for SiCo.

Source: Bureau of Labor Statistics, via Haver Analytics
Note: Shading shows NBER recessions.
Figure 4 – Inflation Expectations

FRBNY SCE: 3-Year-Ahead Inflation Expectations

- Source: Survey of Consumer Expectations, FRBNY
- Note: Shading shows NBER recessions.

Michigan Survey: Inflation Expectations 5 to 10 Years

- Source: University of Michigan
- Note: Shading shows NBER recessions.

5-10 Year Inflation Compensation Decomposition

- Source: NY Fed Calculations, Federal Reserve Board.
- Note: 5-day moving average, zero-coupon yield.