

Minutes of the MONETARY POLICY ADVISORY PANEL¹

Meeting of September 9, 2016

Present: William Dudley, Michael Strine. **Panelists:** Mark Gertler, Takatoshi Ito, Thomas Philippon, Christopher Sims, Michael Woodford. **FRBNY Staff:** Tobias Adrian, Sarah Bell, Bianca De Paoli, Fernando Duarte, Andreas Fuster, Marc Giannoni, Linda Goldberg, Beverly Hirtle, Jonathan McCarthy, Richard Peach, Paolo Pesenti, Robert Rich, Argia Sbordone, Andrea Tambalotti, Joseph Tracy.

The meeting began with a discussion of the current monetary policy toolkit, after which the panelists offered their views on possible communication strategies to support the policy stance. Panelists addressed in particular the issue of monetary and fiscal policy coordination.

The monetary policy strategy and toolkit

The panelists discussed the advantages of reformulating the price stability objective in the form of a target path for the price level. Panelists were not generally in favor of a formal regime change or of a higher inflation target at this time, and indicated that signaling that ‘bygones are not bygones’ and focusing on the average inflation rate over the medium term may suffice in the current environment. They generally agreed on the importance of continuing to stress in communications that the 2 percent longer-run goal is symmetric, so that both temporary overshooting and undershooting of the objective could occur.

The panelists also discussed the use of forward guidance and active management of the balance sheet as policy tools to respond to potential negative shocks. Some panelists expressed skepticism about the policy relevance of simulation exercises discussed at the [Jackson Hole symposium](#), as the results appear to be model-specific. They also were doubtful about the efficacy of balance sheet actions away from the effective lower bound on interest rates, citing some studies that indicate limited macroeconomic effects in those circumstances.

Also in light of the Jackson Hole debate, there was some discussion on the optimal size of the Fed’s balance sheet. Panelists generally agreed that in the long run the balance sheet should be somewhat smaller than it is currently, but believed that an appropriate approach would be to let the balance sheet shrink passively by ending principal reinvestment.

¹ The views presented in these minutes are solely those expressed by the panelists, not by FRBNY officials or staff.

The low rate environment

Panelists discussed the low estimates of r^* , questioning whether the monetary policy stance is as accommodative as one may infer from the low level of the policy rate. They agreed that it would be useful to refer to the level of r^* in policy communication; however, they acknowledged the difficulty in communicating information about an unobservable variable whose estimates are model-dependent.

Panelists also stated that the SEP forecasts for GDP growth and inflation generally have been too optimistic, noting in particular that GDP growth for the first half of 2016 was significantly below most projections, while inflation, after a mild pickup at the beginning of the year, remains stubbornly below mandate-consistent levels. Some panelists argued that it may be appropriate to maintain an accommodative stance at least until incoming information provides strong validation of the forecasts.

Other panelists pointed out that the FOMC has recently appeared to be finding excuses not to raise the interest rate, signaling imminent tightening only to retreat at the sign of disappointing news and potentially adverse events, such as exchange rate developments in China and Brexit. They expressed concerns about how much this behavior might have eroded FOMC credibility.

On monetary and fiscal policy coordination

There was extensive discussion of the limits of monetary policy in raising inflation to the mandate-consistent level if fiscal policy is not sufficiently expansionary. Overall, panelists suggested that FOMC members should consider and communicate the need to harmonize monetary and fiscal policy strategies. The issue was raised of whether this would constrain central bank independence. It was noted that the conventional argument for separating monetary and fiscal decisions was the risk of inflationary financing of fiscal imbalances. However, panelists noted that under current circumstances the reverse is true, as inflation is persistently running too low and the monetary authorities may appear to have insufficient ammunition to deal with potential cyclical downturns. Such coordination would need to take into account the interconnection of fiscal and monetary policy resulting from the consolidated government budget constraint.