EAP Meeting - May 11, 2012

Discussion Questions

We would like to solicit your views on a number of issues concerning the US economic outlook, monetary policy and its communication, and US fiscal policy.

Part I: The Economic Outlook

1. *Inflation:* Since the last EAP meeting in October 2011, overall inflation as measured by the 12-month change in the PCE deflator has moderated. Still, core inflation has risen somewhat since October, contrary to the predictions of many forecasts at that time, and recent rises in oil and gasoline prices have helped to push up shorter-term measures of overall inflation. Consensus forecasts (including the SEP) expect PCE inflation to be at or just below 2% over the next couple of years.

   Questions:

   - To what factors do you primarily attribute the recent increase in core inflation?
   - Will the apparent large amount of economic slack—at least by typical measures—lead to a significant decline in inflation?
   - What do you see as the upside risks to the inflation outlook?

2. *Real activity:* Many of the indicators of real activity and the labor market have displayed notable improvement since last October. Nevertheless, many forecasters expect real GDP growth to remain near the moderate rate of the last two quarters (2.6% annual rate) and the unemployment rate to decline gradually such that it remains above most estimates of its longer-run normal rate over the medium term.

   Questions:

   - What factors are contributing to this expected moderate pace of expansion?
   - Do you see factors in the current situation that would indicate that a faster and more sustainable expansion is possible?
   - How important are the state of household and business balance sheets for your view of the real economic outlook?
   - The unemployment rate has declined more quickly since last October than would be implied by Okun's Law. Do you expect this recent pattern to continue or do you see unemployment and GDP growth moving more in line with Okun's Law?

3. *External risks:* After subsiding somewhat following official policy actions (including the 3-year LTROs), financial market strains associated with the European sovereign debt crisis have exacerbated recently as governments face issues of fiscal consolidation in a weak economic environment.

   Questions:

   - Do you expect significant changes in fiscal consolidation plans, particularly in Spain and Italy, because of continued economic weakness in those countries?
   - What risks do you see of a costly resolution to the crisis?
   - How much of a risk does an intensification of the crisis pose to the US economy?

Part II: Monetary Policy and Communication

1. *Longer-run goals and policy strategy statement:* In January, the FOMC released a statement on longer-run goals and policy strategy: it provided a longer-run objective for inflation, information about its assessment of the longer-run normal rate of unemployment consistent with its statutory mandate, and the principles that will guide policy in attaining these goals.

   Questions:

   - To what extent does the statement of longer-run goals improve the effectiveness of monetary policy?
   - Does communication about the "policy strategy" provide useful information on the FOMC reaction function?

2. *Introduction of policy rate projections:* Since January, the Summary of Economic Projections (SEP) has included the policy rate projections of FOMC participants, based on their views of appropriate policy and economic forecasts.

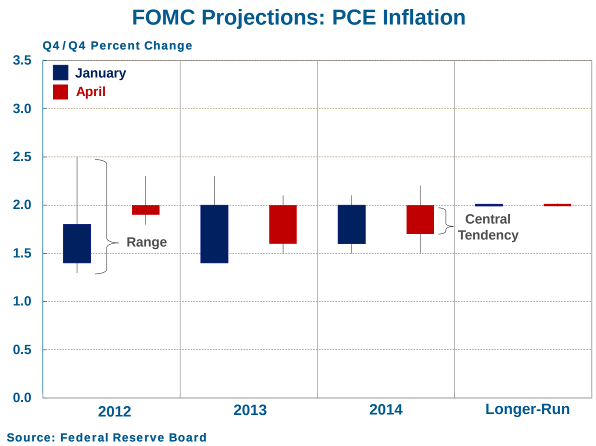
   Questions:

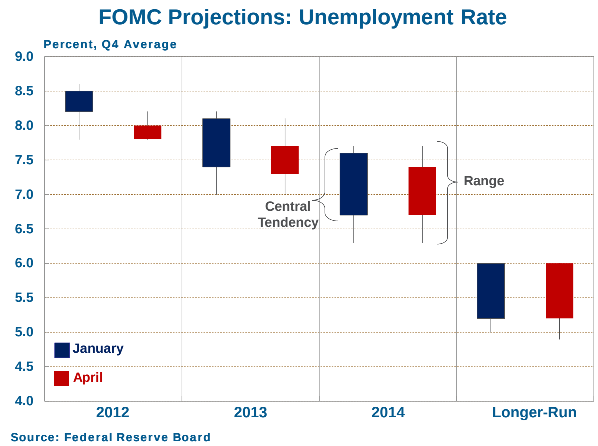
   - Could potential conflicts between participants' policy rate projections and FOMC policy guidance affect policy effectiveness?
   - How could such potential conflicts be resolved?

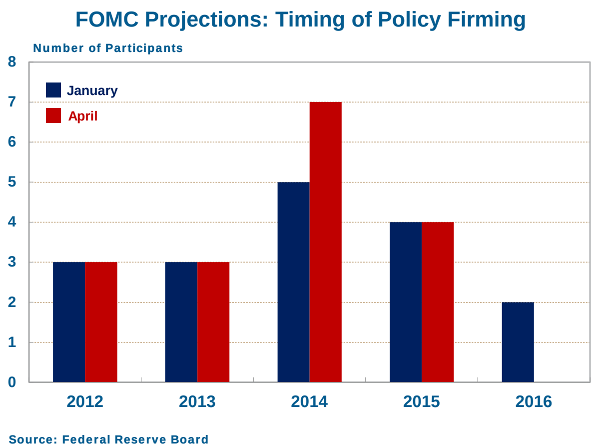
3. *Policy rate and outlook projections:* The figures below show the changes to the economic and policy projections between the January and April SEPs. Medium-term economic projections have changed relatively little, while policy rate projections are modestly less accommodative as some participants moved forward their anticipated liftoff date and raised their projected policy rate for the end of 2014.

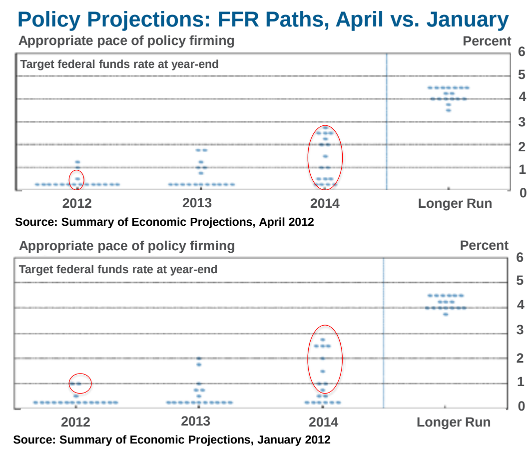
   Questions:

   - How would you interpret these changes in the economic and policy projections in terms of the FOMC participants' policy reaction functions?
   - Have developments over the first months of this year affected your own view of the appropriate stance of monetary policy?









4. *Forward guidance:* In the January statement, the FOMC extended to "at least through late 2014" the period for which it expected the federal funds rate to remain "exceptionally low." This guidance was repeated in March and April.

Questions:

- How should the forward guidance be adjusted going forward?
- Should a date continue to be part of the forward guidance?

Part III: Fiscal Policy

1. *Medium-term policy:* With extended unemployment benefits and the payroll tax cut scheduled to expire at the end of the year, federal fiscal policy is expected to become a significant drag on growth in 2013. In addition, if sequestration under the Budget Control Act is implemented and the Bush tax cuts are not extended, the drag could be considerable (the fiscal "cliff").

   Questions:

   - How much risk do these possible fiscal developments pose to the economic outlook?
   - Are there options to address these fiscal issues that could reduce the risks to the outlook?
   - What, if any, implications do these fiscal issues have for monetary policy over the next year?

2. *Long-run fiscal sustainability:* Beyond the 2013 issues, the federal government debt-GDP ratio appears likely to rise over the next decade under current policies. Consequently, some actions will be necessary to put the US on a sustainable fiscal path.

   Questions:

   - What options would you recommend to address long-run fiscal sustainability issues?
   - On the revenue side, do you have recommendations on tax reform to make the system more efficient in raising revenue and also improve economic efficiency?