

Minutes of the MONETARY POLICY ADVISORY PANEL¹

Meeting of September 25, 2015

Present: William Dudley. **Panelists:** Takatoshi Ito, Frederick Mishkin, Thomas Philippon, Christopher Sims, Michael Woodford. **FRBNY Staff:** Marco Del Negro, Bianca DePaoli, Fernando Duarte, Stefano Eusepi, Jan Groen, Matthew Lieber, Tom Klitgaard, Jamie McAndrews, Alberto Musalem, Matthew Raskin, Robert Rich, Aysegul Sahin, Argia Sbordone, Angela Sun, Andrea Tambalotti, Luis Uranga.

The roundtable discussion focused on the main issues laid out on the agenda: the September FOMC decision and communication around the meeting, the possible implications of recent market turbulence for the U.S. economy, and potential risks from divergent policies in the euro zone and Japan.

The September FOMC policy decision and the timing of lift-off

The meeting began with a discussion of the panelists' reactions to the September FOMC monetary policy decision. The panelists were generally in agreement with the decision at the September meeting to maintain the current target range for the federal funds rate. They noted that the economy had not yet achieved the FOMC's longer-run objectives, particularly for inflation. In addition, they observed that recent international economic developments and the associated turbulence in financial markets had raised the uncertainty around the U.S. economic outlook.

At the same time, some panelists were critical of FOMC communication around the September meeting. A panelist argued that the FOMC statement and the Chair's press conference prompted greater uncertainty among market participants about the FOMC's overall policy strategy, which was then a factor in the market correction that took place after the FOMC announcement. Another panelist said that the September policy decision might have been interpreted by financial market participants as reflecting (negative) inside information that the Committee might have about the U.S. economy and/or the economic situation in China.

Overall, the panelists suggested the FOMC could have been more articulate in explaining the decision of not raising the policy rate. Some panelists argued that the statement should have expressed more clearly the FOMC's assessment of the downside risks stemming from developments in foreign economies and financial markets. One panelist contended that the FOMC should have stressed its resolve to lift off before the end of 2015 barring unexpected shocks to the economy, much in line with the speech given by Chair Yellen on September 24.

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

Some other panelists suggested that the FOMC should present a forecast for inflation and economic activity, making it easier for the public to understand its “reaction function”. The SEP projections, in these panelists’ view, cannot adequately serve this role. First, the SEP aggregates individual forecasts that are conditional on ‘appropriate policy’ assumptions that likely differ across FOMC participants. Second, individual projections of economic activity, inflation and the policy rate are not reported in an integrated manner. In subsequent discussion, some panelists proposed that the FOMC could improve its communication by presenting alternative scenarios for the U.S. economy with the associated likely path of the policy rate. However, panelists broadly agreed that it would be difficult to develop agreement among FOMC participants on a single representative forecast about the U.S. outlook.

The panelists also emphasized that monetary policy decisions should be data-driven and not time-dependent. Some panelists stressed that the FOMC should start normalizing the policy rate only when there are clear signs that inflation has started increasing toward the Committee’s longer-run goal. There was, however, also agreement among the panelists that it is hard to define and communicate a precise set of economic conditions that would appropriately prompt a decision to lift off. Some of the panelists contended that the low level of inflation and the degree of uncertainty about the inflation outlook should encourage the FOMC to ‘test the waters’ and let unemployment undershoot its estimated natural rate until inflation begins to rise. One main concern expressed by these panelists about a premature lift-off was that a consequent return to the effective lower bound could damage FOMC credibility and possibly un-anchor inflation expectations to the downside.

One panelist argued that a small increase in the federal funds rate would not have a large impact on the U.S. economy, provided the FOMC made clear that current economic conditions allow only a very gradual tightening of monetary policy. It was added that if economic activity and inflation were stronger than expected the FOMC could always tighten the policy stance appropriately. Finally, one panelist warned that there is a trade-off between a fully data dependent policy and the desire of the FOMC to be predictable to avoid market volatility.

Sources and potential implications of turbulence in financial markets

The discussion turned to the August financial turbulence, the international economic situation, and the implications of a weaker global outlook for the U.S. economy. Some panelists said that while they expected a fairly benign resolution of the recent apparent economic stresses in China, the risks of a large economic shock were not negligible. Some of the panelists noted that China’s actual growth rate could be substantially slower than indicated by the official data. Panelists generally agreed that there was considerable uncertainty about the current state of the Chinese economy as well as the ability of its government to manage the economy. A troubling scenario was described where a significant contraction of the Chinese economy could contribute to the

end of the long boom in commodity markets. This in turn could exert a sizeable drag on economic activity in emerging markets, some of which have substantial amount of private dollar-denominated debt. In this scenario, a marked reduction in growth and potential defaults in emerging market economies would trigger global financial turbulence and further slowdown in global growth.

Potential divergence of policy paths

Turning to the situation of developed economies, panelists expressed their views that monetary policy likely will remain accommodative for some time in Europe and Japan, in view of the very low level of inflation in both areas. In general, panelists judged that the prospective divergence of policy paths across the advanced economies would not significantly affect their U.S. economic outlook.

During this discussion, some panelists pointed out that the European economy remains fairly weak and that the current immigration situation has further increased political uncertainty in the area, although it is unlikely to be a negative factor for growth.