

MONETARY POLICY PANEL

Luncheon Meeting, September 21, 2012

AGENDA

Monetary Policy after the September FOMC Decision:

Outstanding Issues and the Road to Greater Transparency

At the September meeting, the FOMC decided to undertake additional accommodation through a new asset purchase program, extension of the forward guidance on the federal funds rate target, and significant changes in its communications. Overall, the September statement is more explicit on the state-conditional nature of the policy accommodation.

Notable elements of the September [FOMC statement](#):

- The planned new asset purchases consist of agency MBS at a pace of \$40 billion per month. In addition, the FOMC continued the MEP (about \$45 billion per month of purchases of long-term Treasuries and sales of short-term Treasuries) and its reinvestment policy of agency debt and MBS. More importantly, the FOMC announced its actions as an open-ended program, explicitly linked to achievement of objectives:

“If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases, and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability.”

- The FOMC also extended its guidance on the federal funds rate target to mid 2015. Notably, that guidance was stated more in terms of the FOMC’s objectives rather than reflecting a weak economic outlook:

“To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Committee also decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015.”

Discussion Items

➤ Outstanding Issues With This Policy Stance

▪ **Asset purchases: benefits and costs**

Research suggests that long-term asset purchases can be effective, but their efficacy may be limited in the current environment of low long-term interest rates and restrictions in credit supply to customers with less-than-perfect credit records.

- Do you think that MBS purchases can provide a significant boost to the housing market and the economy more broadly?
- What are the potential problems of an open-ended program?
- Would a potentially large Fed balance sheet complicate eventual exit?

▪ **Inflation expectations**

- Is the new program a threat to the stability of longer-term inflation expectations?

▪ **Financial stability**

- What might be the effects of the even longer period of low rates on risk taking in financial markets?

➤ The Road to Greater Transparency

▪ **Enhancement of the forward guidance**

As we noted above, the statement says that the Committee anticipates it will maintain a highly accommodative stance even after the recovery strengthens. At the same time, it maintains a calendar time reference for the future path of the policy rate.

- Would using explicit thresholds for the unemployment rate and inflation, as suggested on several occasions by Chicago Fed President Evans, facilitate communication of the expected policy path and make accommodation more effective?

“I think the Fed should make it clear that the federal funds rate will not be increased until the unemployment rate falls below 7 percent. Knowing that rates would stay low until significant progress is made in reducing unemployment would reassure markets and the public that the Fed would not prematurely reduce its accommodation.” [[President Evans' August 27, 2012 speech](#)]

The statement also has language that links future balance sheet actions to the achievement of objectives.

- Should the FOMC provide other benchmarks to gauge “substantial improvement” in the labor market, such as the monthly increase in payroll employment, the employment to population ratio, or flow measures such as the job finding rate?

- **Development of an FOMC consensus forecast**

Since January, the FOMC has included projections of the policy rate in the Summary of Economic Projections (SEP) published with the minutes. However, participants noted that:

“[T]he SEP does not provide guidance about how diverse views come together in the Committee’s collective judgment about the outlook and appropriate policy as expressed in its post-meeting statement.” ([June 2012 FOMC minutes](#), p.2)

In order to provide information to help clarify the relationship between the FOMC’s outlook and its policy decisions, at the June FOMC meeting:

“[T]he Chairman asked the subcommittee on communication to explore the feasibility and workability of potential approaches to developing an FOMC consensus forecast.” ([June 2012 FOMC minutes](#), p.2)

The subcommittee has since developed an experimental exercise for the development of a consensus forecast, which was discussed at the July/August FOMC meeting:

“Participants discussed various aspects of the exercise, such as the possible monetary policy assumptions on which to condition an FOMC consensus forecast, the measurement of the degree of uncertainty surrounding each of the projected variables in the forecast, and the potential for communications benefits” and “generally expressed support for a second exercise to be undertaken in conjunction with the September FOMC meeting.” ([July/August 2012 FOMC minutes](#), p.10)

In thinking about the desirable attributes of a consensus forecast:

- What information do you think such a forecast should provide to best clarify the policy decision?
- What can we learn from the experiences of other central banks in producing a consensus forecast?
- Would it be desirable to issue a Monetary Policy Report to more fully characterize outlook and risks, as well as explain how the consensus forecast has been formed?