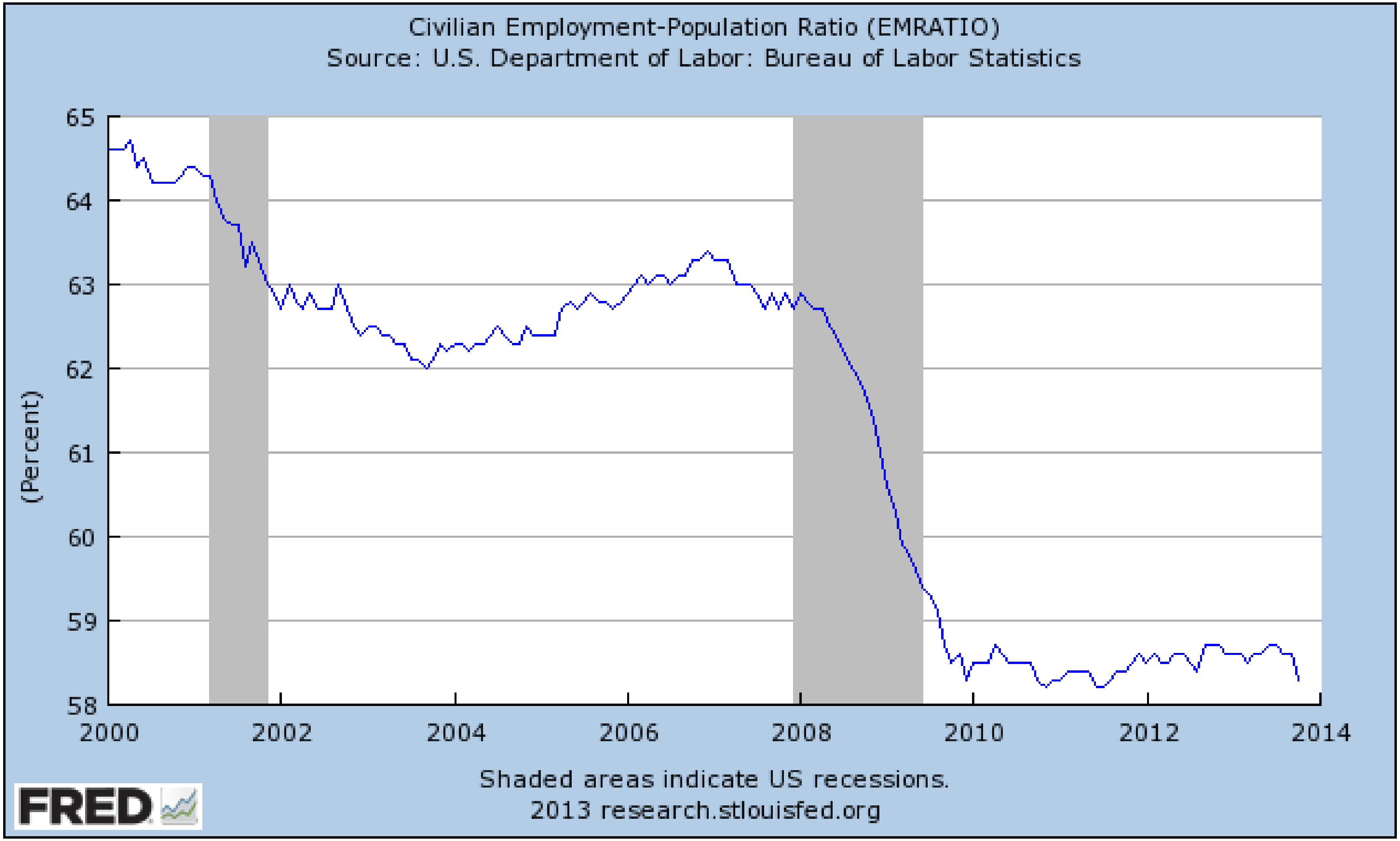
Discussion at NY Fed

Greg Mankiw

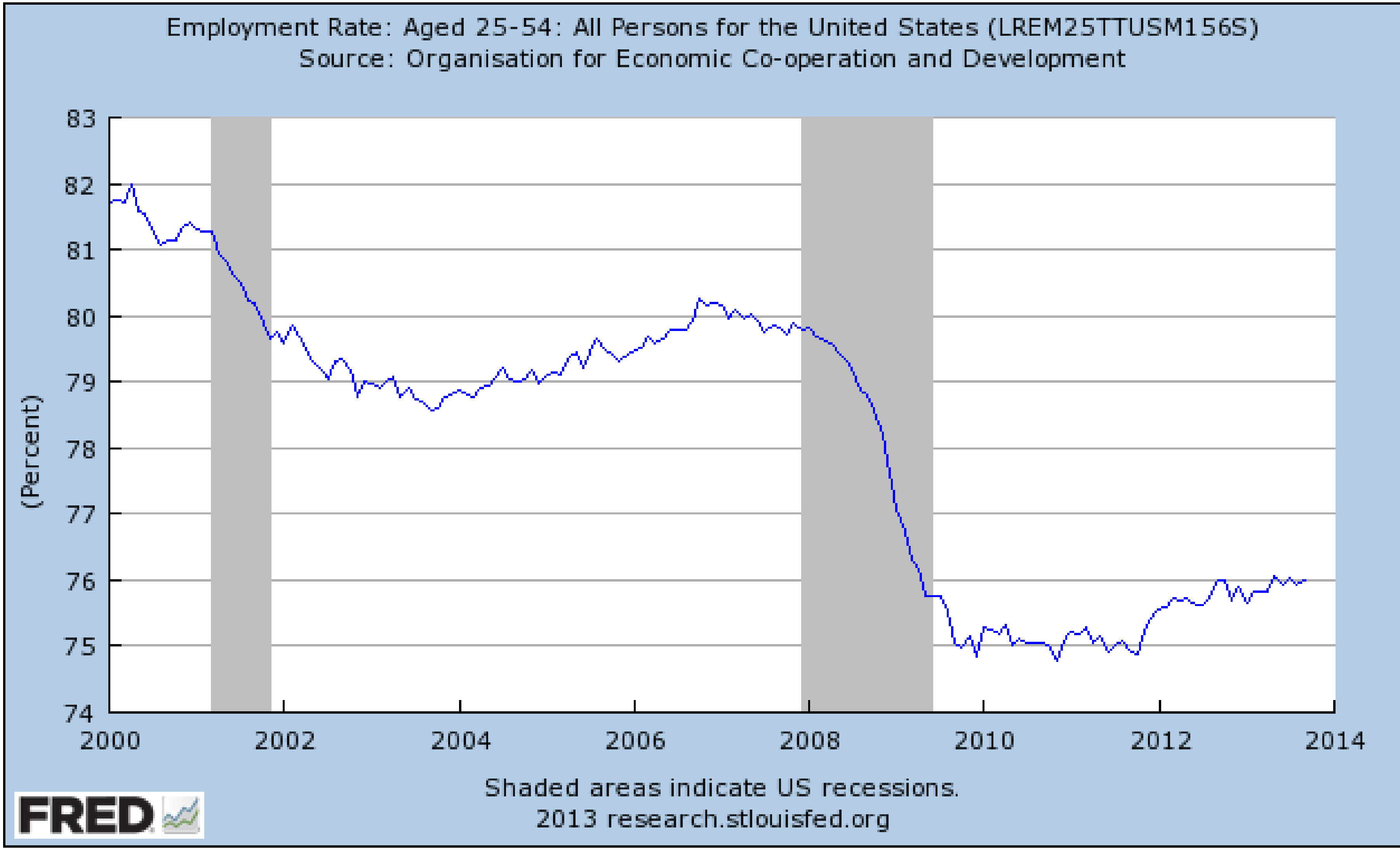
November 2013

Three Questions

1. When to exit?
2. How to exit?
3. What problems might you encounter while exiting?

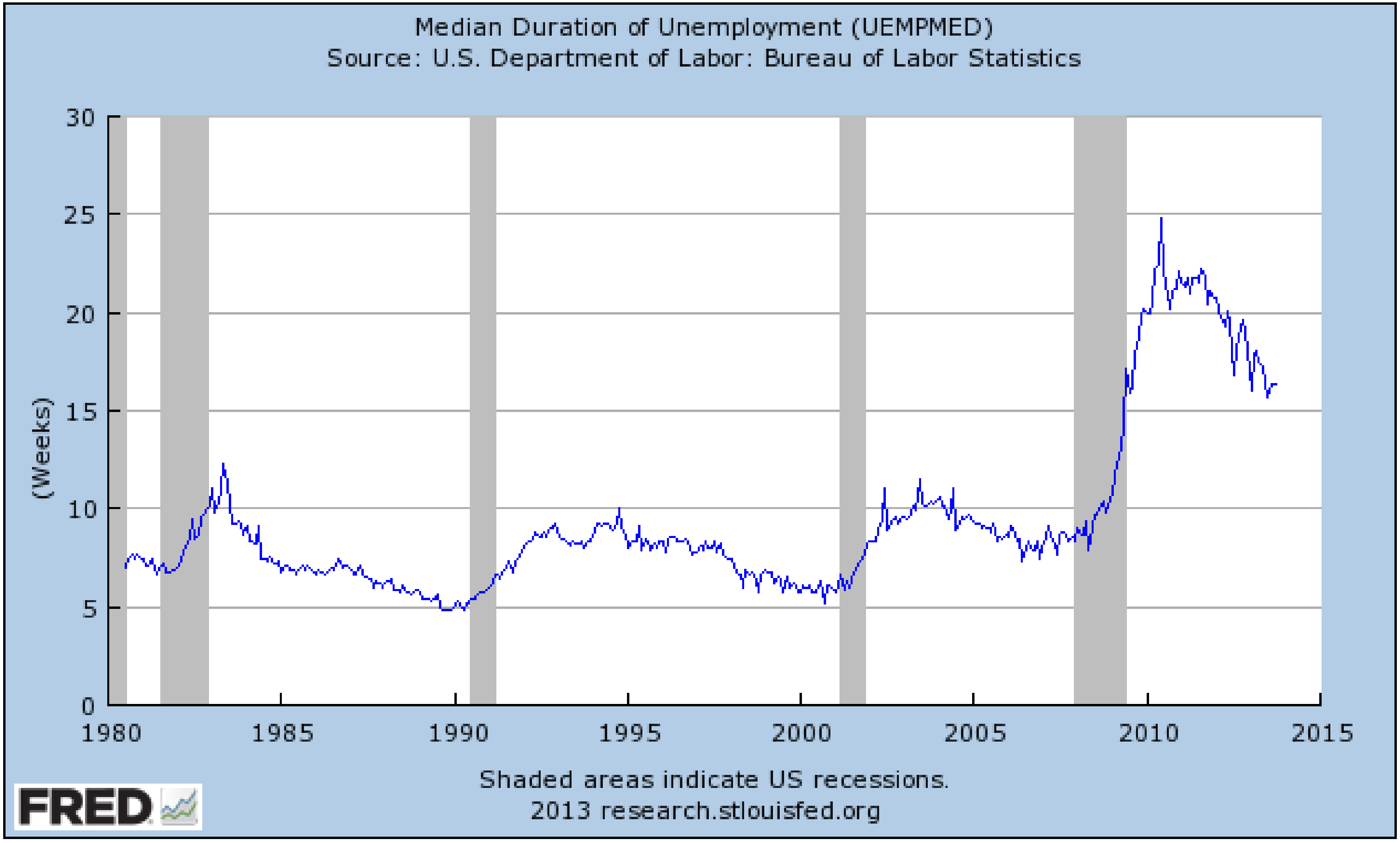


Civilian Employment-Population Ratio (EMRATIO)
Source: U.S. Department of Labor: Bureau of Labor Statistics
65
64
63
62
61
60
59
58
(Percent)
2000
2002
2004
2006
2008
2010
2012
2014
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED

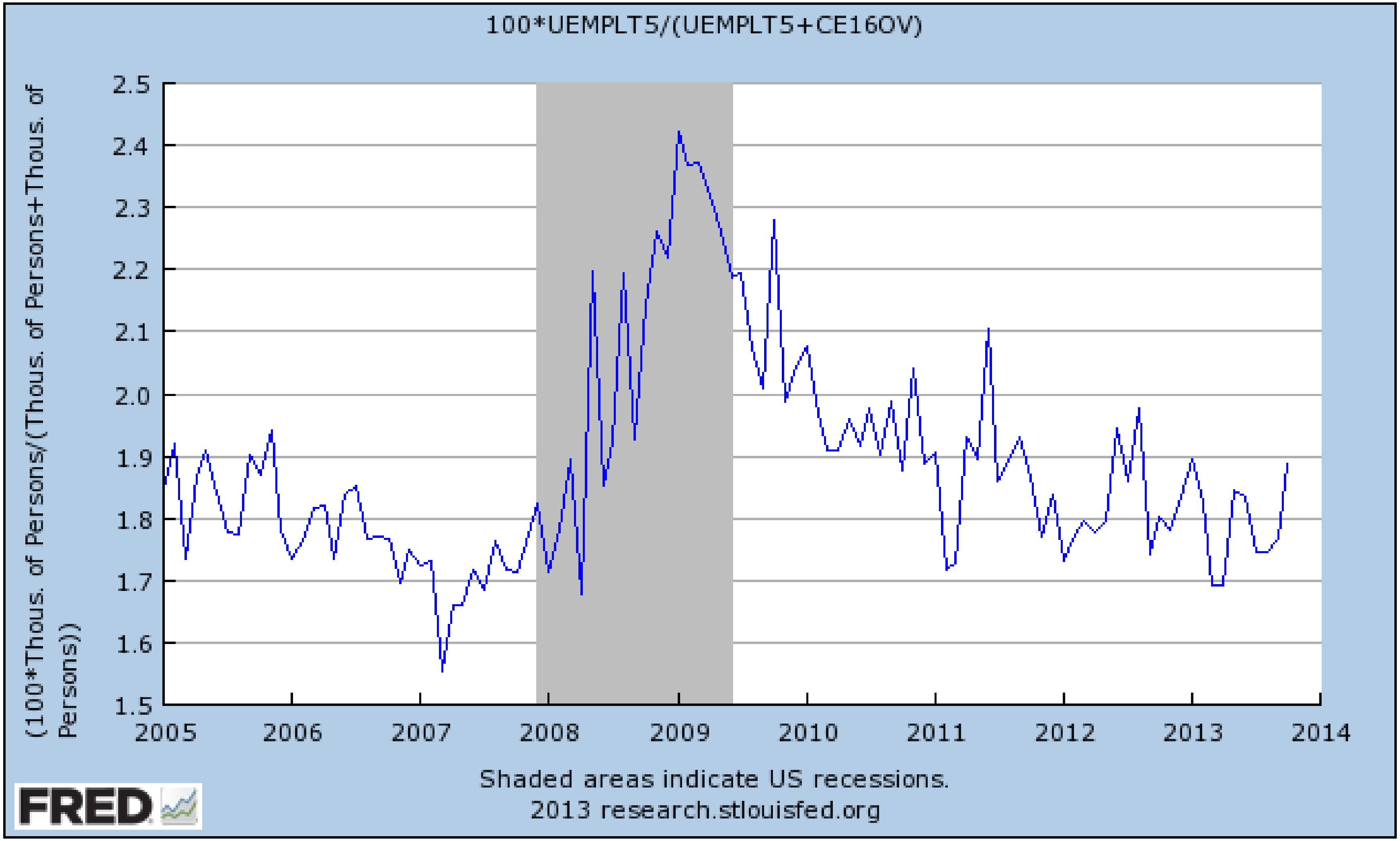

Employment Rate: Aged 25-54: All Persons for the United States (LREM25TTUSM156S)
Source: Organisation for Economic Co-operation and Development
(Percent)
83
82
81
80
79
78
77
76
75
74
2000
2002
2004
2006
2008
2010
2012
2014
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED

What is the natural rate of unemployment?

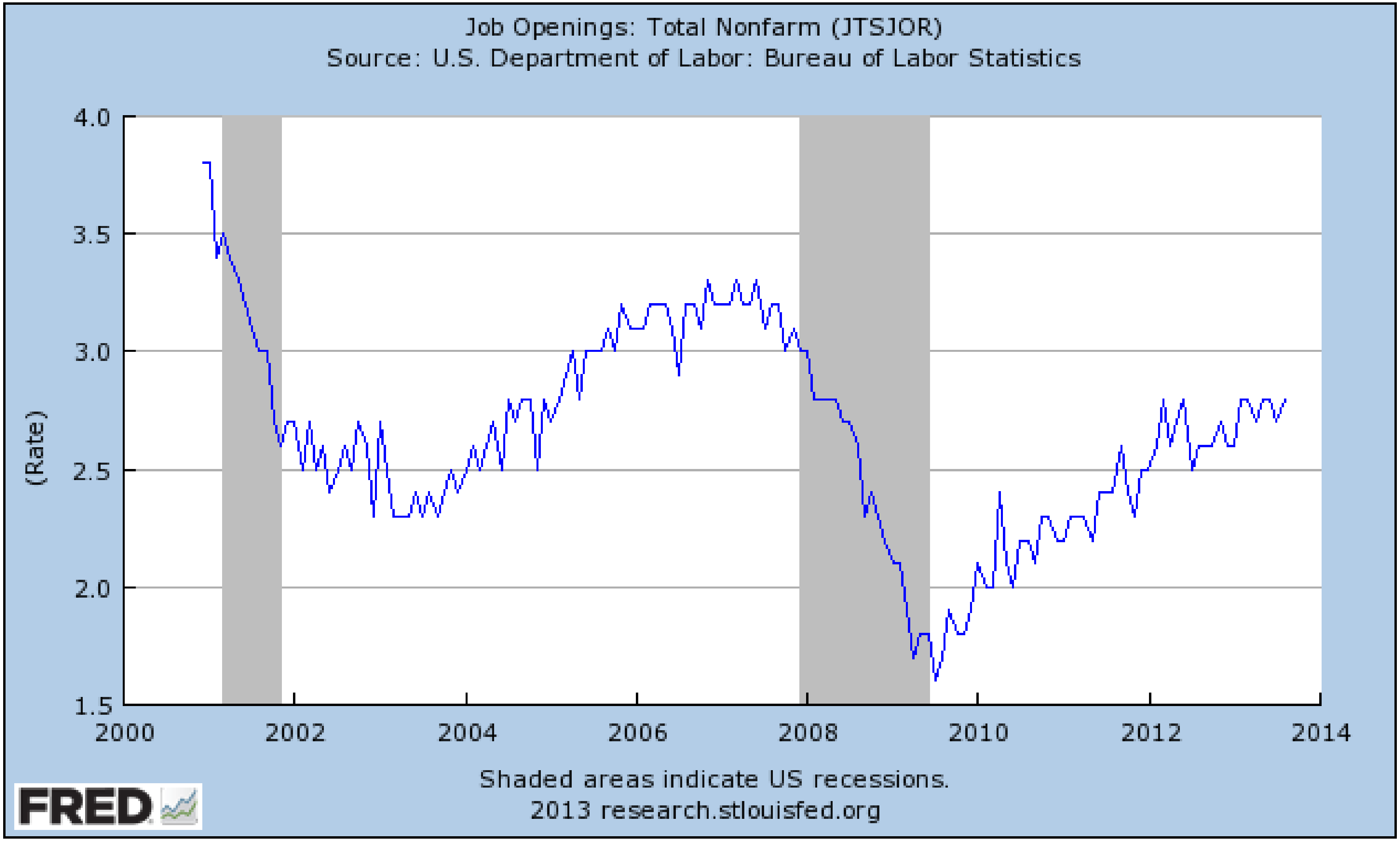
- Recent Fed paper by Reifschneider, Wascher, and Wilcox say the 95 percent confidence interval is about 4.5 to 7 percent.
- And they point out that even that is too small.
- Consistent with older work of Stock & Watson.



Median Duration of Unemployment (UEMPMED)
Source: U.S. Department of Labor: Bureau of Labor Statistics
(Weeks)
30
25
20
15
10
5
0
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED



Short-term unemployment rate: Unemployed less than 5 weeks as percent of adjusted labor force (employed + short-term unemployed)

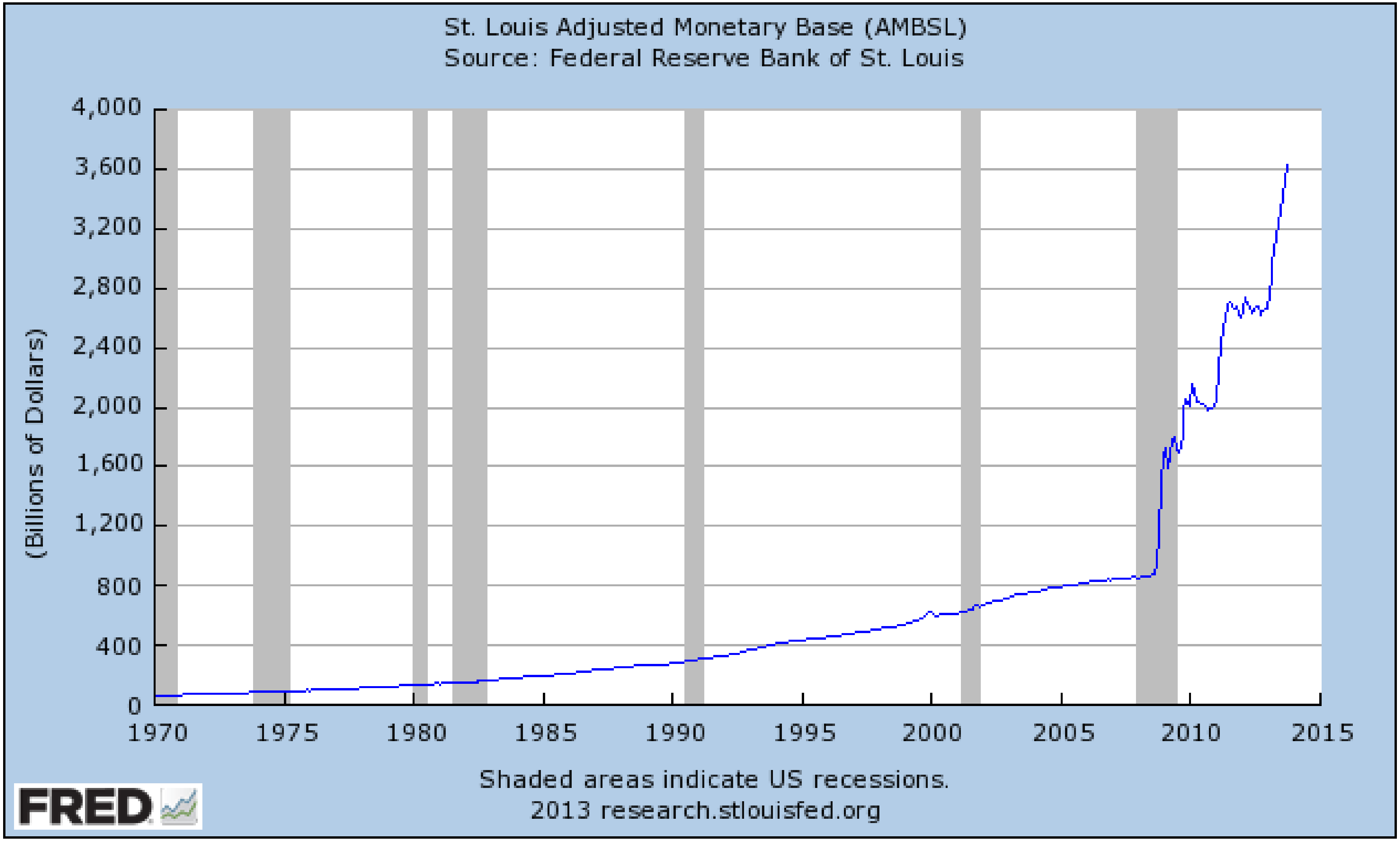


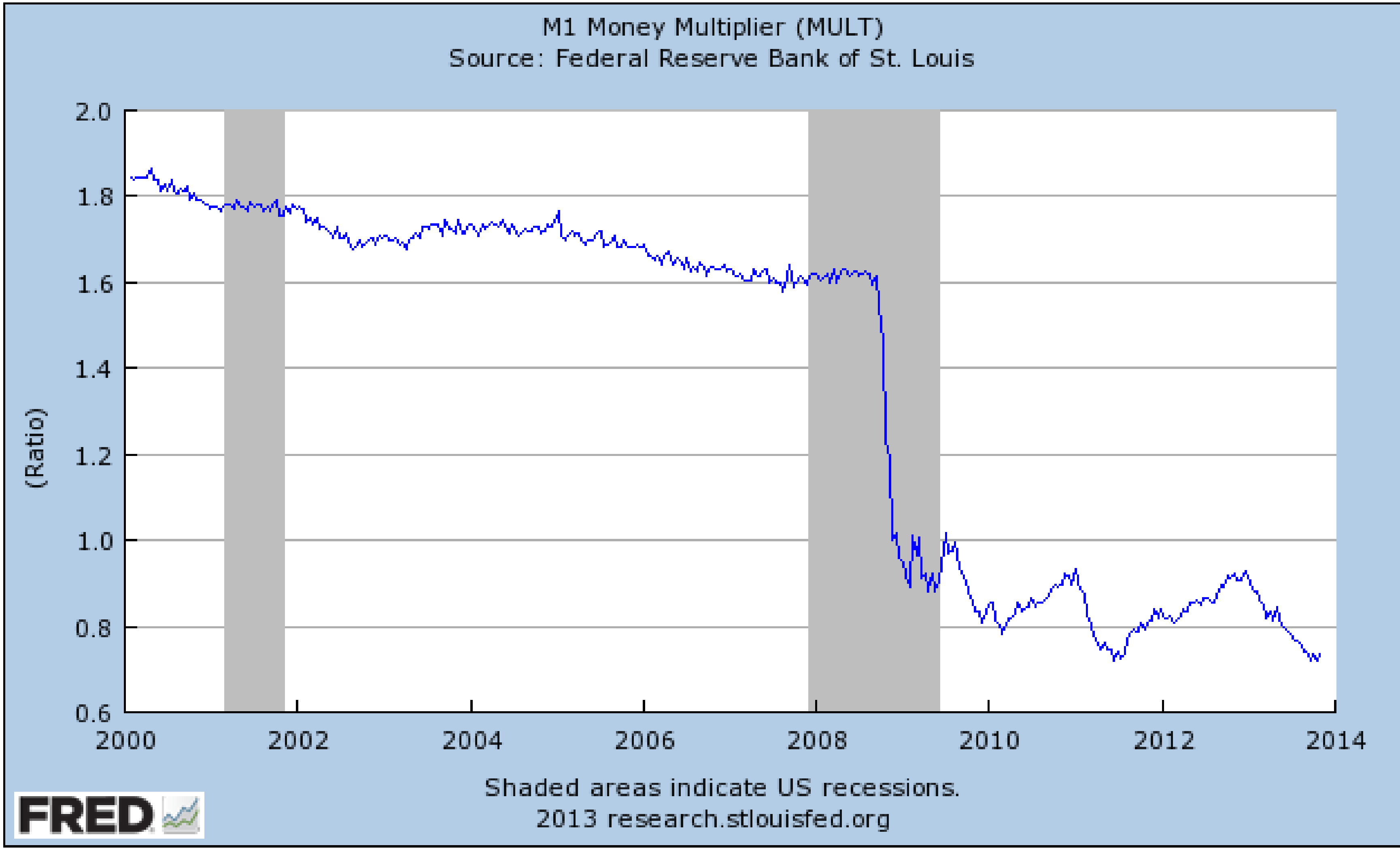
Phillips relationships which are defined in terms of unsatisfied demand variables appear to be somewhat more stable than those using unemployment rates.

-- Katherine Abraham and James Medoff, 1981

How has the Phillips curve changed?

- Smaller coefficient on slack?
- Inflation expectations are more anchored?
- Remember the Great Moderation!


St. Louis Adjusted Monetary Base (AMBSL)
Source: Federal Reserve Bank of St. Louis
4,000
3,600
3,200
2,800
2,400
2,000
1,600
1,200
800
400
0
(Billions of Dollars)
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED


M1 Money Multiplier (MULT)
Source: Federal Reserve Bank of St. Louis
(Ratio)
2.0
1.8
1.6
1.4
1.2
1.0
0.8
0.6
2000
2002
2004
2006
2008
2010
2012
2014
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED

Making a Graceful Exit

- Reverse open market operations?
- Increasing interest on reserves

  "The principal tool that we contemplate is the interest rate paid on excess reserves."

  \- Ben Bernanke, April 2013

- Will this work?

What is the right sequence?

- Reverse course?
- Or not?

“The Fed can start by raising short-term interest rates, currently near zero, while leaving QE3 on hold.”

- Ronald McKinnon, WSJ, 10/27/2013

Problems you might encounter

- Raising interest rates is never popular.
- “So, Ms. Yellen, are you telling me that the Federal Reserve is using taxpayer money to pay banks *not* to make loans to the American people.”