

MONETARY POLICY PANEL

Luncheon Meeting, March 28, 2014

AGENDA

Forward Guidance: Past, Present and Future

Background

Communication about future policy actions has long been a staple of policymaking in central banks. However, with policy rates constrained by their effective lower bound, forward guidance has taken on an even more prominent role and has been a primary policy tool for central banks over the past several years.

The FOMC has adjusted its approach to forward guidance a number of times since it lowered the federal funds rate target to the range of 0 to 1/4 percent in December 2008.¹ It initially stated its anticipation that the federal funds rate would remain low for a nonspecific period (“some time”; “extended period”). In August 2011, it shifted to a time-contingent forward guidance, referring to a specific period through which the target rate would remain low (between August 2011 and September 2012, this period was slowly shifted from “mid-2013” to “late 2014” to “mid-2015”).

In December 2012, the Committee adopted a state-contingent, or outcome-based, forward guidance, setting thresholds that would need to be crossed before the FOMC would consider raising its policy rate. This guidance was reinforced in December 2013 by stating that the target range would be maintained “well past” the time the unemployment threshold was crossed. At its last meeting, the FOMC changed its guidance again, abandoning the reference to thresholds, and opting to state its outcome-based guidance in qualitative terms, linking the maintenance of the federal funds rate target in the range of 0 to 1/4 percent to the assessment of progress--both realized and expected--toward its objectives.

At this meeting we would like to hear your views regarding the efficacy of various forms of forward guidance. In particular we wish for a discussion among the panel participants appraising the recent change in the Committee’s forward guidance and how guidance might evolve further during the eventual process of policy normalization.

We would also like to elicit the panelists’ view on the state of the economy (figures 1 and 2 provide background information) and the potential challenges faced by a continued accommodative policy.

¹ A detailed chronology is in the reference section below.

Questions for Discussion

- As stated above, the March FOMC statement marks a transition from threshold-based guidance to a more “qualitative” form of forward guidance.
 - Do you think the new language helps to clarify the Committee’s policy reaction function?
 - Do you think the Committee should have maintained a reference to an inflation threshold?

- The federal funds rate projections in the March [Summary of Economic Projections](#) (SEP) indicate a somewhat steeper path for the policy rate than those in the December SEP [see figure 3]. Chair Yellen, however, stated at her press conference that “[...] one should not look to the dot plot so to speak as the primary way in which the Committee wants to or is speaking about policy to the public [...].” [[Chair Yellen’s Press Conference](#), March 19, 2014, page 9 of transcript.]
 - In your view, how valuable is the information provided by the federal funds rate projections in the SEP?

- While an assessment of the maximum sustainable level of employment is difficult, uncertain, and subject to revision, the longer-run goal for inflation is explicitly set in the FOMC’s “[Statement on Longer-run Goals and Monetary Policy Strategy](#)” at 2 percent, as measured by the annual change in the price index for personal consumption expenditures. However, inflation has run below that objective for some time (see figure 1).
 - Given the continued shortfall of inflation from the longer-run objective, do you think that a more explicit commitment to raise inflation toward target in due course should be given to the public?
 - If so, what form should this commitment take?

- One concern that has been raised about an extended period of accommodation is that it may make the financial system more vulnerable to instability.
 - Do you think the FOMC should put explicit weight on financial stability considerations in determining the stance of monetary policy?
 - Do you think that the reference to “readings on financial developments” in the current FOMC statement should be strengthened?

Reference: Evolution of Forward Guidance on the Policy Rate

- **Dec. 2008 – Jan. 2009**
 - “The Committee . . . currently anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.”
- **Mar. 2009 – Jun. 2011**
 - “. . . currently anticipates that economic conditions . . . are likely to warrant exceptionally low levels of the federal funds rate for an extended period.”
- **Aug. – Dec. 2011**
 - “The Committee . . . currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels of the federal funds rate at least through mid-2013.”
- **Jan. – Mar. 2012**
 - “. . . are likely to warrant exceptionally low levels of the federal funds rate at least through late 2014.”
- **September 2012**
 - “[T]he Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time *after* the economic recovery strengthens.. and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015”
- **December 2012: state-contingent guidance, establishing thresholds**
 - “[T]he Committee . . . currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. The Committee views these thresholds as consistent with its earlier date-based guidance.”
- **December 2013: reinforcing the threshold guidance**
 - “The Committee now anticipates, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6-1/2 percent,

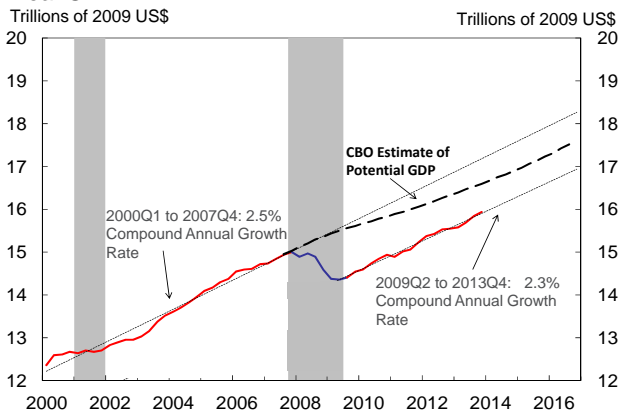
especially if projected inflation continues to run below the Committee's 2 percent longer-run goal.”

- **March 2014: qualitative forward guidance**

- “In determining how long to maintain the current 0 to 1/4 percent target range for the federal funds rate, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. The Committee continues to anticipate, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored.”

Figure 1 Charts: Current Economic Situation

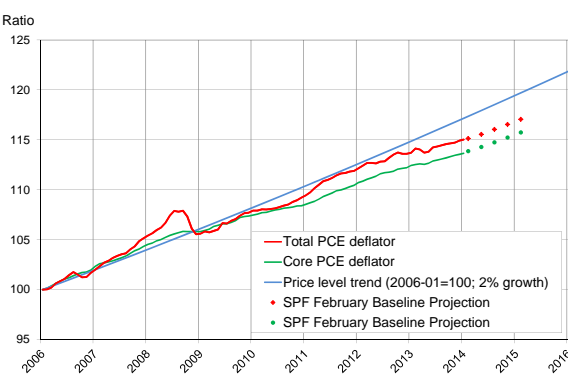
Real GDP



Source: Bureau of Economic Analysis, Congressional Budget Office

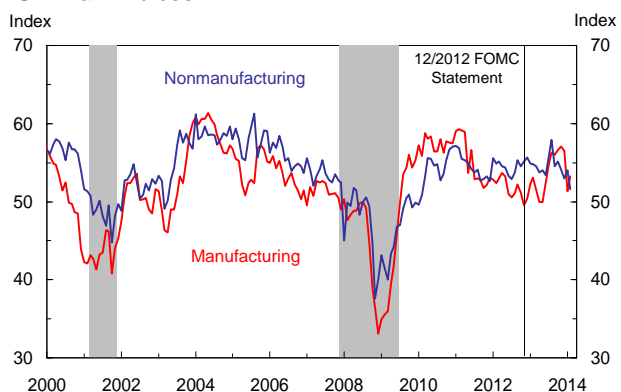
Price Level

(January 2006 = 100)



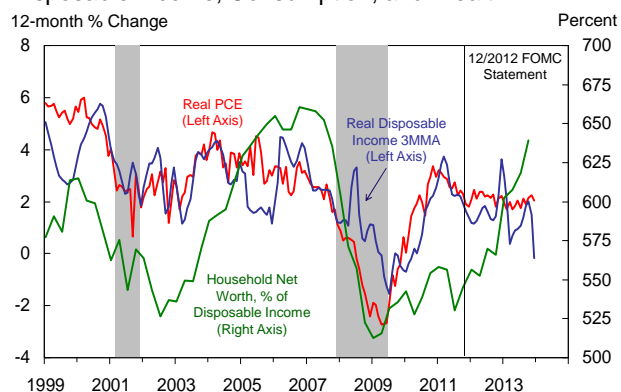
Source: Survey of Professional Forecasters, FRBNY Calculations

ISM Main Indices



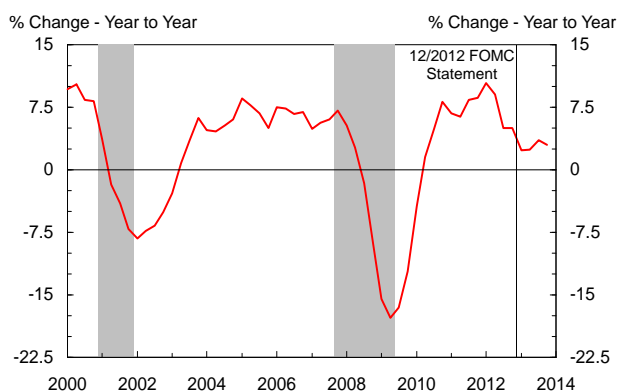
Source: Institute for Supply Management

Disposable Income, Consumption, and Wealth



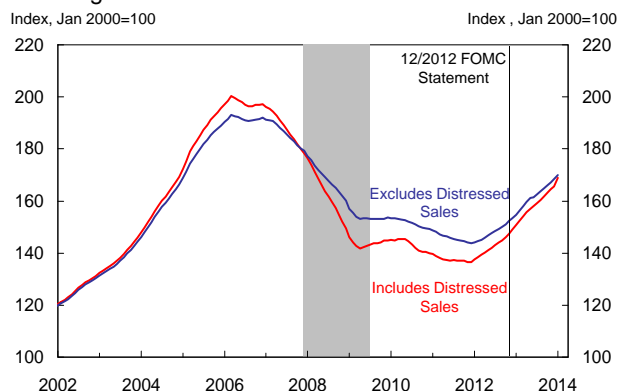
Source: Bureau of Economic Analysis

Business Fixed Investment



Source: Bureau of Economic Analysis

CoreLogic National Home Price Index



Source: CoreLogic/Haver Analytics

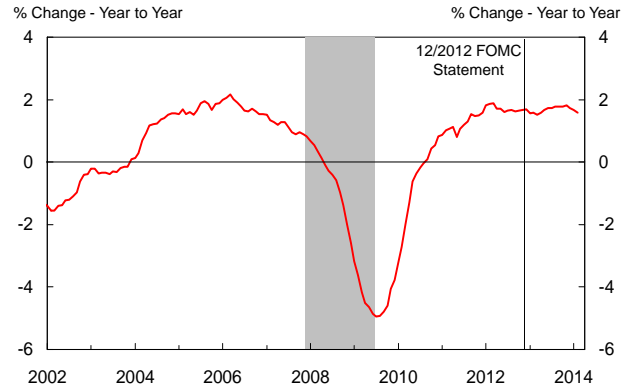
Figure 2 Charts: Labor Market Situation

Indicators of Labor Market Demand

Key Indicators	Pre-recession 01/2004-12/2007	Post-threshold guidance 01/2013-01/2014	Current (February Release)
Payroll Employment Change (thousands)	160	189	175
Job-to-Job Transition Rate	2.2	1.6*	1.6*
Quits Rate (JOLTS**)	2.1	1.7	1.7
Vacancy Rate (JOLTS**)	3.0	2.8	2.8
Hires Rate (JOLTS**)	3.9	3.3	3.3
Job-Finding Rate (CPS)	26.9	19.0	21.4
Vacancy to Unemployment Ratio	0.60	0.35	0.39

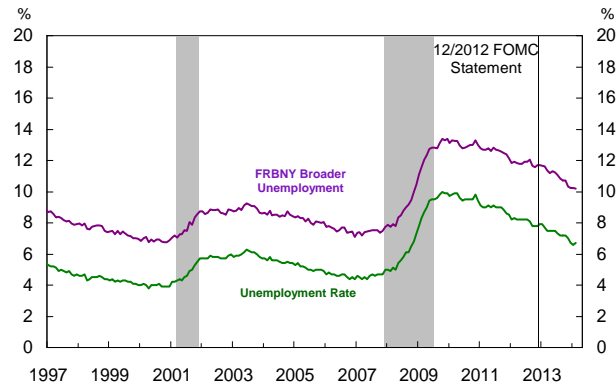
* Job-to-Job Transition Rate is through November 2013 for both periods
 ** JOLTS data are released with a two month lag (i.e. December Release has October data).

Total Nonfarm Payroll Growth



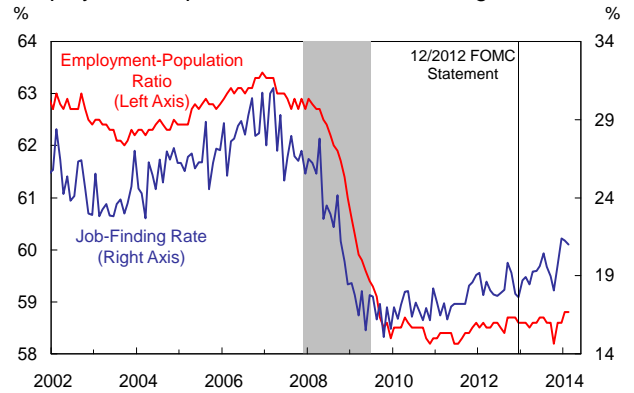
Source: Bureau of Labor Statistics

Unemployment Rate



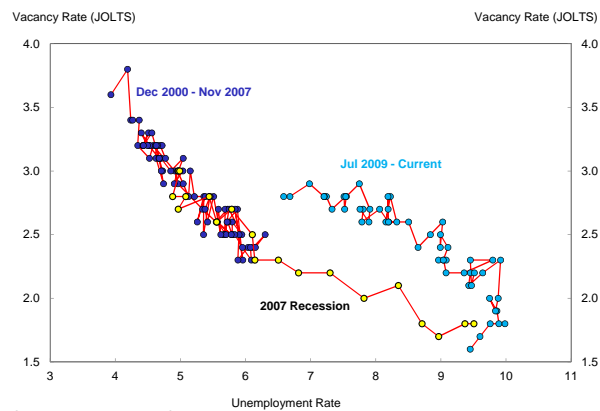
Source: Bureau of Labor Statistics, FRBNY Calculations

Employment-Population Ratio & Job-Finding Rate



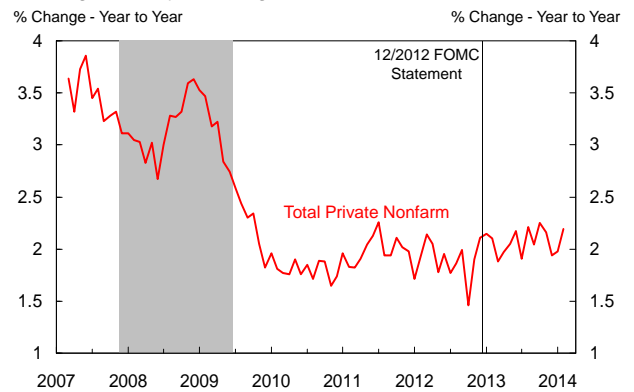
Source: Bureau of Labor Statistics, FRBNY Calculations

Beveridge Curve



Source: Bureau of Labor Statistics

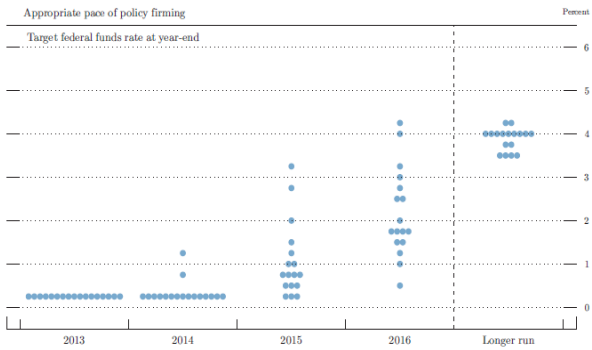
Average Hourly Earnings



Source: Bureau of Labor Statistics

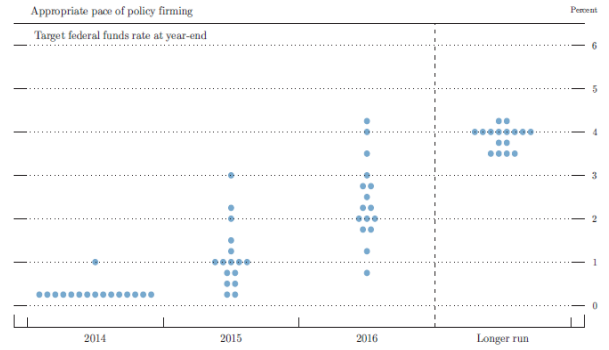
Figure 3 Charts: SEP and Market Reaction

Federal Funds Rate Projections - December 2013 SEP



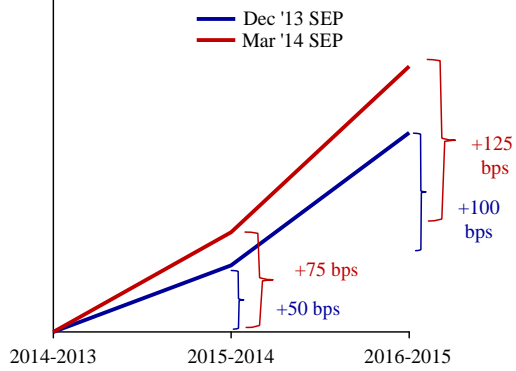
Source: Federal Reserve Board of Governors

Federal Funds Rate Projections – March 2014 SEP



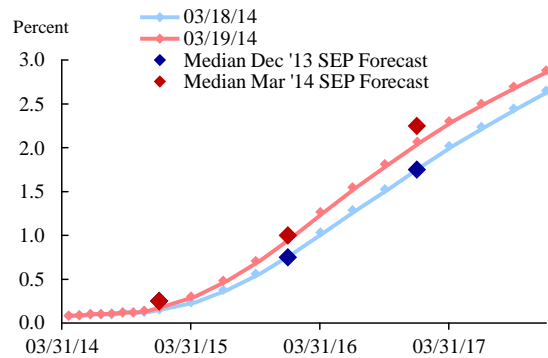
Source: Federal Reserve Board of Governors

**Pace of Tightening Implied by
Median SEP Forecasts**



Source: Federal Reserve Board, Staff Calculations

Implied Federal Funds Rate Path*



*Derived from federal funds futures and Eurodollar futures.
Source: Bloomberg, Federal Reserve Bank of New York, Federal Reserve Board of Governors.