Minutes of the MONETARY POLICY ADVISORY PANEL[1]

Meeting of September 5, 2014

Present - Panelists: Mark Gertler, Frederic Mishkin, Ricardo Reis, Christopher Sims, Michael Woodford. Internal Staff: Richard Crump, Marco Del Negro, William Dudley, Stefano Eusepi, Marc Giannoni, Tom Klitgaard, Jonathan McCarthy, Emanuel Moench, Richard Peach, Paolo Pesenti, Benjamin Pugsley, Matthew Raskin, Julie Remache, Robert Rich, Aysegul Sahin, Argia Sbordone, Ernst Schaumburg, Andrea Tambalotti, Joseph Tracy.

The roundtable discussion focused on two issues: the appropriate timing of the policy rate lift-off and the pace of policy normalization after lift-off. The panelists also discussed and offered their views on other current economic issues.

The economic outlook and the timing of lift-off

About the economic outlook, the general consensus of the panelists was that continued accommodation is warranted as real activity and inflation remain below their targets. The panelists discussed how the gaps between current and potential levels of real activity are more difficult to assess than the inflation gap: inflation is below the Federal Open Market Committee's objective and there are no clear signs of inflation pressure at this time. In discussing the usefulness of readings on wage pressure to gauge the slack in resource utilization, panelists expressed skepticism about the hypothesis of "pent-up" wage deflation, as recently mentioned by Chair Yellen in her remarks at the Jackson Hole Symposium. Their skepticism derived from the observation that the share of workers who experienced no change in nominal wages was small, and the recovery has extended for a long enough time to allow opportunities to reset wages through job switches.

Regarding the timing of the lift-off, panelists largely supported formulating state-contingent guidance rather than providing time-based guidance. Their concern was that time-based guidance could make it difficult for market participants to distinguish changes in the Committee's assessment of the economic outlook from changes in its policy reaction function.

[1] The views presented in these minutes are solely those of the panelists, not of the FRBNY staff.

The normalization process after lift-off

The discussion then moved to the conditions that would determine the pace of tightening. Panelists agreed that there should be clear communication of the Committee's willingness to adjust the pace of increases as necessary. They believed that the pace of tightening should be state-contingent and should be clearly communicated as such; moreover, financial conditions should play a more central role, because they are the channel through which monetary policy is transmitted to real activity. There was discussion of the risks of lifting off early and raising rates more gradually, versus lifting off later and raising rates more quickly. In general, the panelists viewed delaying the lift-off until economic conditions are on a solid ground as preferable, as long as the Committee could maintain its credibility to be able to tighten policy appropriately. Some panelists suggested that communication should prepare market participants for some additional volatility in short term rates.

There was discussion about the normalization of the balance sheet post lift-off and the pros and cons of the timing to end the reinvestment and of any possible asset sales. Panelists generally agreed that ending reinvestment would have a relatively small impact on financial market conditions compared to asset sales. They also noted that ending reinvestment after, rather than before, the lift-off would prevent market participants from reading the end of reinvestment as a signal of the upcoming lift-off. In addition, panelists viewed the risks of capital losses from delaying the end of reinvestment as small. By contrast, they judged asset liquidation, if it were to occur, to have potentially large effects on the yield curve.

About implementation, panelists discussed the coordinated use of the interest on excess reserves (IOER) and the overnight reverse repurchase agreement facility (ONRRP) to control the federal funds rate (FFR) and transmit policy to other short-term rates. Because costly arbitrage prevents increases in the FFR from immediately passing through to other short term rates, panelists agreed that the use of the ONRRP would contribute to establish a floor on short term rates, and enable the Committee to implement the desired normalization path when appropriate. Some panelists raised a concern about clear communication to the public about the nature of the Fed's interest-bearing liabilities, especially if they were perceived as being subject to the Treasury's debt limit.

The issue of whether forward guidance remains appropriate after exiting the zero lower bound was raised. Some panelists viewed explicit forward guidance as unnecessary since changes in the yield curve could be implemented through changes in the policy rate and the signals they provide. There were also concerns among the panelists that forward guidance after exiting the zero lower bound would be made more complicated by changes in the composition of voting members over time. Nevertheless, some panelists maintained that a basic principle of discussing future policy in communication is valuable and that inertia in setting the policy rate may represent an implicit form of forward guidance.

Communication issues

Panelists generally agreed that the Summary of Economic Projections (SEP) process could be improved. The biggest gains would be in presenting the joint distribution of inflation and policy rates instead of separate figures. There was also discussion about whether it would be helpful to associate names of participants to the projections, or distinguish between voting members and non-voting participants. Some panelists were, however, concerned that publishing names might influence the submitted projections, and pointed out that the distinction between voters and non-voters was not crucial as non-voting participants become voting members on a rotation basis and can influence Committee dynamics and choices regardless of whether they serve as voters.

Panelists also discussed the possible production of a monetary policy report that would publish projected paths of inflation and output conditional on explicit policy strategies, as other smaller central banks routinely do. Although this proposal was viewed as desirable, it was recognized to be operationally difficult due to the size of the Committee and its geographical dispersion.

Additional policy issues

The panelists were asked whether monetary policy orthodoxy has changed after the financial crisis. In general, panelists expressed the view that there has been some departure from the "clean-up after" doctrine regarding financial vulnerabilities, and agreed that there is a clear role for macro prudential policy in addressing such vulnerabilities. One panelist, however, warned that although the dynamics of financial crises are similar, their triggers are rarely the same, which points to the difficulty of targeted regulatory action.

In discussing which monetary policy instruments should be deployed to support financial stability, panelists were largely in agreement that the first line of defense should be macro prudential regulation. Nevertheless, panelists acknowledged that in practice---especially because of the fragmented regulatory power in the U.S. and a lack of a clear financial stability mandate---regulatory action is difficult and typically slow in being enacted. Some panelists expressed preference for designing policies that are automatic stabilizers. In light of difficulties with decisive macro prudential actions, panelists believed that although the policy rate could be an instrument for financial stability, it is not a very good one.

Finally, there was discussion of the recent ECB reductions in the policy rates and the parallel announcement of upcoming asset purchases. There was discussion of the time to implement this policy change from early discussions roughly 6 months in advance. One panelist also raised concerns about the institutional arrangements of monetary and fiscal policy in the euro area, since there is no institutional authority to make consolidated fiscal decisions.