Minutes of the Economic Advisory Panel Meeting

November 15, 2019

Present: Chair: John Williams. External Panelists: Julia Coronado, Kathryn Dominguez, Michael Feroli, Kristin Forbes, Simon Gilchrist, Jan Hatzius, Sydney Ludvigson, Lisa Lynch, Greg Mankiw, Laura Veldkamp. New York Fed staff: Kristian Blickle, John Clark, Fernando Duarte, Thomas Eisenbach, Fulvia Fringuellotti, Linda Goldberg, Beverly Hirtle, Tom Klitgaard, David Lucca, Stephan Luck, Jonathan McCarthy, Meg McConnell, Neil Mehrotra, Richard Peach, Paolo Pesenti, Matthew Raskin, Joshua Rosenberg, Argia Sbordone, Or Shachar, Kevin Stiroh, Michael Strine, Angela Sun, Andrea Tambalotti, Giorgio Topa, Desi Volker. Research visitors Giancarlo Corsetti and Gauti Eggertsson were also in attendance.

The topic of the first half of the meeting was introduced by Kristin Forbes with a presentation on Monetary Policy under Heightened Uncertainty. Following the presentation, the panelists discussed the relationship between uncertainty and tail risks. Panelists observed that an environment of heightened uncertainty mostly reflects changes in agents' beliefs about tail risks rather than the intrinsic volatility of the data themselves because the probabilities of tail events are harder to estimate than second moments, making their assessment more sensitive to incoming data. Consequently, agents' subjective uncertainty can fluctuate considerably, with significant effects on their decisions. Panelists also discussed how monetary policy affects firms' decisions in the presence of heightened uncertainty. Lower interest rates make delaying decisions, such as investment, less costly, which might dampen their stimulative effect in an uncertain environment. Sydney Ludvigson briefly highlighted results from her research on the endogenous relationship between uncertainty and business cycles, which found that increases in uncertainty might be a cause of economic slowdowns, but uncertainty also increases endogenously when the economy slows for other reasons. By distinguishing between real and financial uncertainty, this research shows that real uncertainty is mostly a reaction to other business cycle shocks, while financial uncertainty appears to be a mostly independent source of economic fluctuations.

The second half of the meeting started with a presentation by Simon Gilchrist on Financial Conditions and the Real Economy. The presentation was followed by an exchange among the panelists on the connections between the prices of different assets and the macroeconomy, including the differential ability of indicators such as credit spreads, the term premium, and stock market returns to predict future economic activity. Panelists connected the differences in the relationships between the returns on different assets and the real economy back to the previous considerations on tail risks. This exchange then led to a discussion of the concept of GDP at risk, which uses current financial conditions to predict changes in the distribution of future GDP growth. Research on GDP at risk shows that certain measures of financial conditions predict movements in the tail of the distribution of future GDP growth, with tighter financial conditions predicting both a lower mean and larger variance of this distribution. The panelists agreed that connecting this notion of tail risk with the ones discussed earlier would be fruitful.

The next topic of discussion was the relationship between monetary policy and financial stability. The panelists discussed various alternative approaches to factor financial stability considerations into the conduct of monetary policy, the difficulty of quantifying financial stability risks, the interaction between monetary and macroprudential policy tools, as well as alternative institutional arrangements to manage those tools. Other topics that were discussed included the extent to which fiscal policy contributed to boost GDP growth over the past two years; the impact of intangible capital investment on productivity and on physical capital investment; the current state of the labor market and what indicators provide the most reliable signals on it; and the resilience of consumption expenditures given the relatively high level of the personal saving rate.