Monetary Policy Advisory Panel
Meeting of October 20, 2017
Minutes

Present: William Dudley. Panelists: Markus Brunnermeier, Gauti Eggertsson, Kristin Forbes, Mark Gertler, Frederic Mishkin, Thomas Philippon, Christopher Sims, Michael Woodford. FRBNY Staff: Ozge Akinci, Sarah Bell, Marco Del Negro, Fernando Duarte, Beverly Hirtle, Lorie Logan, David Lucca, Jonathan McCarthy, Paolo Pesenti, Simon Potter, Julie Remache, Aysegul Sahin, Argia Sbordone, Angela Sun, Andrea Tambalotti.

The discussion primarily was centered on two issues on the agenda: the persistence of broadly accommodative financial conditions despite the removal of monetary policy accommodation since December 2015, and continued low inflation readings alongside further strengthening in the labor market.

Monetary policy and financial conditions

Noting that asset prices appeared to be less responsive to increases in the policy rate than they had been historically, panelists discussed whether the monetary transmission mechanism might have weakened over recent years. They also debated whether financial conditions were perhaps inappropriately loose for the current macroeconomic backdrop, offering differing views. During this part of the discussion, one panelist pointed out that mortgage rates were a particularly important aspect of financial conditions for the economic outlook. That panelist didn't judge those rates to be particularly low at this time.

Overall, panelists agreed that U.S. financial markets were increasingly influenced by domestic and global factors beyond U.S. monetary policy. They also discussed whether relatively loose financial conditions signaled greater risks to financial stability. One participant argued that there is some evidence of undue risk-taking behavior on the part of market participants. Moreover, some panelists expressed skepticism about what was seen as relatively high equity market valuations, and it was noted that realized and implied volatility measures are very low compared to historical standards. One panelist pointed out that these patterns could signal that market participants have become too complacent. This panelist also noted that less definitive forward guidance on the policy rate path from policymakers could be suitable in the current environment.

Participants also discussed the Federal Open Market Committee's plans for normalization of the size of the Federal Reserve's balance sheet. They noted that communication about the process had been handled well and appeared to have minimized the risks of another 'taper tantrum' episode. They largely thought that decoupling balance sheet policy and interest rate decisions was appropriate, but viewed the balance sheet as an important part of the policy toolkit to be used if the effective lower bound on the nominal policy rate binds again.

Low inflation concerns

Several panelists highlighted that recent low inflation alongside an apparent strong labor market has been hard to reconcile with New Keynesian macro models. This led to a discussion of uses, interpretations and alternatives to the Phillips Curve, and of whether the long-run natural rate of unemployment may be lower than the consensus of current estimates. Some panelists argued that firms' market power appeared to have generally increased over the past couple of decades, and that this trend may be affecting the relationship between inflation and labor market tightness.

Several panelists argued that fiscal policy may need to be used more actively in the current environment of low interest rates because monetary policy could be constrained more often by the effective lower bound on nominal interest rates. Some pointed out the benefits of fiscal rules, particularly regarding adjusting automatic stabilizers on the basis of the economy's point in the business cycle.

There was also a discussion of the fiscal theory of the price level. One panelist judged that the current economic environment displayed some similarities with an "active fiscal/passive monetary" policy regime, using the taxonomy of Leeper. Under such a theoretical regime, inflation may not remain low if there is a significant unbacked fiscal expansion.

Other issues

Panelists also discussed risks to the economic outlook arising from political developments in Europe. The overall view was that despite the unsettled situation in Catalonia at the time of the meeting, downside risks in Europe were not very pronounced. It was noted that incoming economic data for Europe, particularly confidence indicators, had been relatively strong.

Finally, panelists provided their views on the implications for monetary policy of a possible transition to a new Federal Reserve Chair, focusing on the longstanding debate about discretionary versus rule-based monetary policy making.