

## Minutes of the Economic Advisory Panel Meeting

November 15, 2013

**Present:** Panel members: Jeffrey Frankel, Mark Gertler, Austan Goolsbee, Jan Hatzius, Gregory Mankiw, Peter Hooper, Anil Kashyap, Catherine Mann, Frederic Mishkin, Kenneth Rogoff, Michael Woodford, Jacob Frenkel.

Internal staff: Tobias Adrian, Stefania Albanesi, William Dudley, Marc Giannoni, Linda Goldberg, Thomas Klitgaard, Jamie McAndrews, Jonathan McCarthy, Richard Peach, Simon Potter, Aysegul Sahin, Argia Sbordone, Andrea Tambalotti, Michael Fleming, Meg McConnell, Terry Checki, Robert Rich, Beverly Hirtle, Kevin Stiroh, Jack Gutt, Sandy Krieger, Christine Cumming, Rodney Garratt, Joe Tracy.

The meeting began with two presentations on the meeting's central theme of the future challenges facing the Federal Reserve. In the [first presentation](#), N. Gregory Mankiw discussed issues related to the exit from unconventional monetary policy. Regarding the timing of exit, he focused on the labor market because of its prominent role in Federal Reserve communications for asset purchases and interest rate policy. Although he saw several labor market measures, such as employment-to-population ratios, pointing to a still-considerable slack in the economy, other measures suggested that labor market slack may be beginning to dissipate appreciably. In particular, he noted rising job opening rates and a lower short-term unemployment rate. Mankiw also questioned how precisely anyone could measure the natural rate of unemployment, and how responsive inflation might be to reductions in unemployment. He took note of the observation that inflation expectations appear to be well-anchored, but also mentioned that expectations could change quickly and thus one should not take too much comfort from current readings of expectations. Mankiw also cautioned that in the future, when the Federal Reserve seeks to raise market interest rates yet still has a large balance sheet, paying interest on reserves may be unpopular and consequently difficult for the Fed to do in a timely fashion.

In the [second presentation](#), Michael Woodford discussed Federal Reserve communication regarding both its interest rate and balance sheet policy tools. For interest rate policy, Woodford discussed his view that there are important advantages to providing consistent further guidance regarding both the timing of "liftoff" and the post-liftoff strategy. Furthermore, Woodford pointed out that because the current thresholds of a 6.5 percent unemployment rate and a 2.5 percent forecasted PCE inflation rate presumably are not derived from the FOMC's previous reaction function and that it presumably will not return to that reaction function in the immediate post-liftoff period, it may be beneficial for the FOMC to express its intention in terms of a price level target. He noted that the actual price level lags well behind a 2 percent trend for the PCE deflator if measured from the start of the recession in 2007. Woodford also mentioned that an

inflation floor could strengthen the FOMC's forward guidance, but would be less effective than a price level target in approximating an "optimal control" policy. He then turned to communication on balance sheet policy, suggesting that it would be more appropriate for the FOMC to communicate its balance sheet intentions in terms of the expected path of the balance sheet rather than the pace of purchases, as theory suggested a closer analogy between the stock of assets and the level of the short-term interest rate. He also expressed the view that the reaction that followed the discussion of "tapering" in the summer reflected inadequate previous FOMC communication, and should not be taken as a reason not to continue to communicate the committee's intentions regarding balance sheet policy.

In response to the presentations, panelists supported Woodford's suggestion about communication of balance sheet policy, namely that all Fed communication about the balance sheet be about the expected path of the balance sheet, and not statements of flows. One panelist questioned whether interest rate guidance might not be a "zero-sum" tool: the benefits gained during the phase of low rates might be all erased once rates rise. Another panelist noted that there appear to be capacity limits for Fed securities purchases, so that forward guidance is an important tool. Another panelist suggested that an inflation floor would likely be a very weak tool since it appeared to that panelist that market participants already understood that funds rate increases were unlikely if inflation was expected to be significantly below the FOMC's longer-run goal. That panelist preferred a reduction in the unemployment threshold to provide additional policy accommodation.

One panelist pointed to the complex relationship between the balance sheet size and long-term interest rates, and suggested considering a target for broader financial conditions. That panelist also noted significant fiscal drag as a concern for the economy. Other panelists were critical of the perceived inadequate communication in the run-up to the September FOMC meeting. Some panelists also noted the tension between communicating the diversity of views within the FOMC and providing a consistent message to reinforce longer-term policy commitments. Another panelist discussed the complex international effects of LSAP policies, which depended on countries' accumulation of foreign exchange reserves. Another panelist focused on the relative deleveraging done by the U.S. and countries in Europe.

A general discussion on the state of the economy followed. A variety of views were expressed about the underlying strength of the U.S. economy. While some panelists were optimistic that the U.S. economy could grow at faster rates in 2014 than so far in the current expansion, members generally expressed concern that most forecasters have overpredicted growth during the expansion. They cautioned that premature signs of reduction in monetary policy accommodation could reduce confidence in the recovery.

In the discussion of U.S. monetary policy, panel members continued to note the sensitivity of markets to news about potential changes in the rate of asset purchases. Members generally agreed that the FOMC faces a significant challenge in communicating possible changes in the

rate of asset purchases as well as the process of eventually renormalizing the policy stance in a way that minimizes financial market disruptions.