Minutes of the Economic Advisory Panel Meeting

November 21, 2014

Present: External advisors: Alan Blinder, Julia Coronado, Michael Feroli, Jeffrey Frankel, Mark Gertler, Marvin Goodfriend, Austan Goolsbee, Jan Hatzius, Peter Hooper, Anil Kashyap, Gregory Mankiw, Kenneth Rogoff. Internal Staff: Tobias Adrian, Idanna Appio, John Clark, Christine Cumming, Gerard Dages, Bianca De Paoli, Marc Giannoni, Beverly Hirtle, Tom Klitgaard, Jamie McAndrews, Jonathan McCarthy, Meg McConnell, Richard Peach, Aysegul Sahin, Argia Sbordone, Michael Strine, Andrea Tambalotti, Joseph Tracy.

At the beginning of the meeting, Jamie McAndrews announced that the charter for the EAP had been revised such that the term of membership on the panel is three years, with the possibility of one renewal. The purpose of this change is to encourage diversity and renewal of thought in the EAP.

Lingering Effects of the Financial Crisis and U.S. Growth

The first topic of discussion focused on a presentation by Kenneth Rogoff on the difference in recoveries in the US, the Eurozone, and Japan following the global financial crisis. He noted that the Eurozone has performed poorly while the US has performed fairly well relative to historical recoveries from financial crises.

Among the reasons for the relatively stronger US recovery, he cited more aggressive monetary policy easing and the early implementation of bank stress tests in the US, as well as the slower policy response in the Eurozone due to the structure of the EU government. He also pointed to insufficient structural reform, not only in the Eurozone but also in Japan, as a reason for poor growth in those areas. In addition, he cited a slowdown in Chinese and emerging market growth and the growing importance of secular factors, such as demographics and inequality, as headwinds to the global growth outlook. Finally, he argued that the continued debt overhang in the Eurozone, combined with the continued structural issues and low inflation, has been a major factor behind the stagnation in the Eurozone.

Responding to this presentation, panelists discussed the relative impact of aggregate demand versus structural issues in the weaker recoveries in the Eurozone and Japan.

Spillovers to Emerging Markets

The discussion then turned to a presentation by Jeffrey Frankel on the effects of US monetary policy on emerging markets. He began with an overview of historical emerging market responses to US monetary policy changes. Historically, changes in US monetary policy have been associated with changes to capital flows to emerging market economies. In the early 2000s, emerging markets “strengthened their defenses” in response to the 1990s crises, adopting more flexible exchange rate regimes, stronger budgets, and shifting away from dollar-denominated debt. These policies helped them weather the financial crisis, but more recently several major emerging markets have “backslided,” with higher budget and current account deficits as well as dollar-denominated debt becoming more prevalent, especially in the private sector of these economies.

Some emerging market officials recently have expressed concerns about the effects on emerging markets of some US monetary policy actions. In particular, Brazilian finance minister Mantega criticized US monetary easing in 2010 as "Currency War" aggression, while RBI Governor Rajan criticized US monetary authorities in 2014 of not taking sufficient account of emerging market effects when speculation of US tightening had sizable adverse effects on emerging economies' asset markets and currencies. He argued that the criticisms were not fully convincing for several reasons. One is that the spillovers could be addressed by direct regulation of financial flows. The second is that the Federal Reserve's obligation is to American citizens rather than emerging markets (although he notes that curtailing foreign financial crises usually is in the interests of Americans). Finally, floating exchange rates are supposed to allow different countries to pursue different monetary policies.

He ended with a suggestion that emerging markets receive more representation in the G-20 and a discussion of how the simultaneous tightening of US monetary policy and loosening of Eurozone and Japanese monetary policy might affect emerging markets.

In the panelists' discussion of this topic, it was noted that the "trilemma" of international macroeconomics might not actually hold if macroprudential policy is another channel through which to achieve economic and financial stability. There was also a discussion on how rising real US interest rates can lower commodity prices, which would negatively impact commodity-exporting countries.

Economic outlook

The meeting then turned to presentations of economic outlooks from two panelists. First, Jan Hatzius presented his outlook. Noting that the past year has seen broad-based growth at rate of approximately 3%, he forecasted more of the same in the near future. Hatzius projected the labor market to reach full employment sometime in 2016, and inflation to remain below target through that time. He expected the first interest rate hike possibly occurring in the September 2015 FOMC meeting, but there was the potential that interest rates could remain low for longer. Looking abroad, he believed that the Eurozone economies appear to be improving gradually, but that more monetary policy easing was needed to sustain the recovery and enable inflation to move closer to the ECB's objective. Hatzius saw recent political changes as potential risks to the outlook.

Peter Hooper then presented his outlook. He noted that the recovery had been restrained over recent years by a number of drags that were now receding, including the run-down of the housing overhang, the rebuilding of household and corporate balance sheets, and fiscal drag. He noted that fiscal drag in the past five years had averaged well over 1% of GDP per year, significantly more than in Europe and Japan. Hooper said that much improved household finances would support US GDP expansion at above 3% over the year ahead, and that this would move unemployment below current estimates of NAIRU by next summer. With wage inflation already beginning to show some early signs of picking up, he expected Fed liftoff to occur in June 2015, with the risks skewed toward September because of still subdued price inflation. He saw global growth picking up somewhat over the year ahead, with China being an exception.

General Discussion

After completing the formal agenda, panel members had a general debate of various topics. One line of discussion followed the importance of implementing structural reforms in Eurozone economies, with some arguing that structural reform was greatly needed in the Eurozone to achieve long-term growth. It was also noted that an issue in the Eurozone was the appropriate mechanisms to make transfers to credit-constrained periphery countries.

Another line of discussion followed the effectiveness of pursuing macroprudential regulatory policies. Most panelists felt that many institutions, domestic and foreign, lacked the political credibility and knowledge to pursue appropriate countercyclical macroprudential policies, although one panelist argued that since the financial crisis regulation has tightened quite a lot. Panelists agreed, however, that macroprudential policy has not yet been used extensively in a countercyclical manner.

Another topic of discussion was the amount of slack in the US labor market. Some panelists saw considerable cyclical improvement in the labor market, as suggested by indicators such as the unemployment rate and quit rates, but were disappointed by structural developments in the labor market. Panelists differed on the relative contributions of cyclical and structural factors in the fall in the labor force participation rate, and which aggregate labor cost indicator provided a better signal of labor market slack. There was also a discussion about the trend for labor productivity growth.

Finally, the panelists discussed the desirability of “overshooting” on the inflation target. Various panelists insisted that overshooting on the inflation target was highly desirable. However some panelists questioned the ability of the Fed to accomplish this due to the zero lower bound. Other panelists raised concerns about the potential loss of credibility. It was also noted by a number of panelists that in the face of uncertainty in the measurement of economic slack, it would be better to be patient about lifting off from the zero lower bound.