Monetary Policy Advisory Panel
Luncheon Meeting
Agenda

Has the Economic Environment Changed?

Background

When this Panel last met in September, the discussion focused on the implications of a low interest rate environment for the conduct of monetary policy. Panelists addressed the challenges that monetary policy would face if a low interest rate environment would remain a feature of the economic landscape for the foreseeable future, and discussed the adequacy of the Fed's tool box in such an environment.

Today a new narrative has emerged following the U.S. presidential election.[1] While economic activity data have continued to signal moderate expansion of the U.S. economy similar to that of recent quarters, business survey measures and consumer sentiment have moved up considerably (Figure 1). In addition, labor market data have been solid. Financial conditions appear to have improved since the election, particularly reflecting a robust increase in equity prices (Figure 2). The step-up in the survey measures and the easing in financial conditions have prompted observations that animal spirits may have been "unleashed."

Still, assessments of near-term growth display sizable divergences: The FRBNY staff nowcast projects real GDP growth of near 3 percent for the first quarter (Figure 3), while the Atlanta Fed GDPNow projects growth of below 1 percent. Private judgmental forecasts for Q1 generally are between these two projections. Private forecasts for medium-term economic growth have moved up modestly and now generally fall in the range of 2 to 2½ percent. The median projections of FOMC participants prepared for the March Summary of Economic Projections (SEP) were around 2 percent in 2017 – 19.

The global economic outlook appears to be somewhat brighter than it was last fall. Data for the major advanced economies generally indicate stronger growth than was previously anticipated. In addition, output growth in the Chinese economy has not decelerated substantially, and risks of a significant slowdown don't seem to have materialized. Foreign risks to the U.S. economy

[1] For a more detailed review of economic developments, see the Research Staff's "U.S. Economy in a Snapshot", March 2017.

seem lower than they were a year ago, but a cautionary attitude in assessing external developments remains appropriate.

Largely reflecting the recent rise of consumer energy prices (as well as the dropping out of the energy price declines from late-2015/early 2016), the 12-month change in the overall PCE deflator has risen to near 2 percent. Meanwhile, various measures of underlying inflation, including core inflation, generally have risen more modestly and appear to be approaching 2 percent. Longer-term inflation compensation has risen from the extremely low levels of mid-2016, but is still low on a historical basis, and survey measures of inflation expectations generally have been little changed. It also appears that deflationary forces in major foreign economies have abated over recent months. The medians of forecasts from the Survey of Professional Forecasters and the median projections of FOMC participants prepared for the March SEP have PCE inflation of near 2 percent over 2017 – 19.

The FOMC decided to raise the target range for the federal funds rate at both the December and March meetings, with the range now at ¾ to 1 percent. Maintaining the same language adopted in recent communication, the FOMC statement issued after the March meeting said: "The Committee is maintaining its existing policy of reinvesting principal payments from its holdings […] and it anticipates doing so until normalization of the level of the federal funds rate is well under way." [2] In her press conference, Chair Yellen noted that at the March meeting the FOMC discussed issues related to an eventual change in reinvestment policy, but that no decisions were made at the meeting.

Given these developments, we would like to shift gears in the conversation at this meeting, and invite you to share your views on whether the tide finally has turned away from the extended period of low growth and low interest rates, and if so, what the policy implications are.

Questions for Discussion

End of 'secular stagnation' concerns?

- Do you believe that the risks of a secular stagnation scenario for the U.S. economy and the global economy have significantly abated?
- What factors and policies could in your view generate a sustained higher growth rate of the U.S. economy?
- If concerns about global secular stagnation have diminished, do you expect a reversion of the downward trend in long-term interest rates across major economies?

[2] See the "Policy Normalization Principles and Plans" statement of September 16, 2014 for more information about the key elements of the FOMC's intended approach to policy normalization.

Policy normalization and the balance sheet [3]

- In your view, what considerations should guide the determination of the appropriate long-run size and composition of the Federal Reserve's balance sheet?
- As stated in the minutes of the November 2016 FOMC meeting: "Most participants did not indicate support for using the balance sheet as an active tool in other situations [i.e., other than ELB situations] or for other purposes, although a few expressed support for undertaking further study of this possibility." In your view, how actively should the balance sheet be used in the future for monetary policy?
- Do you think that an announcement of a change in reinvestment policy has the potential to lead to a sharp change in financial conditions? If so, what communications would be effective to minimize the risks of such effects?

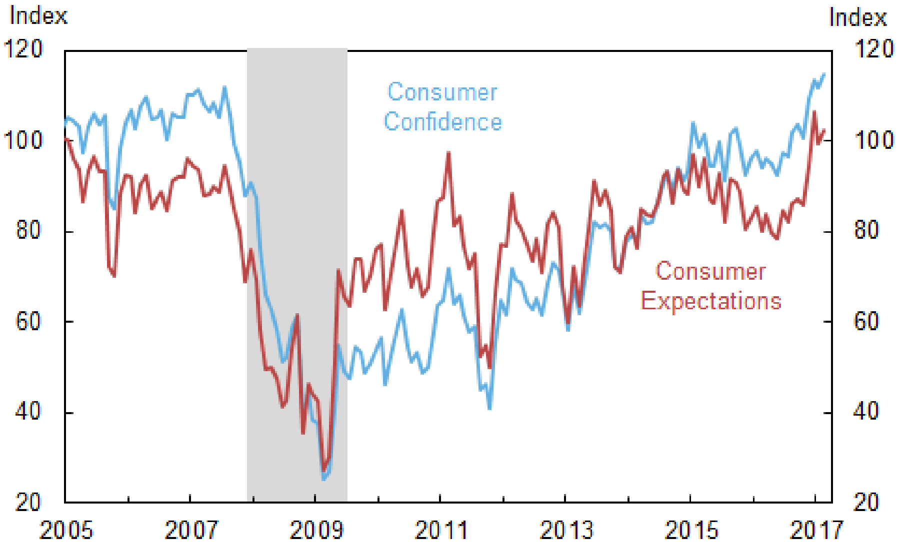
Global economy issues

- How strong do you judge the signs of recovery to be in the rest of the world?
- Beside political risks, what issues in the current global landscape do you think deserve close attention?
- What are your views about the possible impact of U.S. monetary policy spillovers to the rest of the world?

[3] See Figure 4 for the most recent Board staff public projections that come from Ferris, Erin E. Syron, Soo Jeong Kim, and Bernd Schlusche (2017), "Confidence Interval Projections of the Federal Reserve Balance Sheet and Income," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, January 13.

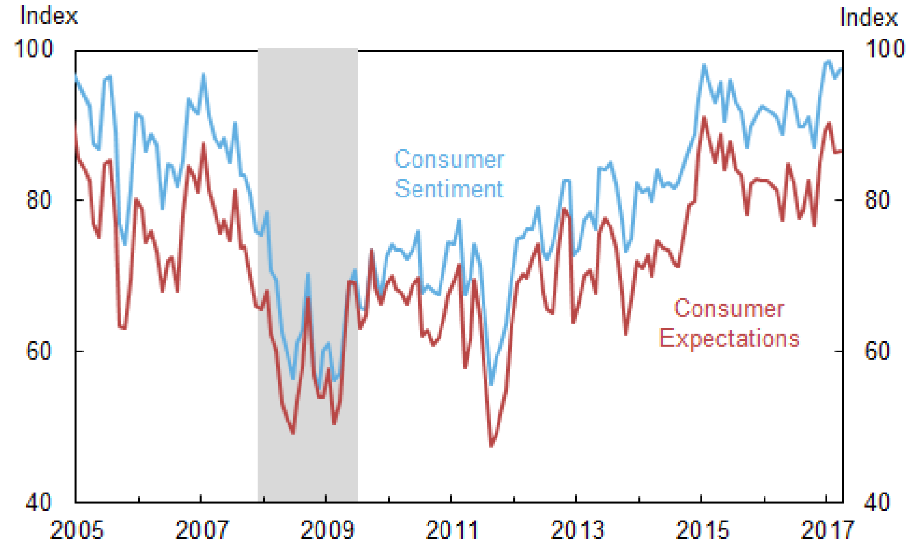
Figure 1 – Consumer and Firm Exuberance

Conference Board Indices



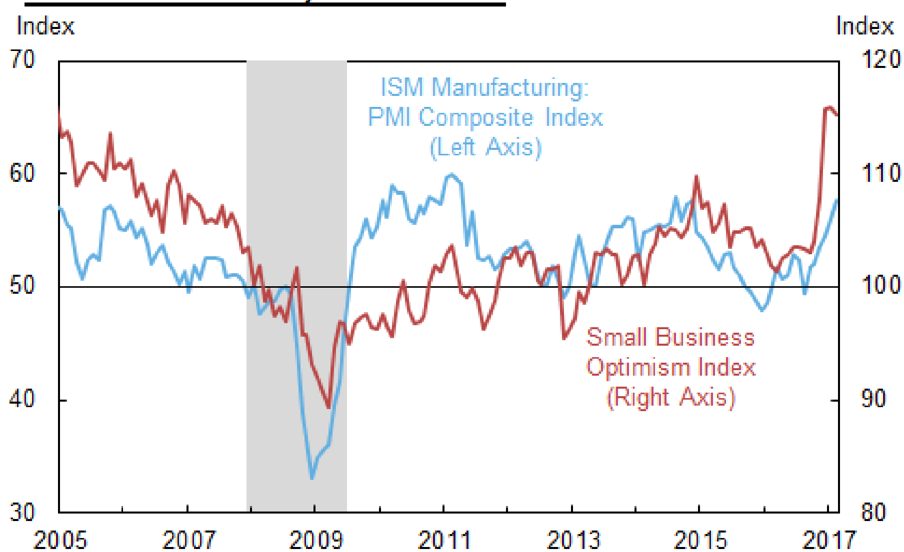
Source: The Conference Board. Note: Shading shows NBER recessions.

Michigan Indices



Source: University of Michigan. Note: Shading shows NBER recessions.

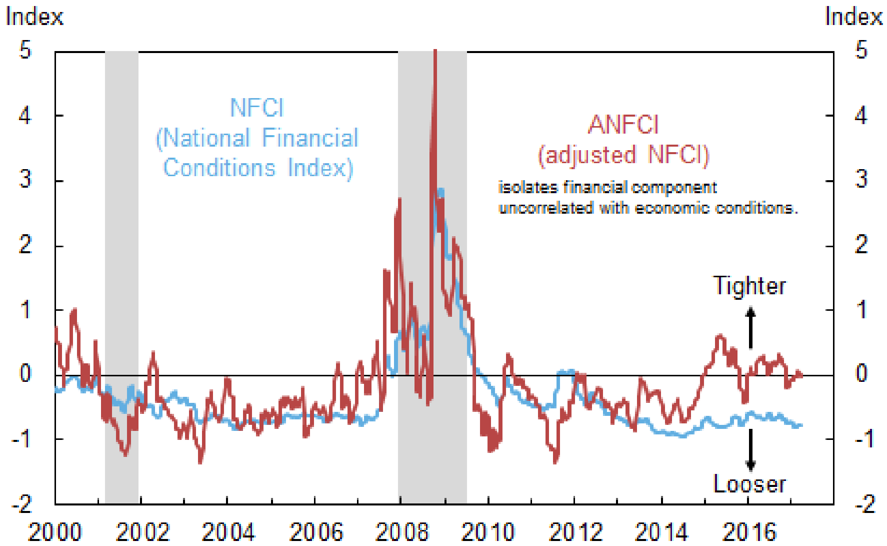
Business Survey Measures



Source: Institute for Supply Management;
National Federation of Independent Business. Note: Shading shows NBER recessions.

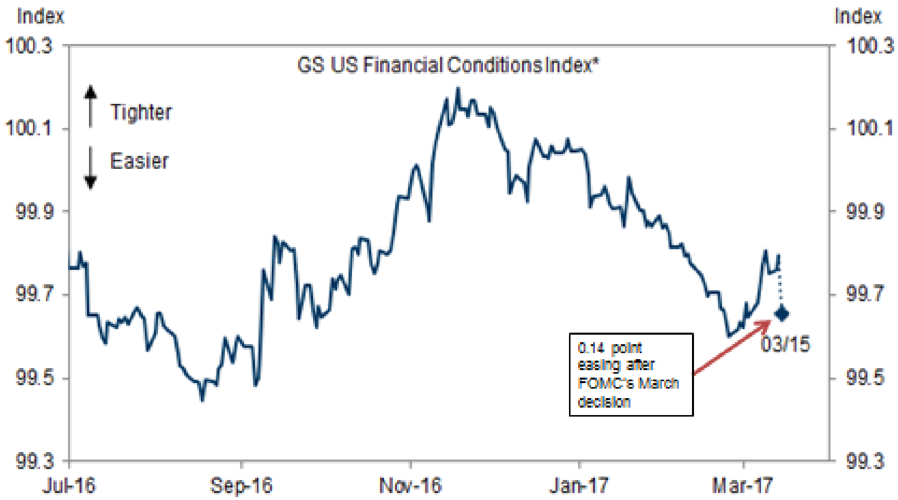
Figure 2 – Financial Market Developments

Chicago Fed Financial Conditions Index



Source: Federal Reserve Bank of Chicago. Notes: Shading shows NBER recessions.

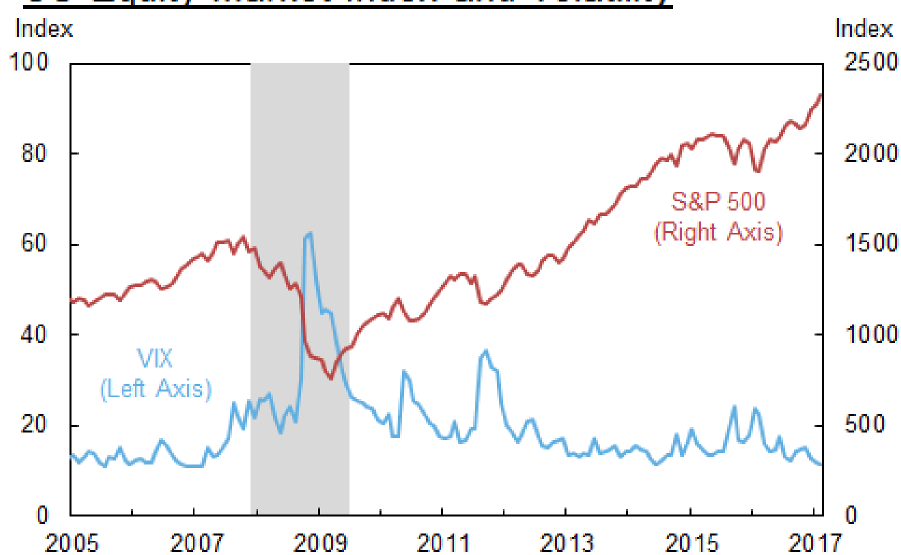
Goldman Sachs US Financial Conditions Index



*Weighted average of riskless int rates, spreads, equities, and FX, based on effects on 1-yr fwd US GDP growth. Most recent daily move is a preliminary estimate.

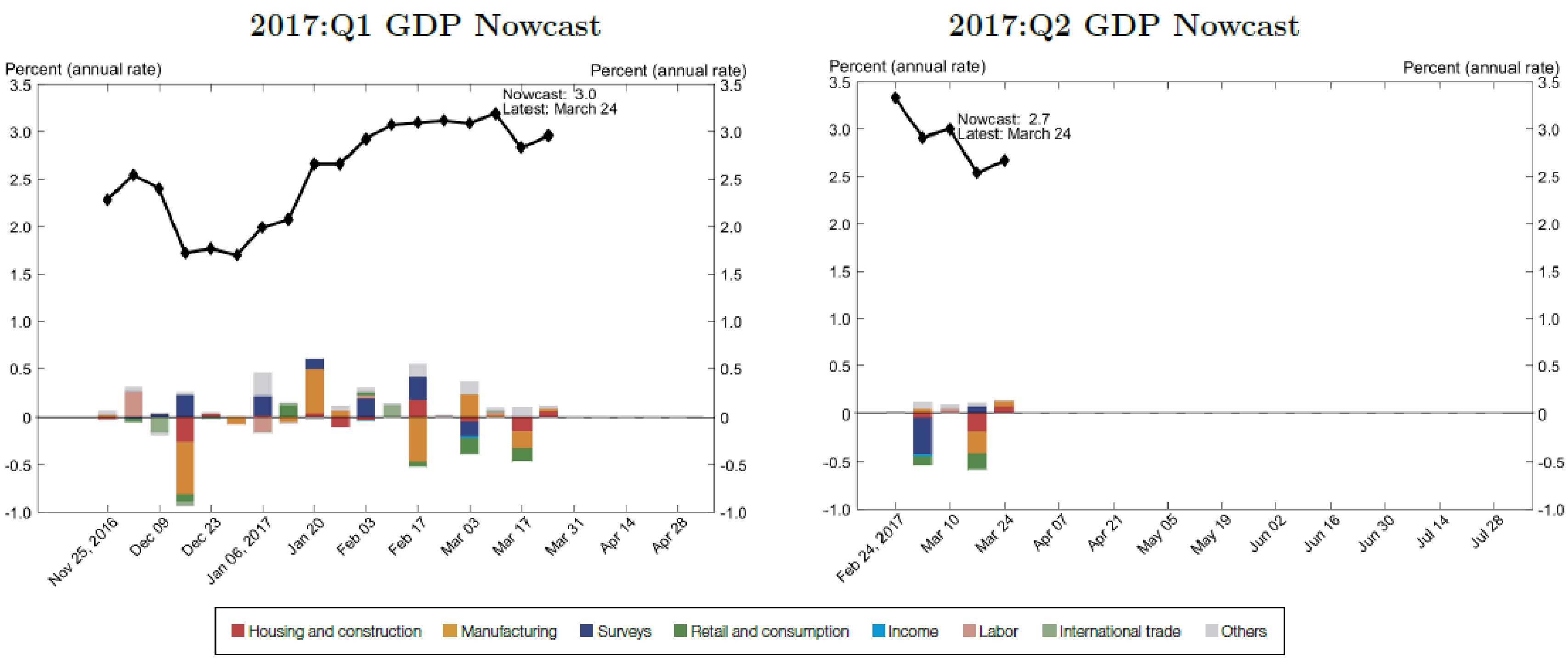
Source: Goldman Sachs via CNBC.

US Equity Market Index and Volatility



Source: Wall Street Journal via Haver Analytics. Note: Shading shows NBER recessions.

Figure 3 – Nowcast for GDP Growth

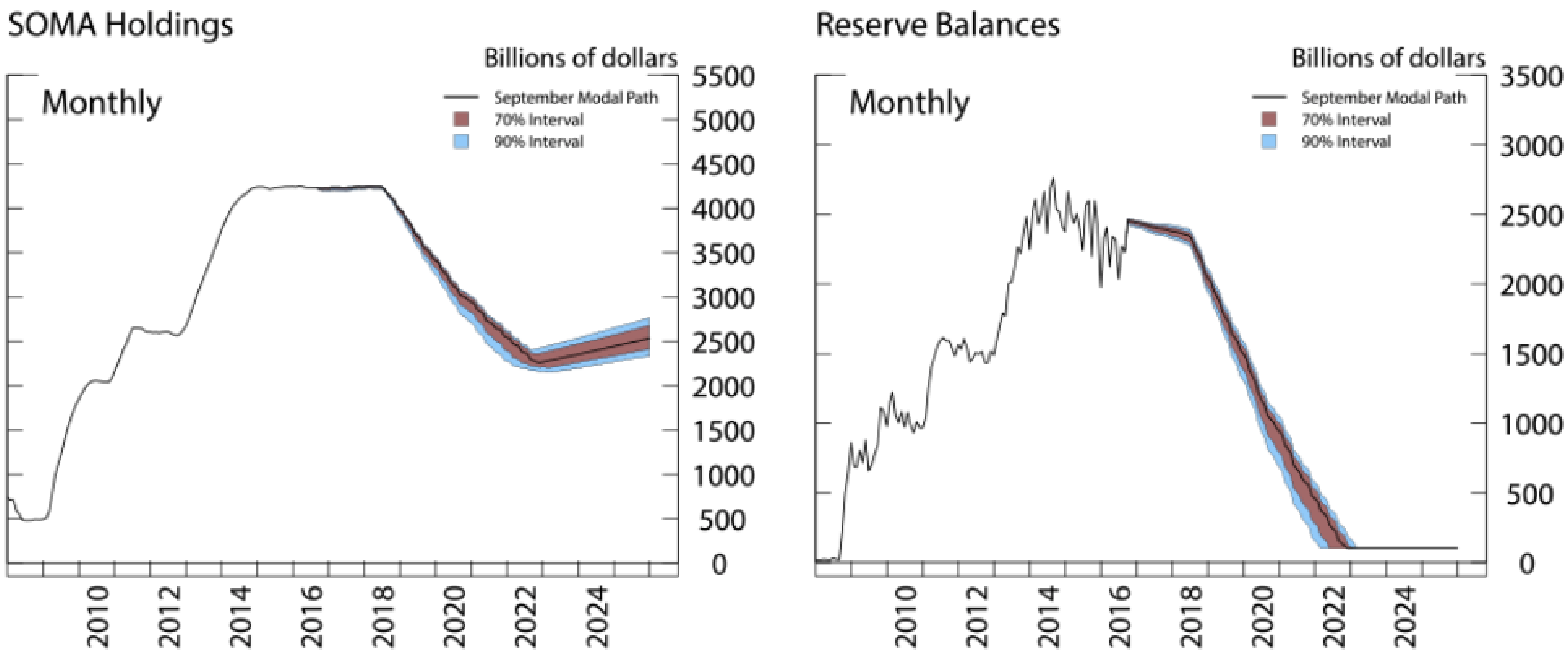


Update	Release Date	Data Series	Reference Period	Units	Forecast	Actual	2017:Q1 Weight	2017:Q1 Impact	2017:Q1 Nowcast GDP Growth	2017:Q2 Weight	2017:Q2 Impact	2017:Q2 Nowcast GDP Growth
					[a]	[b]	[c]	[$c(b-a)$]		[c]	[$c(b-a)$]	
Mar 17									**2.83**			**2.53**
	Mar 23	New single family houses sold	Feb	MoM % chg.	-1.60	6.09	0.008	0.065		0.010	0.080	
	Mar 24	Manufacturers' new orders: Durable goods	Feb	MoM % chg.	0.327	1.67	0.016	0.021		0.018	0.024	
	Mar 24	Manufacturers' shipments: Durable goods	Feb	MoM % chg.	0.928	0.265	0.079	-0.052		0.092	-0.061	
	Mar 24	Mfrs.' unfilled orders: All manufacturing industries	Feb	MoM % chg.	0.516	-0.020	-0.015	0.008		-0.028	0.015	
	Mar 24	Manufacturers' inventories: Durable goods	Feb	MoM % chg.	0.481	0.220	-0.210	0.055		-0.308	0.081	
		Data revisions						0.025			-0.007	
Mar 24									**2.96**			**2.66**

Figure 4 – Balance Sheet Projections

Balance sheet size and reserve balances under different macroeconomic outcomes, based on simulations using FRB/US. The red and blue areas represent the range of outcomes for the 70- and 90-percent confidence intervals, respectively.

For all scenarios it is assumed that the timing of a change in the FOMC's policy on reinvesting payments of principal on Treasuries and agency MBS is the median number of months forward as reported in FRBNY's September 2016 Survey of Primary Dealers (21 months for Treasuries and 24 for MBS). The long-run level of reserve balances is assumed to be $100 billion in this exercise.



Source: Ferris, Erin E. Syron, Soo Jeong Kim, and Bernd Schlusche (2017), "Confidence Interval Projections of the Federal Reserve Balance Sheet and Income," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, January 13.