MONETARY POLICY PANEL

Luncheon Meeting, March 25, 2016

AGENDA

U.S. policy normalization and financial market volatility

Background

When this Panel last met in September, a period of significant turbulence in financial markets was coming to what would prove to be a temporary close. The summer turbulence appeared to emanate from concerns about policy decisions and the economic outlook in some major economies, and their implications for the global outlook. At its September meeting, the FOMC decided to maintain the federal funds rate target range at 0 to 25 basis points, and its statement noted that recent global developments could restrain economic activity and put downward pressure on inflation.

Today we convene in a post-liftoff landscape: the FOMC decided to raise the federal funds rate target range a notch in December, as it expected real growth to remain moderate and inflation to rise gradually to 2 percent over the medium term. In addition, the SEP projections displayed a steeper path of increases than the market-implied expected path. Nevertheless, liftoff was well enough anticipated by market participants to generate little immediate reaction, and the mechanics of liftoff proceeded smoothly. However, there was a renewal of financial turbulence at the beginning of this year that appeared to arise from similar concerns about the global and U.S. outlook as in the summer episode. This turbulence began to subside in mid-February, in part because of better U.S. data. Recent economic developments are reviewed in our monthly 'Snapshot' of the U.S. economy (the March issue can be found here). In the first part of the year, we have also seen accommodative policy actions by a number of central banks, including the PBOC, BOJ, and ECB. The March SEP projections show a shallower path for the median projection of the federal funds rate than in December, with little change in the economic outlook.

At this meeting we would like to hear your views on the following interrelated topics:

- **Recurrent turbulence in financial markets**
- **Inflation and inflation expectations**
- **The SEP federal funds rate projections**

Questions for Discussion

On the recurrent turbulence in financial markets

- How do you interpret the recurrent turbulence experienced by domestic and global financial markets and their implications for the economic outlook?
- Our staff DSGE model shows that a tightening of financial conditions of the size associated with the mid-2015 increase in spreads is roughly equivalent to a 1 percentage point increase in the target policy rate (fig. 1). What are your views about the implications of tightening financial conditions on the path of policy normalization?

On inflation and inflation expectations

Recent data show some firming in both core CPI and core PCE inflation (fig. 2), while many measures of inflation expectations and compensation remain low on a historical basis (fig. 3).

- Do you see inflation as finally on a solid path to rise to 2 percent over the medium term?
- What are your views about the gradual decline over the past year in survey measures of medium- (our Survey of Consumer Expectations 3-year) and longer-term (the Michigan survey 5-10 year) inflation expectations?
- What signal do you take from the decline of market-implied inflation compensation measures since mid-2014?
- What implications do you draw from the more explicit FOMC statement that the 2 percent inflation goal is a symmetric objective?
- What is your assessment of any upside risks to the inflation outlook?

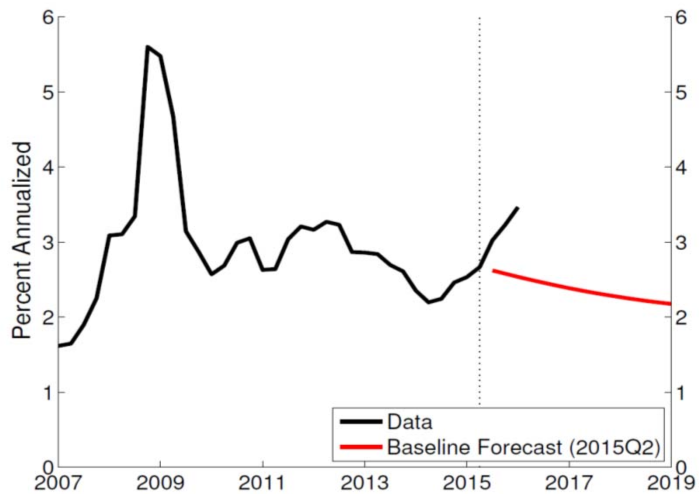
On the SEP federal funds rate projections

The most recent SEP projections show a flattening of the path of the median of FOMC participants' projections for the federal funds rate (the projected 'appropriate policy' paths of each participant), closing to some extent the divergence with market-implied and private forecasters' expectations. The path is also relatively close to our DSGE model forecast of the nominal "natural" rate (fig. 4).

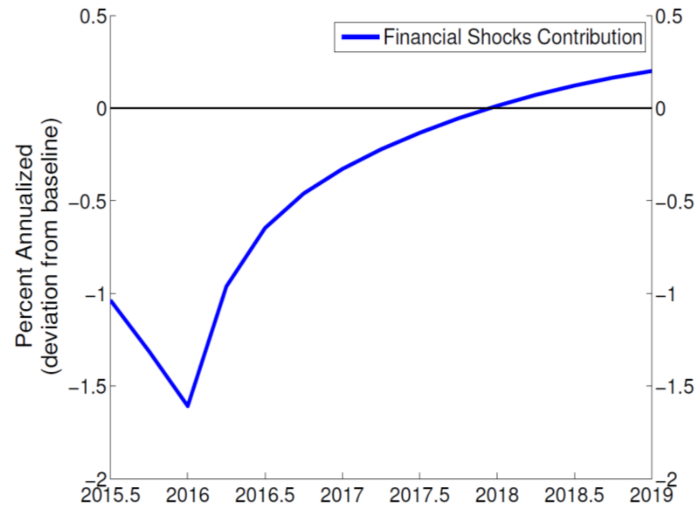
- Some post-FOMC commentary suggested that this shift in the SEP projections reflected a change in the policymakers' reaction function. What is your interpretation of this shift?
- What are your views on recent accommodative monetary policy actions of other major central banks, notably ECB and BoJ?
- Do you see major risks if policy divergences across major economies widened further?

Figure 1 - FRBNY DSGE Model: FFR Equivalent to Tighter Financial Conditions

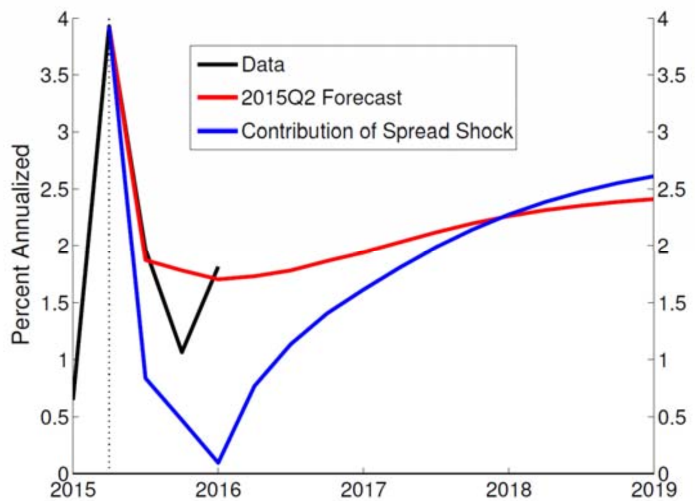
Baa-10y Tr. yield spread vs baseline model forecast



Contribution to GDP growth forecast



GDP growth: forecasted & counterfactual vs. actual



FFR forecasts: baseline vs path that would generate same tightening as spread widening

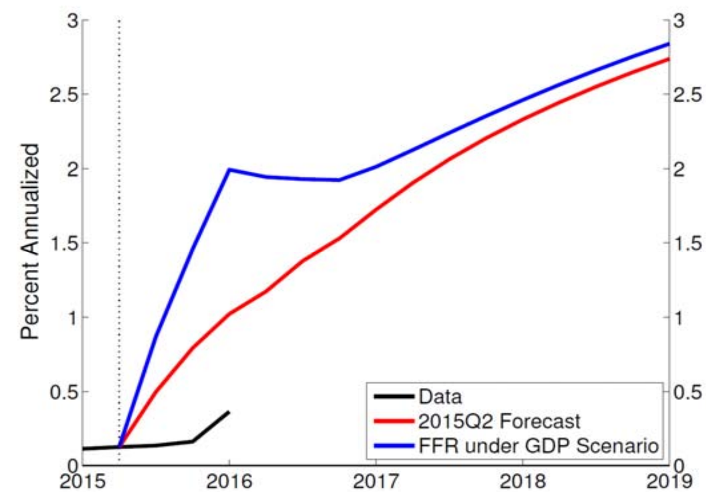
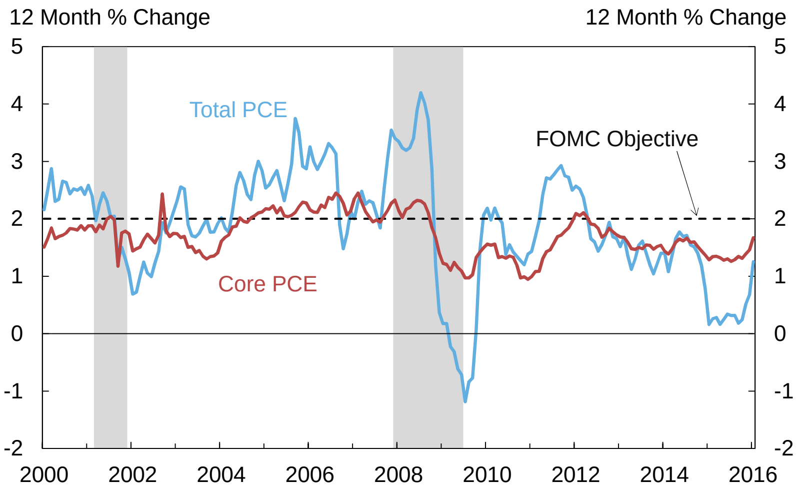


Figure 2 - Inflation Indicators

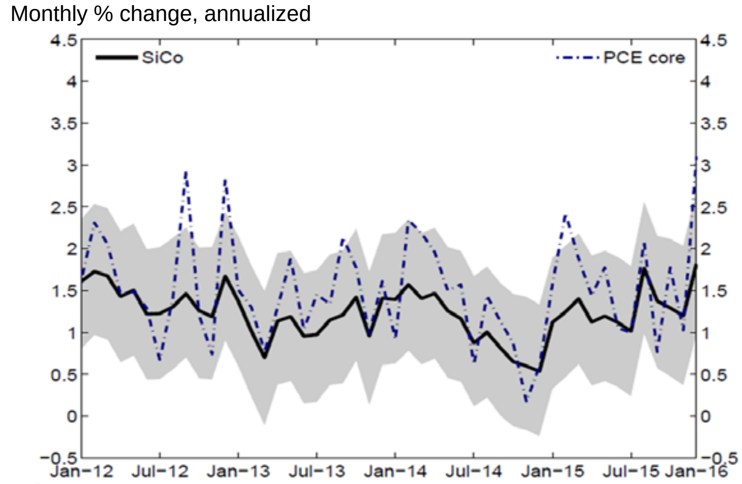
PCE Deflator



Source: Bureau of Economic Analysis, via Haver Analytics

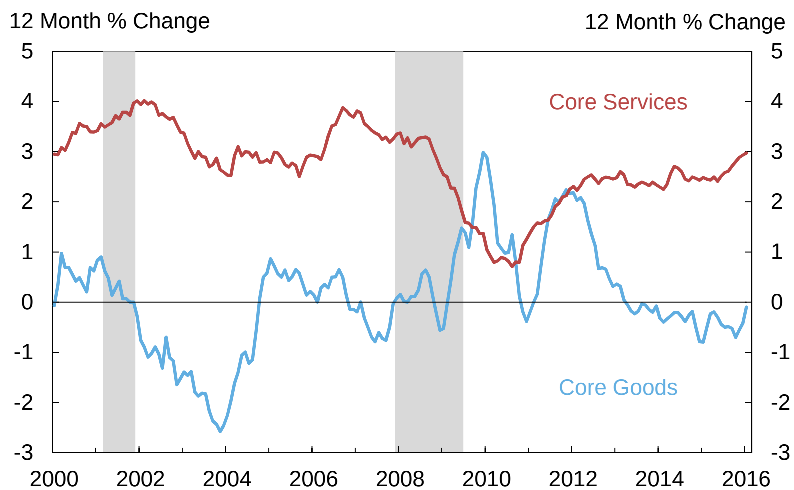
Note: Shading shows NBER recessions.

Signal Component (SiCo) model for core PCE



Source: FRBNY

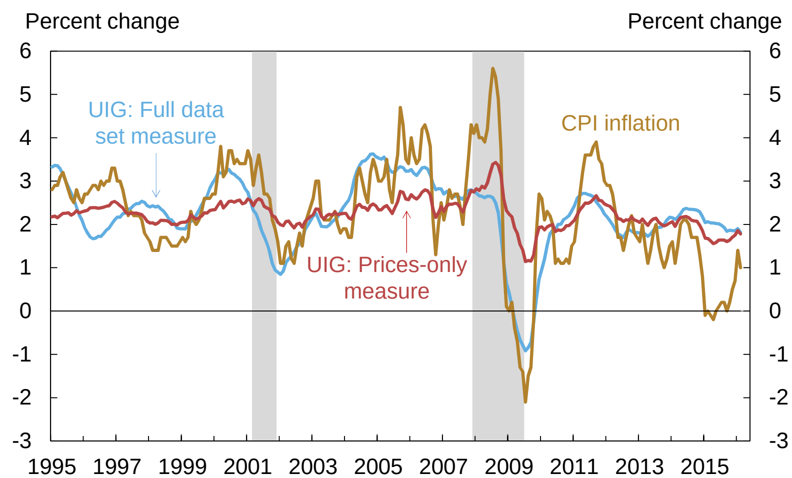
CPI Inflation: Core Goods and Core Services



Source: Bureau of Labor Statistics, via Haver Analytics

Note: Shading shows NBER recessions.

CPI Inflation: 12-Month Change and UIG Measures

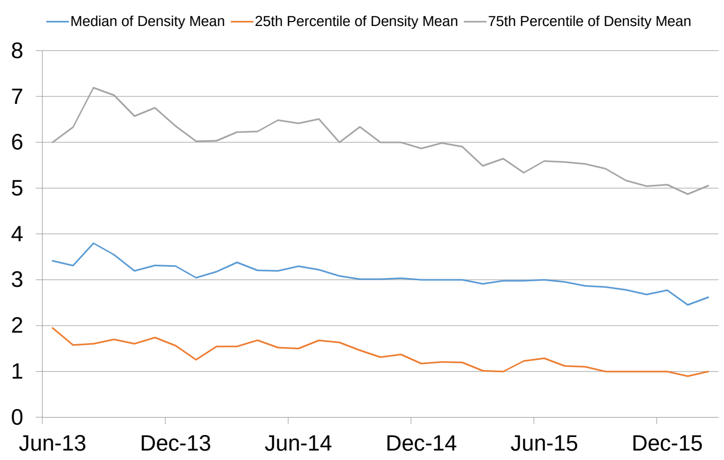


Source: Bureau of Labor Statistics, via Haver Analytics and FRBNY.

Note: Shading shows NBER recessions.

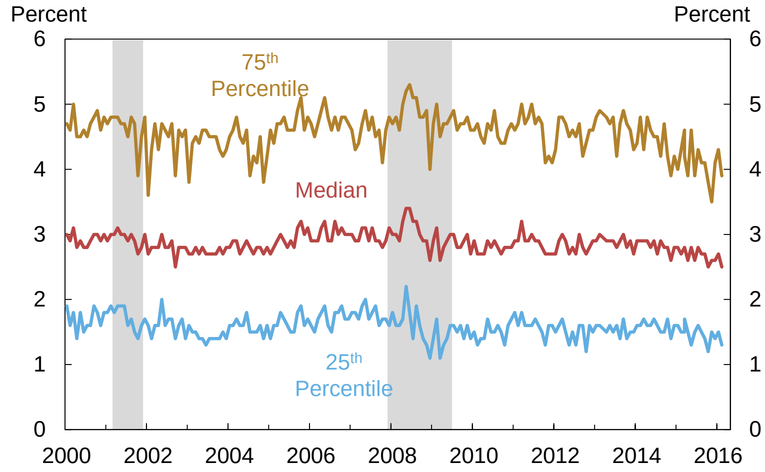
Figure 3 - Inflation Expectations

FRBNY SCE: 3-Year-Ahead Inflation Expectations



Source: Survey of Consumer Expectations, FRBNY

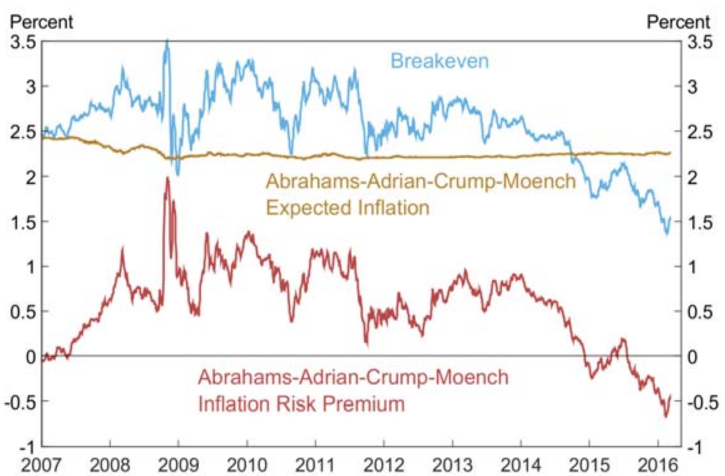
Michigan Survey: Inflation Expectations 5 to 10 Years



Source: University of Michigan

Note: Shading shows NBER recessions.

5-10 Year Inflation Compensation Decomposition

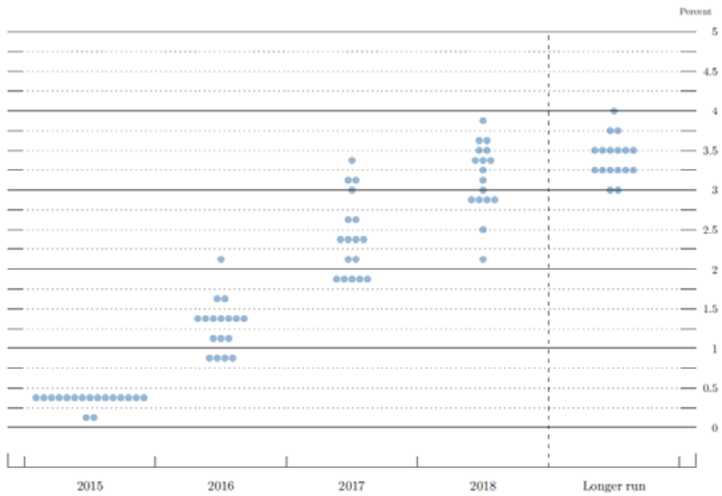


Source: NY Fed Calculations, Federal Reserve Board.

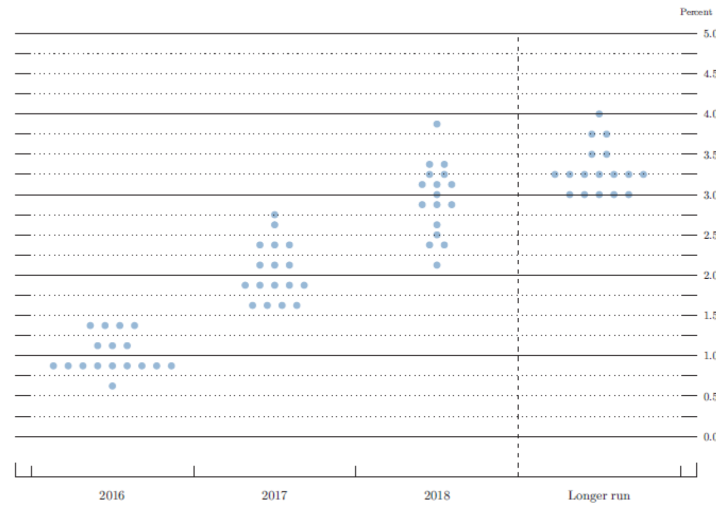
Note: 5-day moving average, Zero-coupon yield.

Figure 4 - FFR Target Expectations: SEP, Markets, Model-Implied

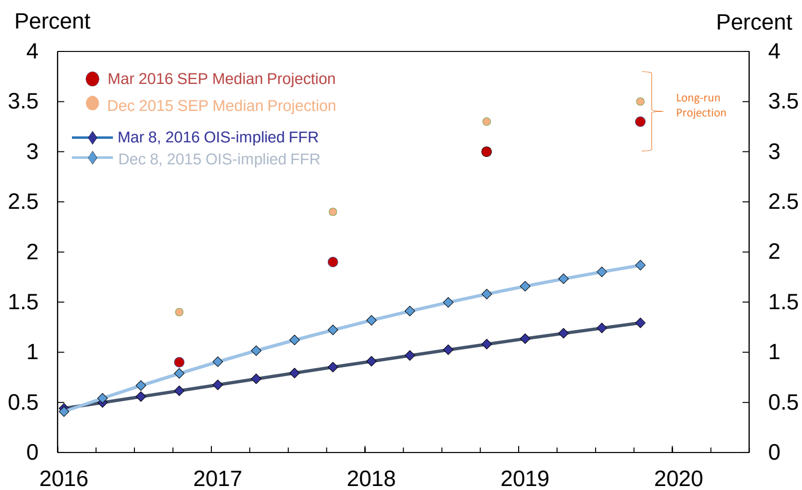
Federal Fund Rate Projections: **Dec. 2015 SEP**



Federal Fund Rate Projections: **March 2016 SEP**

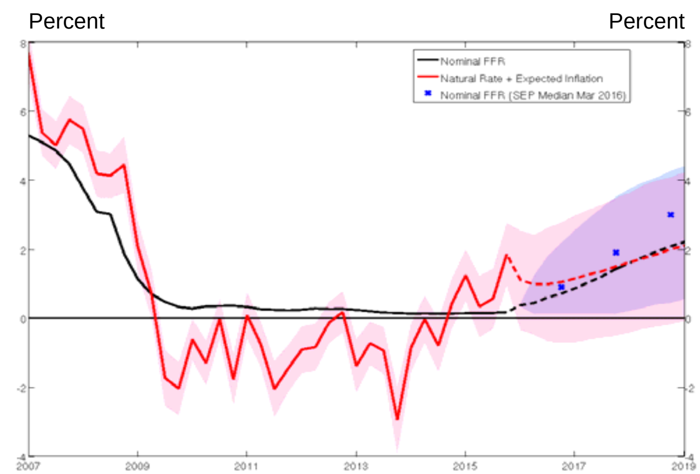


Market-Implied Path of FFR vs. SEP Dots



Source: FRBNY and Federal Reserve Board

DSGE Model FFR and 'Natural' FFR Paths vs. SEP Dots



Source: FRBNY