



OF THE *EAST BAY*

FPA of the East Bay  
Chapter Breakfast Meeting  
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# U.S. Monetary Policy & National Economic Outlook

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# OVERVIEW

- 1. Current national economic situation & outlook**
- 2. Goals and tools of U.S. monetary policy**
- 3. Recent monetary policy actions:**
  - Large scale asset purchases (LSAPs)
  - Forward policy guidance

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# CURRENT NATIONAL ECONOMIC SITUATION

- Growth remains moderate, but steady acceleration is expected in 2013.
- There is improvement in the labor market, but it has been slow over the past two years. Substantial labor market slack is expected to remain into 2016 and perhaps beyond.
- Inflation has been subdued and is expected to remain below the Fed's 2% target over the next few years.

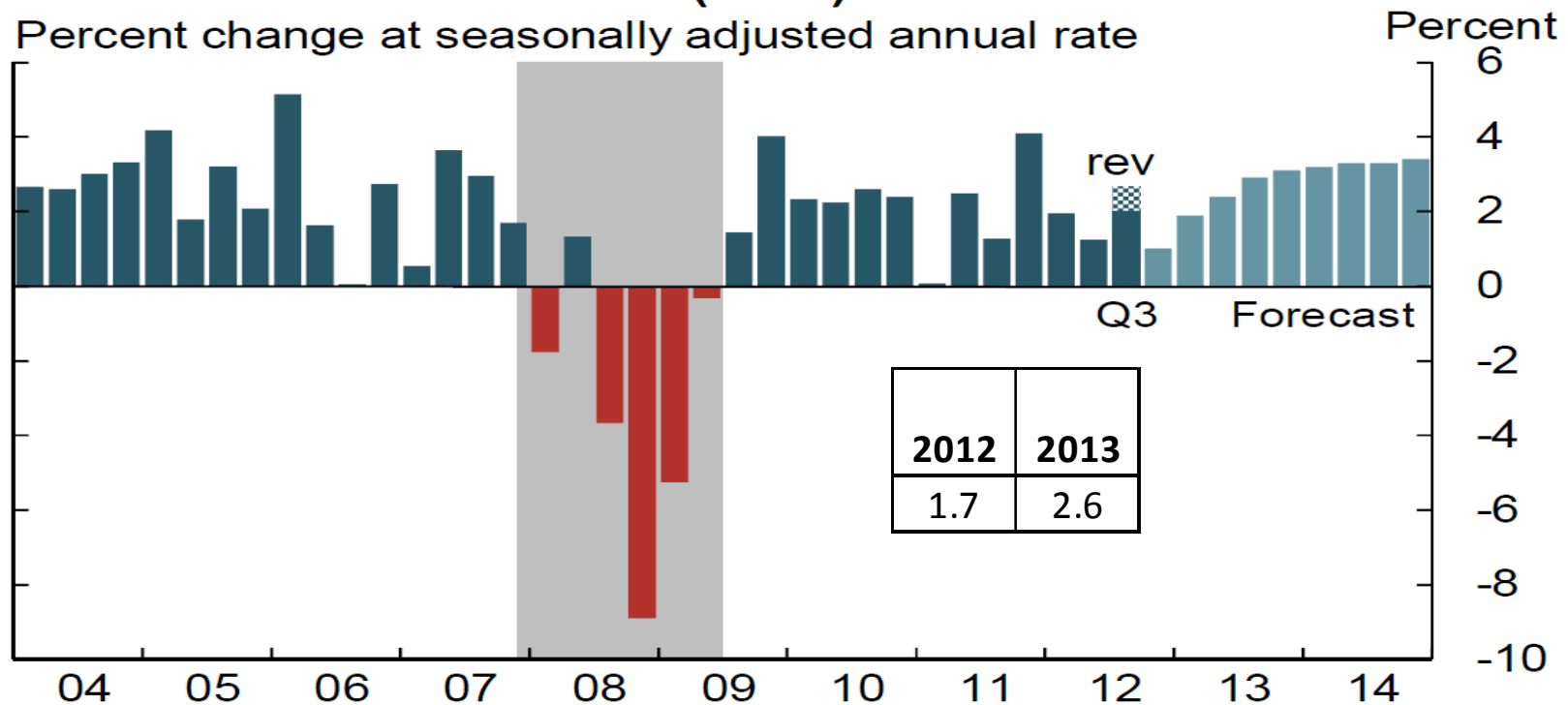


# NATIONAL ECONOMIC OUTLOOK: FRBSF PROJECTIONS FOR REAL GDP (12.13.12)

## GDP uneven, gradual recovery continues

### Gross Domestic Product (GDP)

Percent change at seasonally adjusted annual rate



Source: BEA and FRBSF staff.

Source: *FedViews*, December 13, 2012

<http://www.frbsf.org/publications/economics/fedviews/index.php>

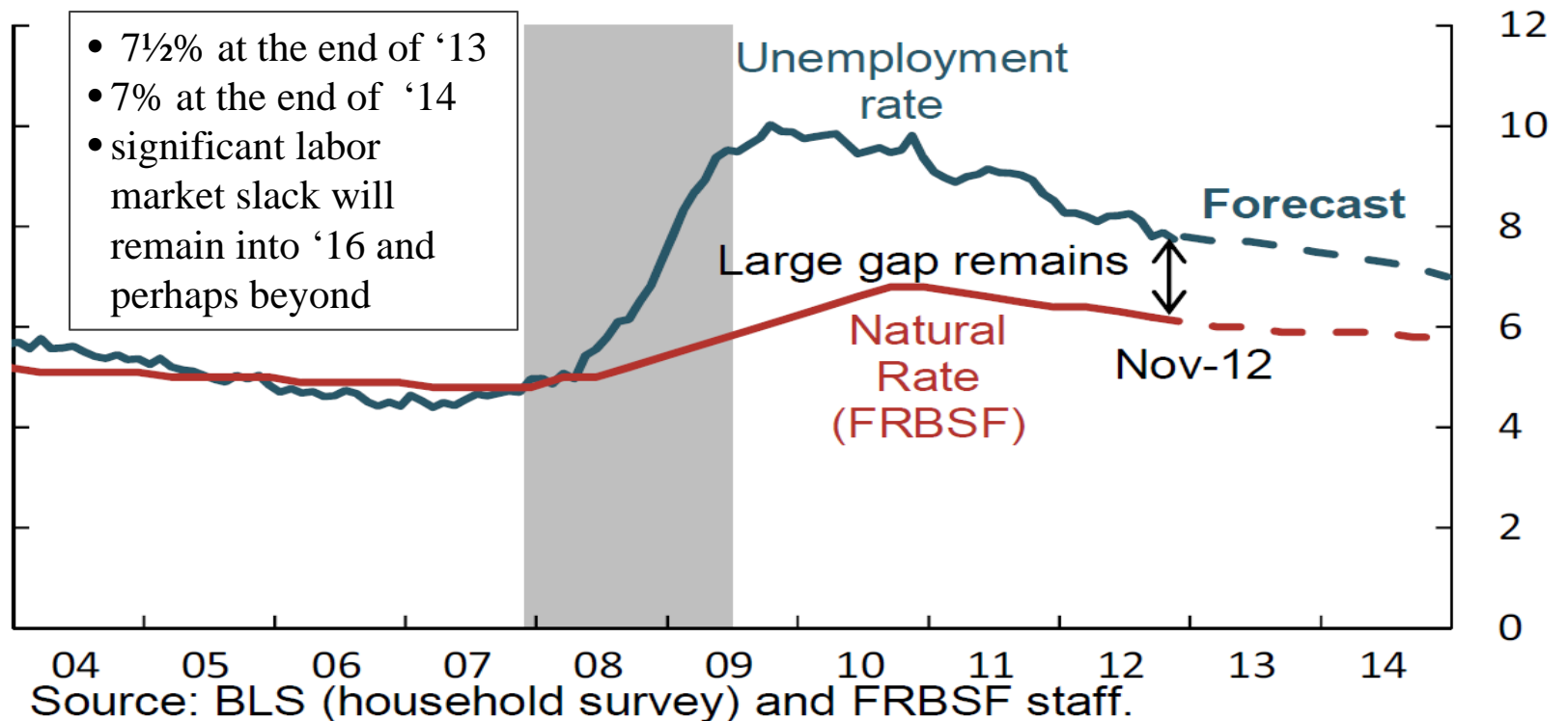
# NATIONAL ECONOMIC OUTLOOK:

## FRBSF PROJECTIONS FOR UNEMPLOYMENT RATE (12.13.12)

### Persistent unemployment gap

#### Unemployment rate

Monthly observations (sa); forecast is quarterly average



Source: *FedViews*, December 13, 2012

<http://www.frbsf.org/publications/economics/fedviews/index.php>



# NATIONAL ECONOMIC OUTLOOK: FRBSF PROJECTIONS FOR PCE INFLATION (12.13.12)

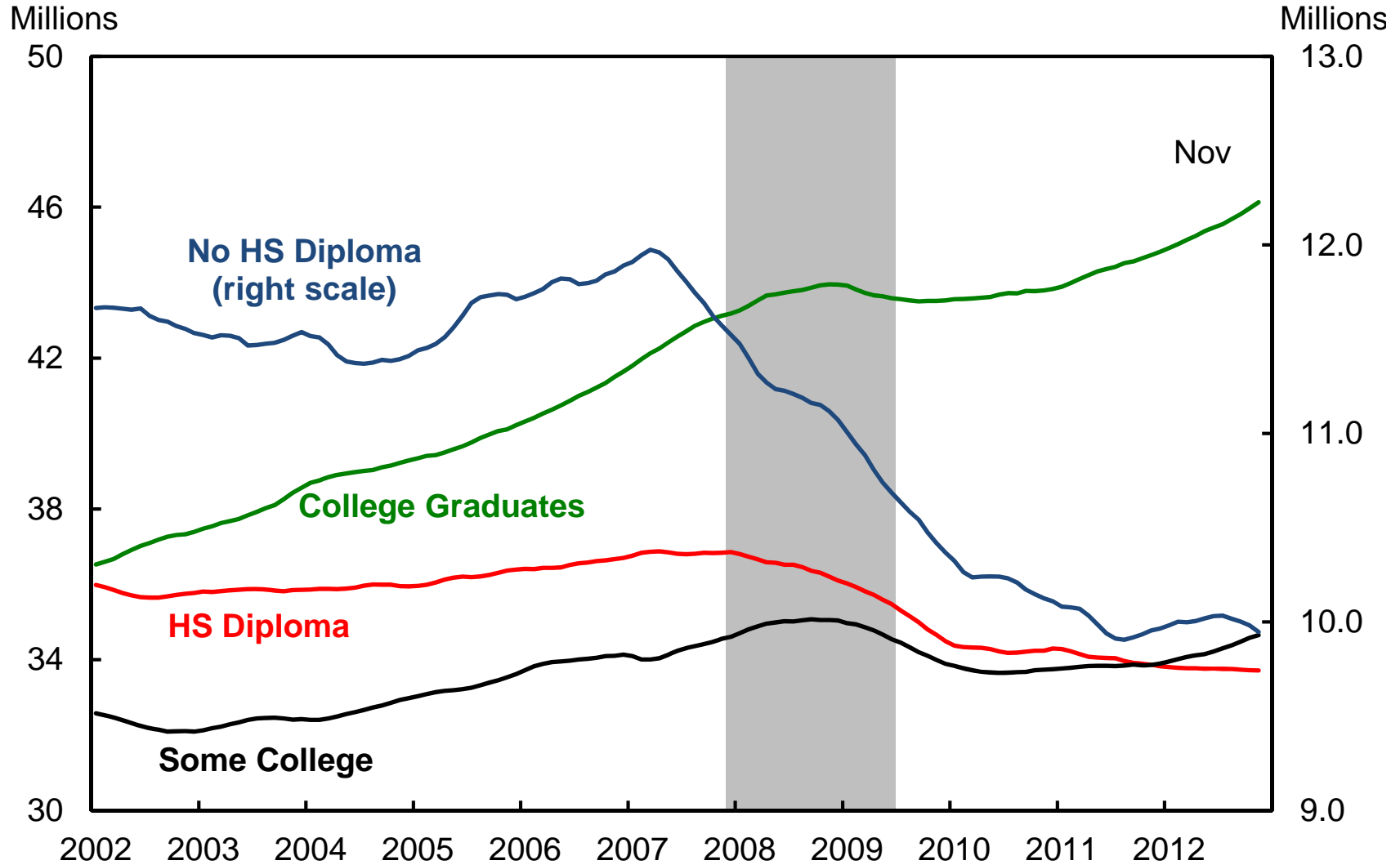


Source: *FedViews*, December 13, 2012  
<http://www.frbsf.org/publications/economics/fedviews/index.php>

# JOB GROWTH MAINLY FOR THE HIGHLY EDUCATED

## Employment by educational attainment

12-month moving average; seasonally adjusted

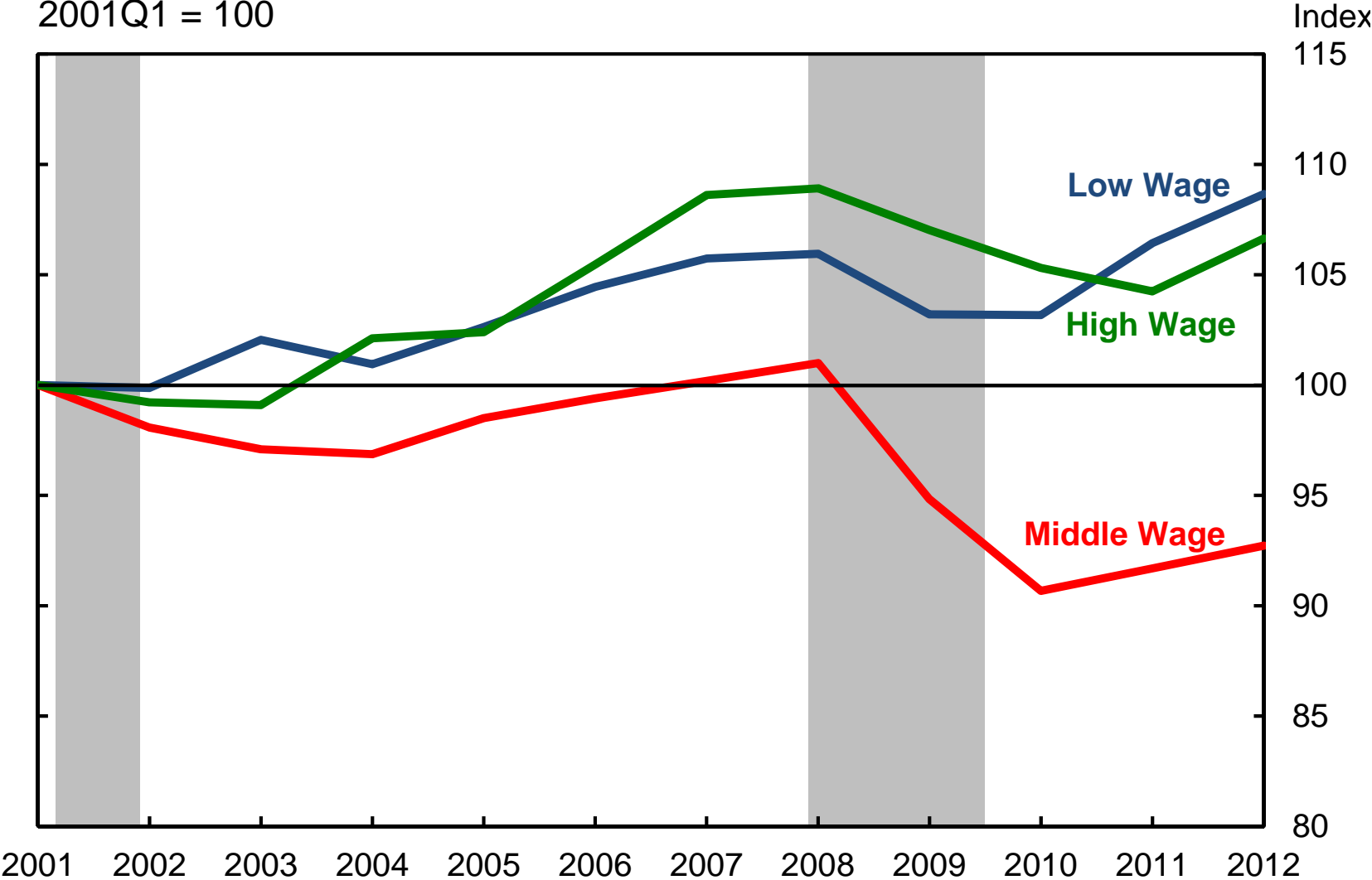


Source: Bureau of Labor Statistics (household survey). Restricted to individuals age 25 or older.

# OCCUPATIONS: HIGH/LOW WAGE EMPLOYMENT GROWING

## Employment Levels by Occupation Group

2001Q1 = 100



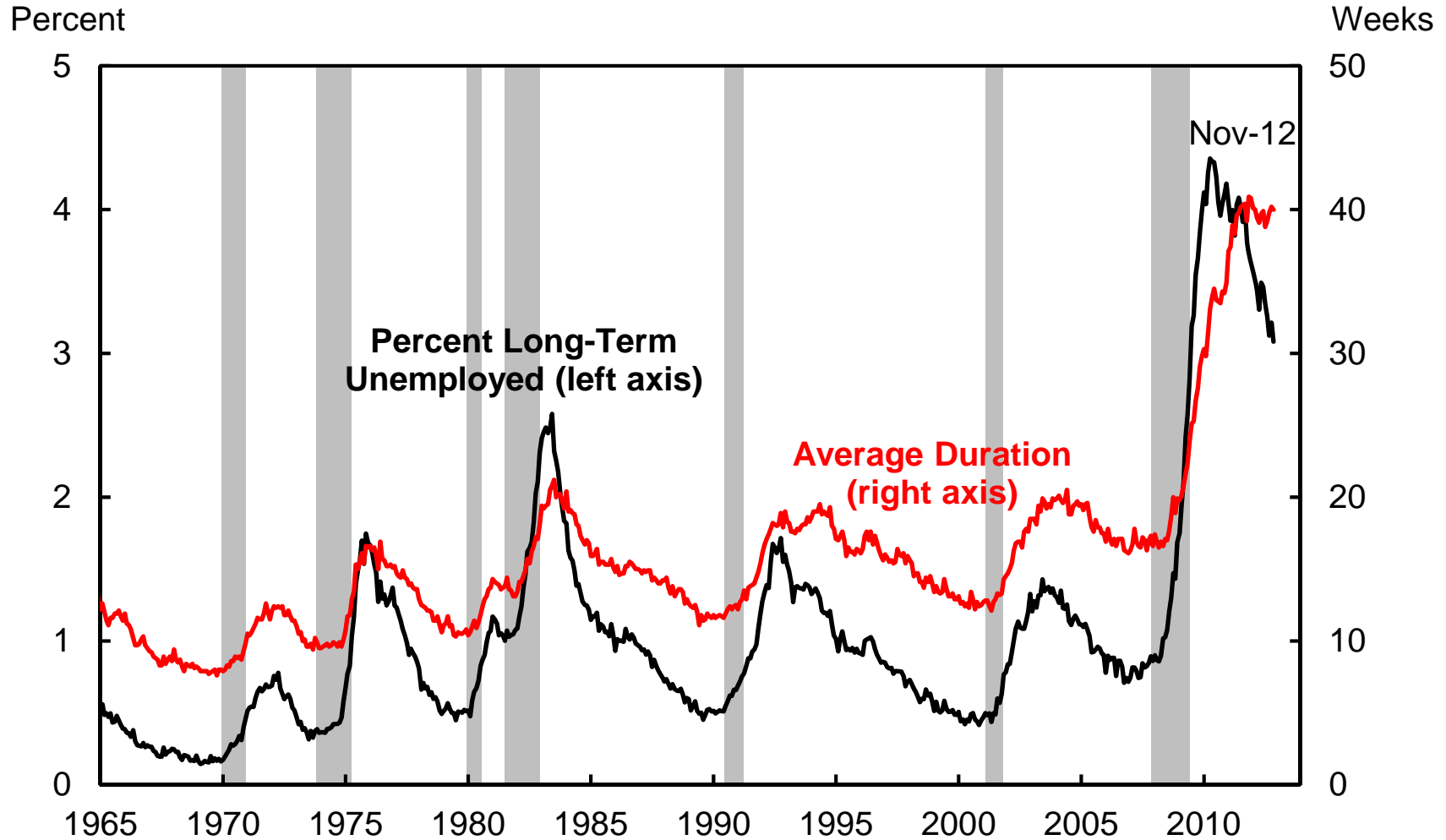
Source: Based on Figure 3 in "The Low-Wage Recovery and Growing Inequality," NELP Data Brief, August 2012. Data through 2012Q1.



# LONG-TERM UNEMPLOYMENT: STRUCTURAL?

## Measures of unemployment duration

Seasonally adjusted

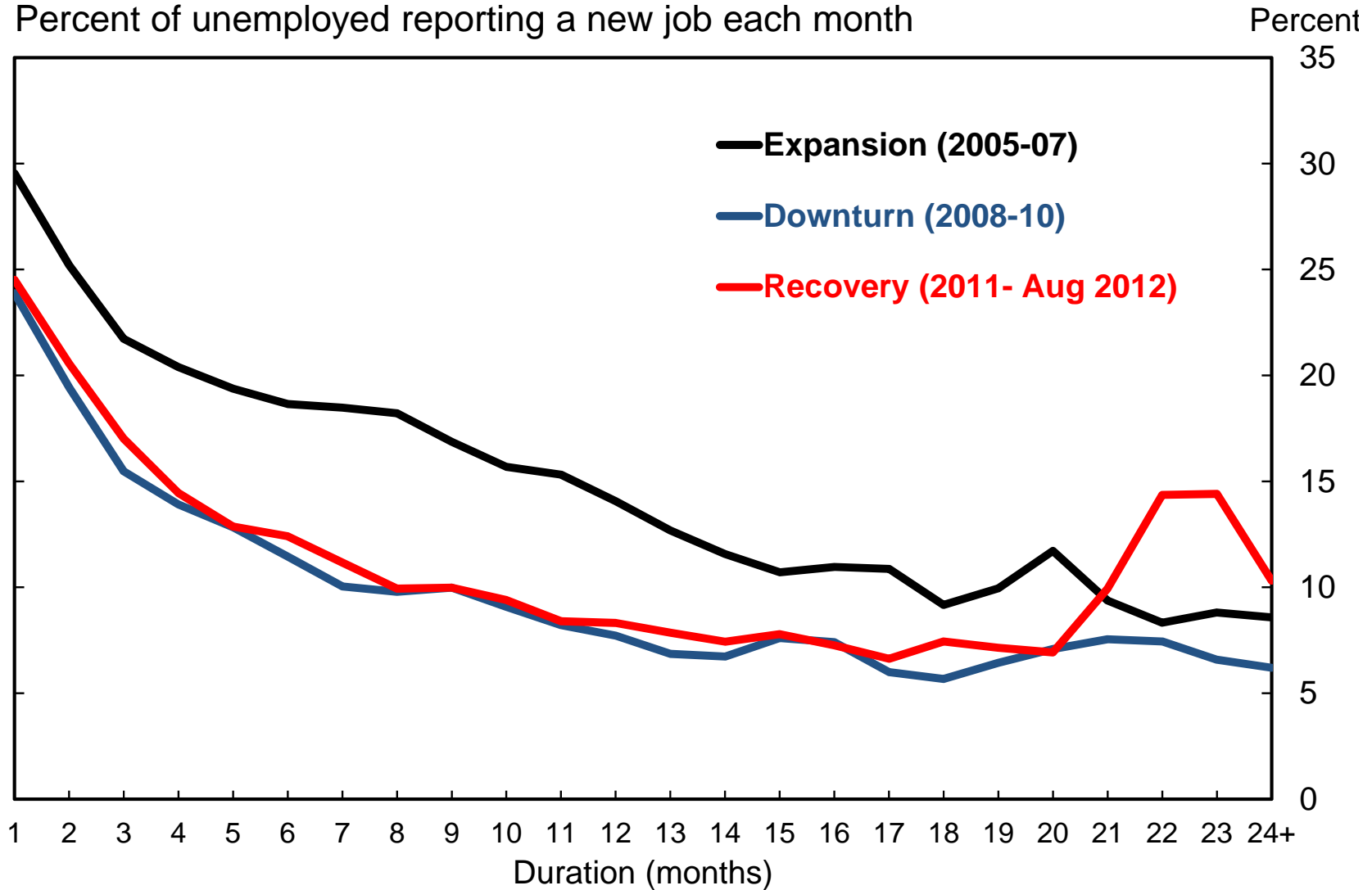


Source: Bureau of Labor Statistics (household survey) and FRBSF calculations. Percent long-term unemployed is the number unemployed for >6 months as a share of the labor force.

# LONG-TERM UNEMPLOYED: IMPROVED PROSPECTS

## Job Finding Rates, by Unemployment Duration

Percent of unemployed reporting a new job each month



Source: FRBSF calculations (smoothed) using matched monthly CPS microdata (corrected).

# **U.S. MONETARY POLICY GOALS**

**Congress has set these two monetary policy goals for the Fed:**

- 1) Promote maximum sustainable output and employment**
- 2) Promote stable prices**

# INTERMEDIATE POLICY OBJECTIVES

- **Conventional Monetary Policy**
  - Target short-term interest rates
  - Provide liquidity to depository institutions
- **Unconventional Monetary Policy**
  - Influence long-term interest rates more directly
  - Provide liquidity more broadly to the financial system

# TOOLS FOR ACHIEVING INTERMEDIATE POLICY OBJECTIVES

## TOOLS

### Interest Rate Policies:

- **Open market operations (conv.)**  
used in conjunction with paying interest on reserves
- **Large-scale asset purchases (unconv.)**
- **Communications**
  - Transparency
  - Forward guidance

## OBJECTIVES

- **Target federal funds rate**
- **Affect long-term rates more directly**
- **Affect short-term and long-term rates**

### Providing Liquidity:

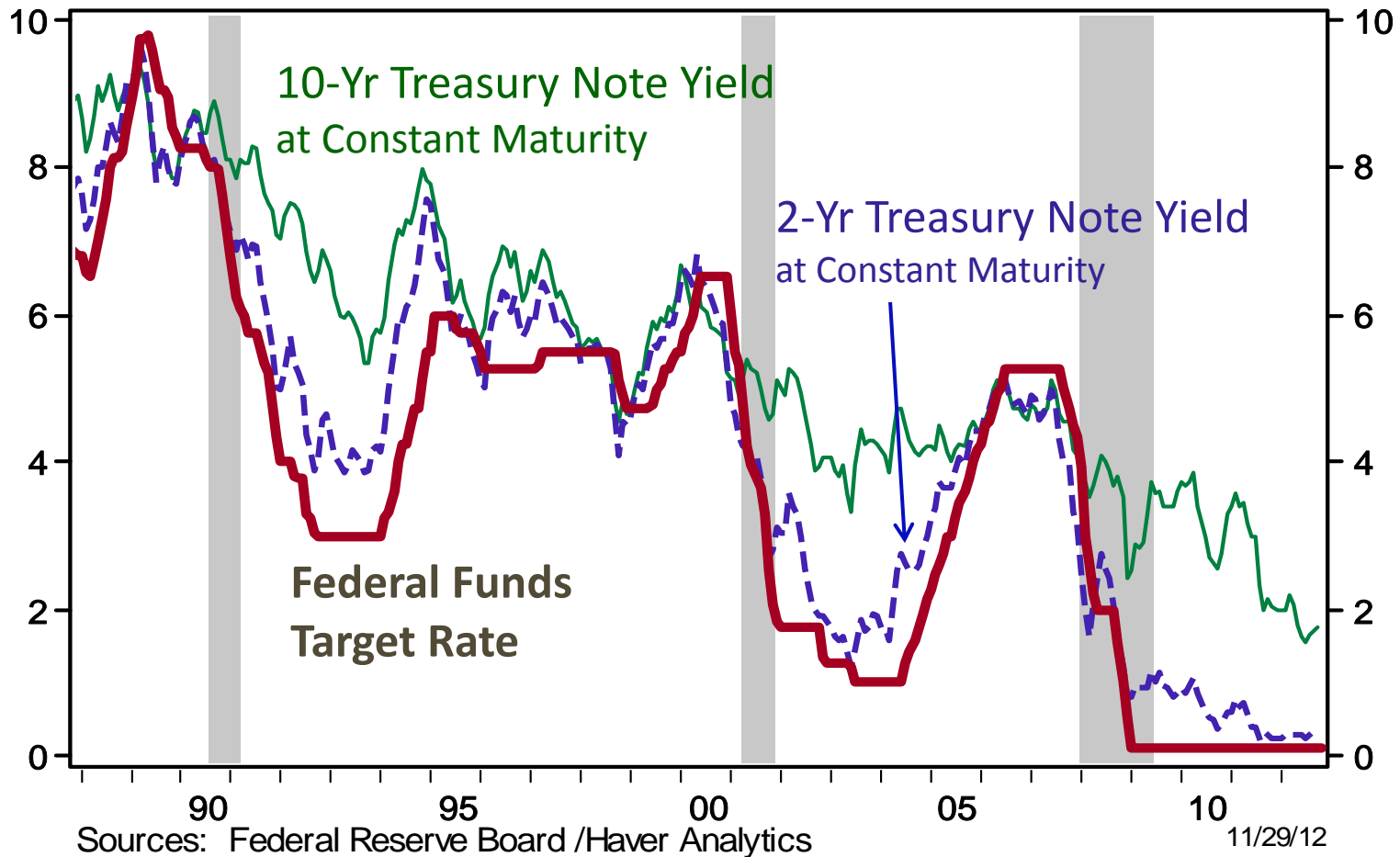
- **Discount window (conv.)**
- **New credit facilities (unconv.)**
- **Provide liquidity to depository institutions**
- **Provide liquidity to the financial system**

# FRAMEWORK FOR THINKING ABOUT MONETARY POLICY TOOLS

**Long-term interest rates are determined by:**

- **Short-term interest rate**
- **Expected short-term interest rates**
- **Term premium** (compensation investors require to hold assets for longer periods of time instead of holding a series of short-term instruments)
  - affected by supply of long-term securities available to the public

# CONVENTIONAL TOOLS OF MONETARY POLICY: TARGET FEDERAL FUNDS RATE (FEEDS THROUGH TO LONGER-TERM RATES)



# MOVING LONG-TERM RATES AT ZERO LOWER BOUND

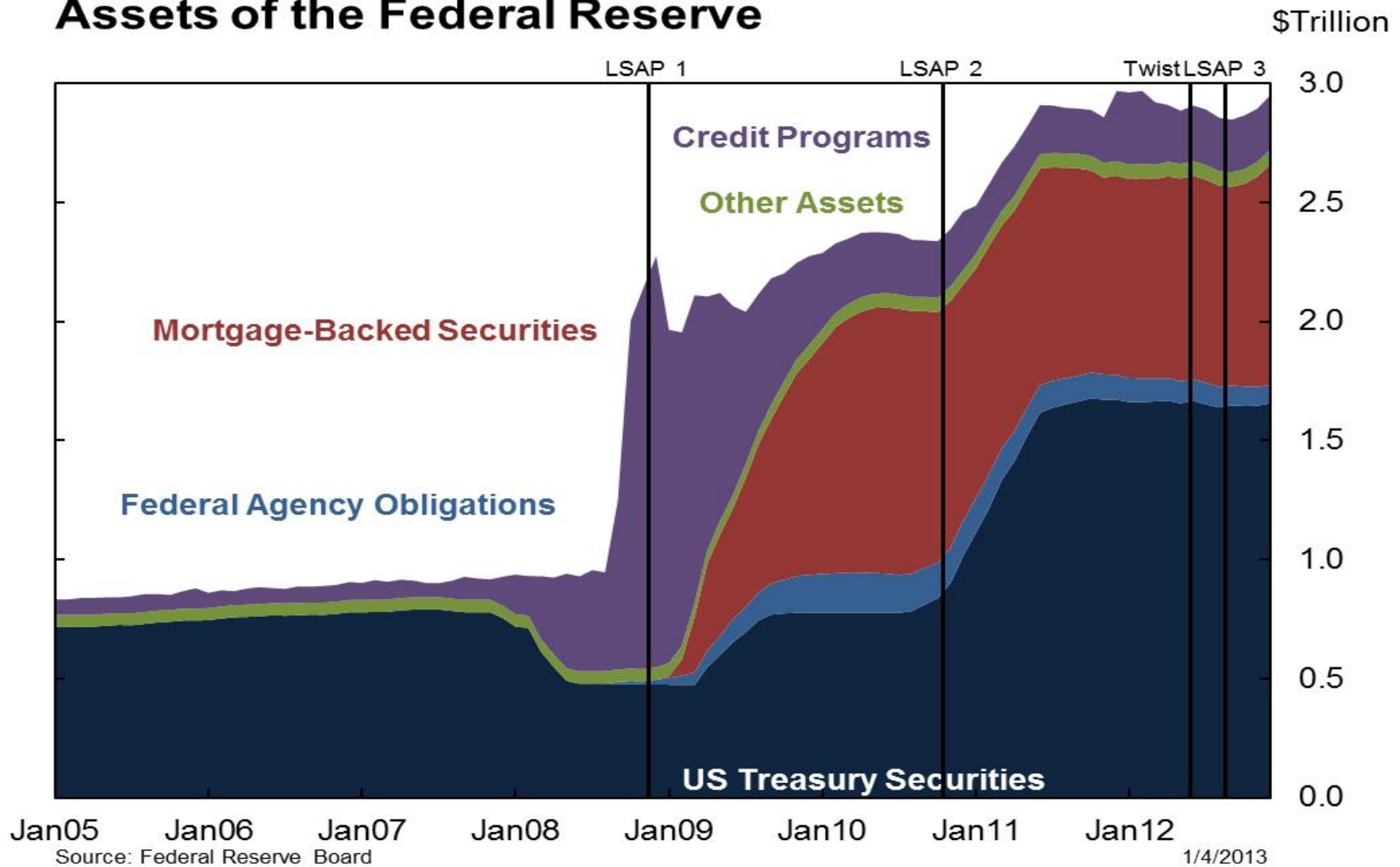
- **Forward Guidance**
  - Affects public interest rate expectations
- **Large Scale Asset Purchases (LSAPs)**
  - *Signaling channel*  
Affects public expectations of short-term interest rates
  - *Portfolio channel*  
LSAPs reduce supply of long-term securities available to the public, reducing term premium

*Note:* The Fed's authority to pay interest on reserves (effective date: October 1, 2008) was a necessary step to facilitate balance sheet policies.



# UNCONVENTIONAL MONETARY POLICY ACTIONS INCREASED THE SIZE AND CHANGED THE COMPOSITION OF THE FEDERAL RESERVE BALANCE SHEET

## Assets of the Federal Reserve



# ESTIMATED EFFECTS OF LARGE SCALE ASSET PURCHASES (LSAPs) & MATURITY EXTENSION PROGRAM (MEP)

- **LSAP1:** \$1.7 trillion purchases of Treasury and agency securities reduced yield on 10-year Treasury securities by between 40 and 110 basis points.
- **LSAP2:** \$600 billion in Treasury purchases lowered 10-year Treasury yield by 15 to 45 basis points  
Gagnon et al (2011), D'Amico and King (2010), Hamilton and Wu (2012), Swanson (2011), Wright (2012), Krishnamurthy and Vissing-Jørgensen (2012)
- **MEP:** Likely similar to LSAP2
- **QE3:** More challenging to estimate because it is open ended; had a large impact effect on MBS rates.
- **Effects on real economy more difficult to estimate**

# *Transparency and Forward Guidance: New Initiatives*

## **1. Funds rate guidance**

- Aug 2011 statement: “at least through mid-2013”
- Jan 2012 statement: “at least through late 2014”
- Sept 2012 statement: “at least through mid-2015”
- **Dec 2012 statement: calendar date-based guidance replaced with numerical thresholds for unemployment rate and inflation**

## **2. Statement of FOMC’s longer-run goals and policy strategy (1/2012)**

- Inflation target of 2 percent
- Estimates of the longer-run normal rate of unemployment with a central tendency of 5.2 to 6 percent

## **3. Quantitative guidance regarding FOMC expectations for future monetary policy (1/2012)**

## **4. LSAP 3 was announced (9/2012)**

- Open ended
- Contingent on labor market conditions and inflation

## FORWARD GUIDANCE: INTRODUCTION OF NUMERICAL THRESHOLDS (“6<sup>1</sup>/<sub>2</sub> 2<sup>1</sup>/<sub>2</sub> POLICY”) ON 12/12/12

...To support continued progress toward maximum employment and price stability, the Committee expects that a **highly accommodative stance of monetary policy will remain appropriate for a considerable time** after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate **at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored...**

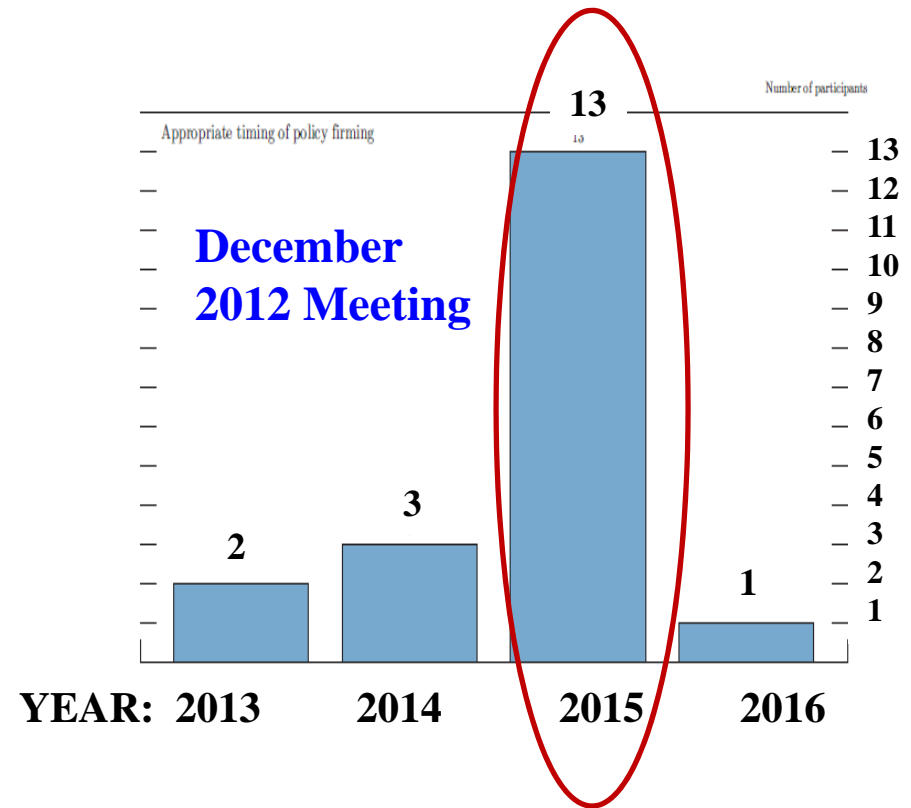
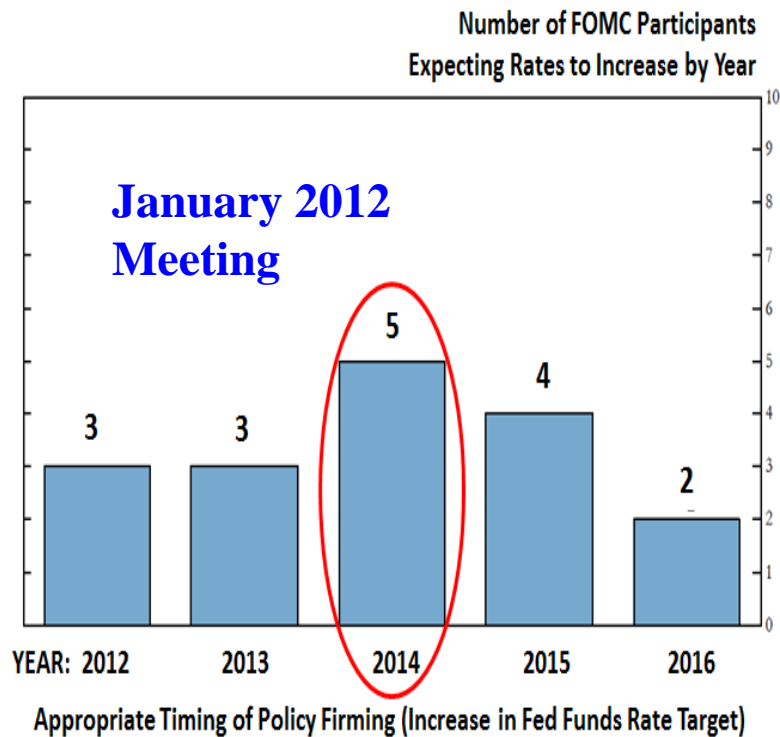
# FORWARD GUIDANCE CHANGE: KEY TAKEAWAYS

## (SEE CHAIRMAN BERNANKE'S PRESS CONFERENCE OF 12/12/12)

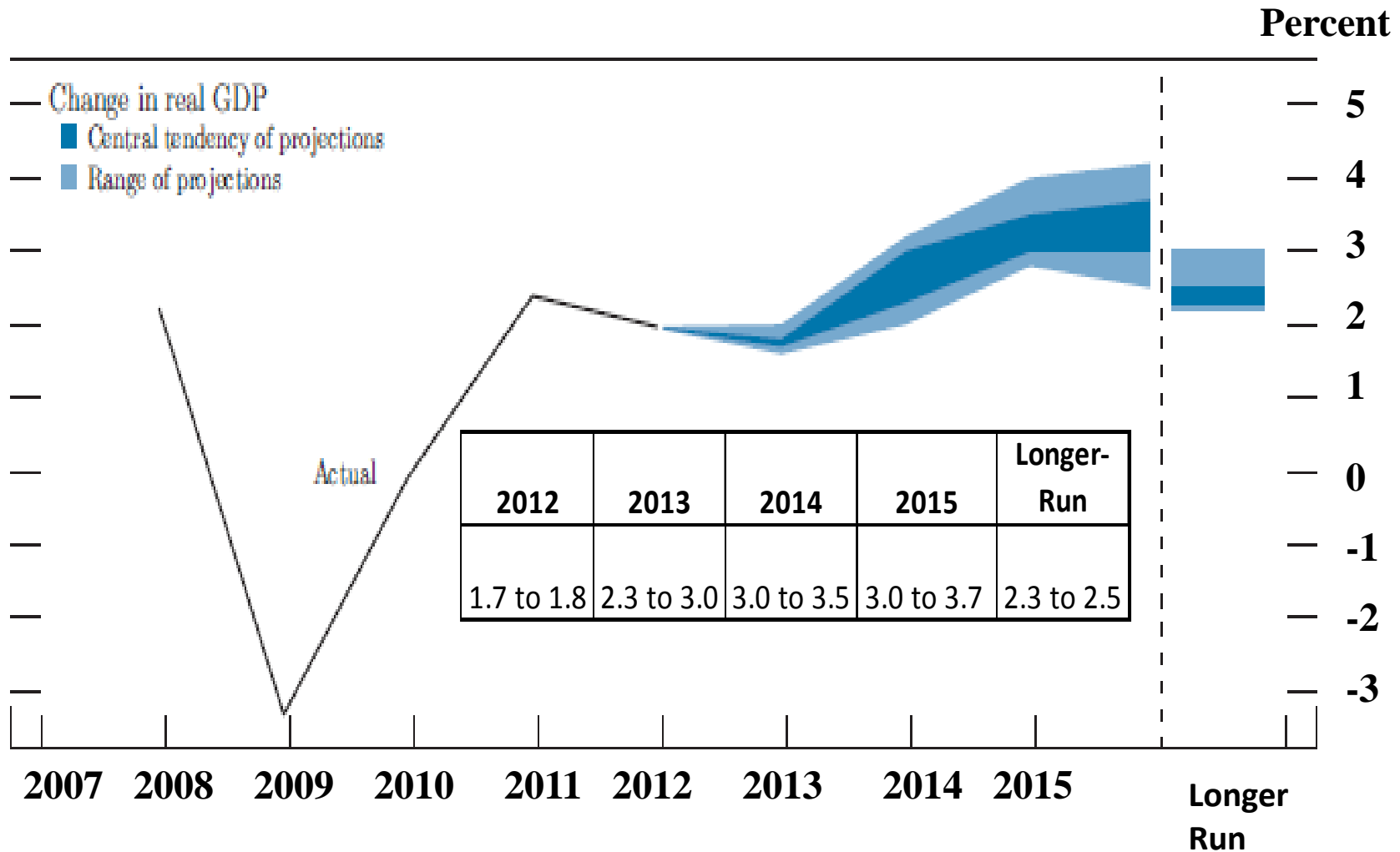
1. 6<sup>1</sup>/<sub>2</sub> percent threshold for unemployment is not the FOMC's longer-term objective for unemployment.
2. Reaching one of the thresholds does not automatically trigger immediate reduction in policy accommodation.
3. No single indicator provides a complete assessment of the state of the labor market; changes in the unemployment rate will be considered in the broader context of labor market conditions.
4. Inflation threshold is expressed in terms of *projected inflation* 1-2 years ahead rather than current inflation.
5. FOMC will continue to monitor a wide range of information on economic and financial developments to ensure that policy is conducted in a manner consistent with the dual mandate.

<http://www.federalreserve.gov/monetarypolicy/fomcpresconf20121212.htm>

# QUANTITATIVE GUIDANCE REGARDING FOMC EXPECTATIONS FOR FUTURE MONETARY POLICY

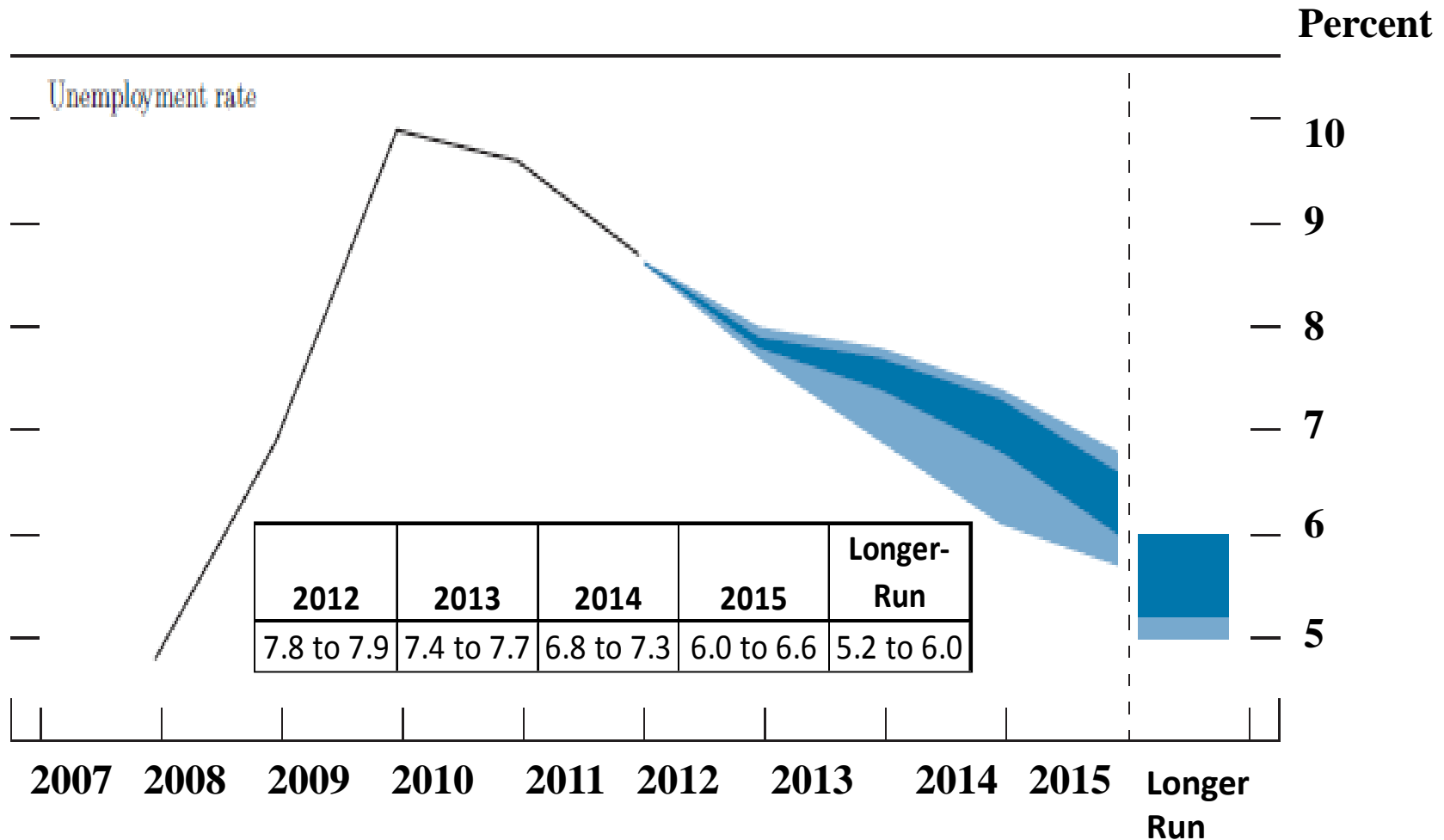


# NATIONAL ECONOMIC OUTLOOK: FOMC PROJECTIONS FOR REAL GDP (12.12.12)



Source: Economic Projections of the Federal Reserve Board Members and Federal Reserve Bank Presidents, December 12, 2012 (<http://www.federalreserve.gov/monetarypolicy/files/fomcprojt20121212.pdf>)

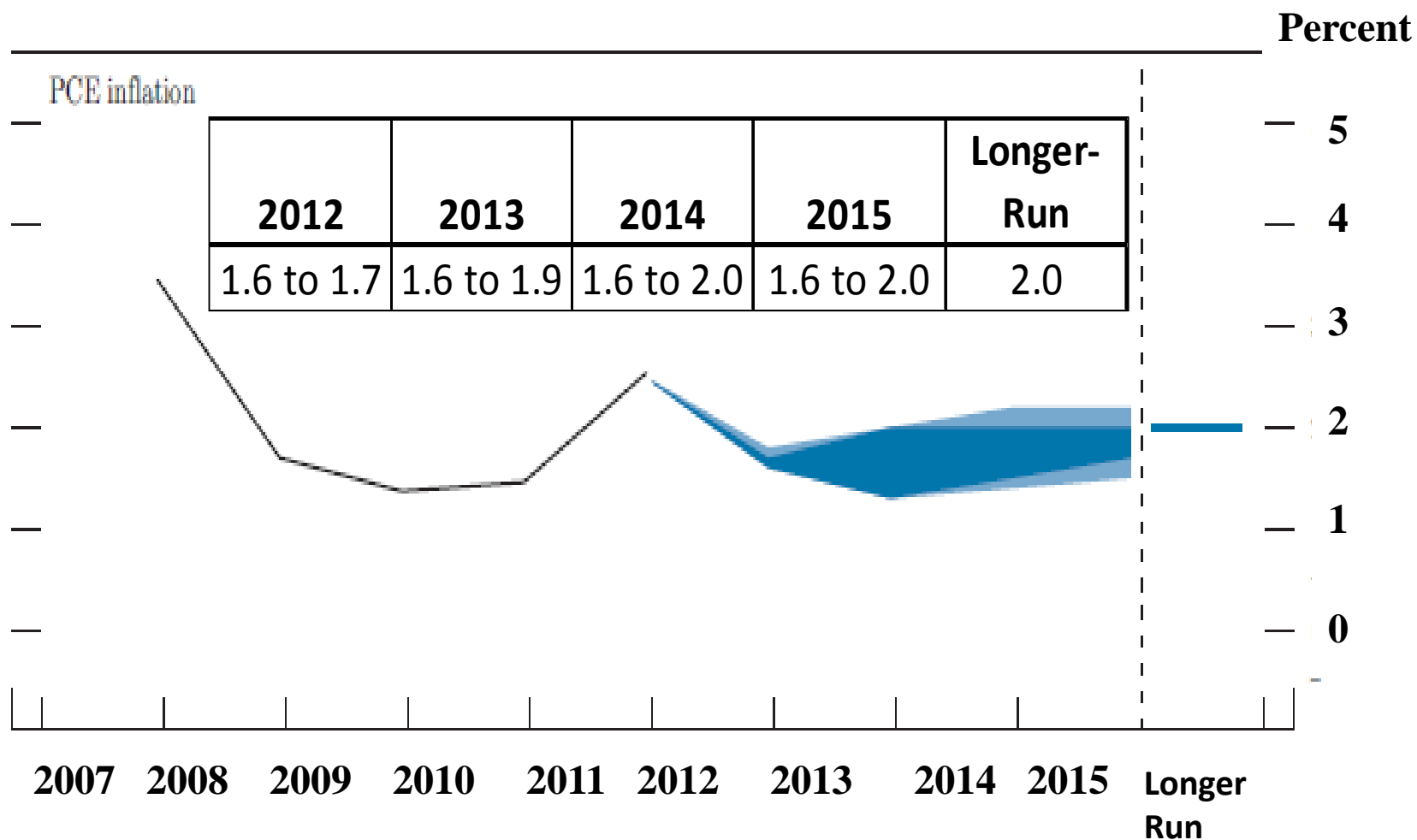
# NATIONAL ECONOMIC OUTLOOK: FOMC PROJECTIONS FOR UNEMPLOYMENT RATE (12.12.12)



Source: Economic Projections of the Federal Reserve Board Members and Federal Reserve Bank Presidents, December 12, 2012 (<http://www.federalreserve.gov/monetarypolicy/files/fomcproptabl20121212.pdf>)



# NATIONAL ECONOMIC OUTLOOK: FOMC PROJECTIONS FOR PCE INFLATION (12.12.12)



Source: Economic Projections of the Federal Reserve Board Members and Federal Reserve Bank Presidents, December 12, 2012 (<http://www.federalreserve.gov/monetarypolicy/files/fomcprojt20121212.pdf>)

# SUMMARY

- **National Economy:**
  - Moderate growth in 2013
  - Gradual decline in the unemployment rate
  - Large degree of labor market slack to persist at least through 2015
  - Inflation to remain below the Federal Reserve's target of 2% over the next few years
- **Monetary Policy:** against a macroeconomic backdrop that includes high unemployment and high inflation, the FOMC will maintain its highly accommodative policy