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The Federal Reserve's Framework for Monetary Policy—Recent Changes and New Questions

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Outline

- Changes to the Federal Reserve's monetary policy framework
 - Greater clarity regarding objectives and strategy
 - Nontraditional policy tools
- Additional questions
 - Value of alternative objectives?
 - Monetary policy and financial stability?



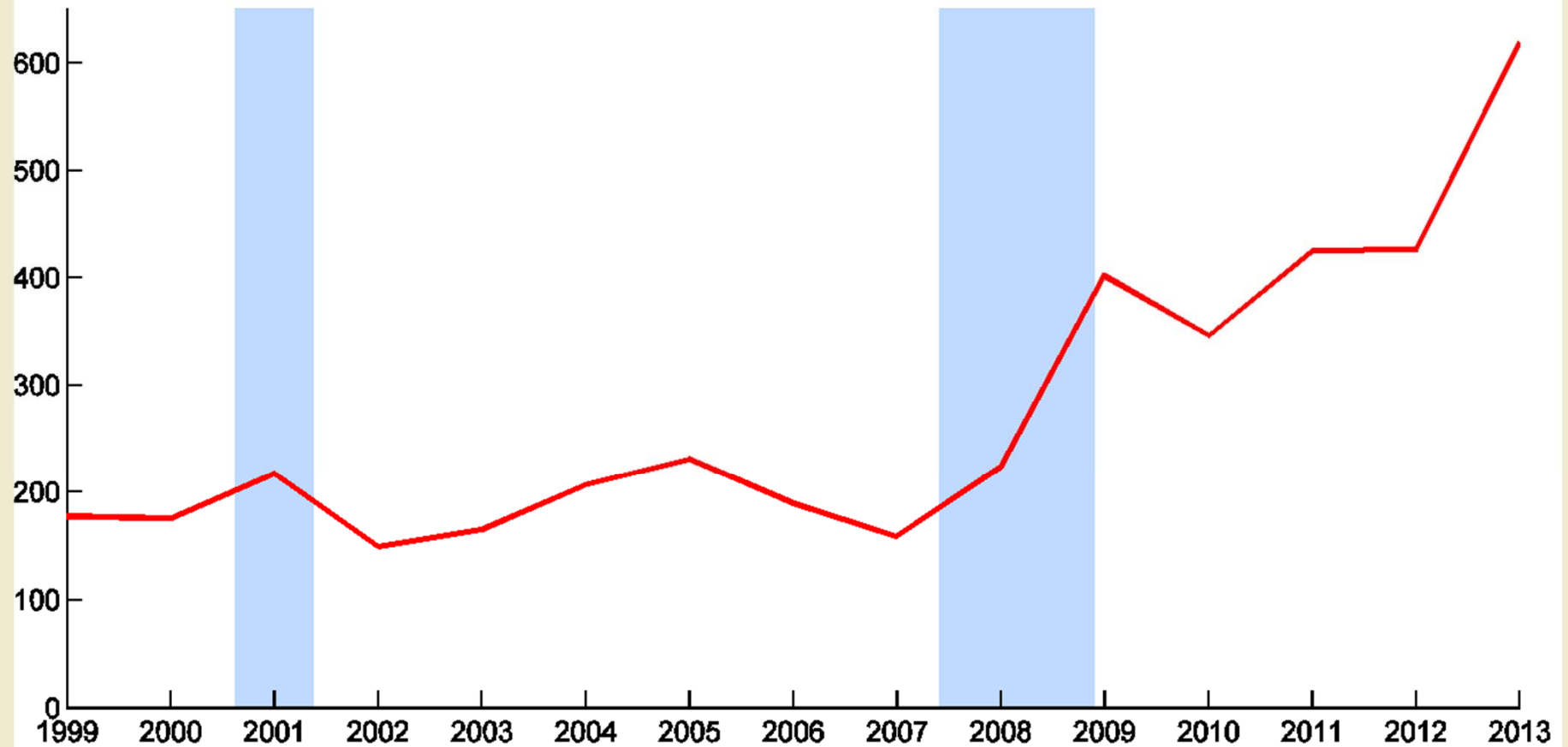
Greater Clarity Regarding Objectives and Strategy

Table 1. Recent Innovations in Federal Reserve Communications Regarding Monetary Policy Objectives and Strategy

<u>Date</u>	<u>Innovation</u>
December 2005	Minutes publication lag reduced to three weeks
November 2007	Summary of Economic Projections (SEP)
January 2009	Addition of longer-run projections to the SEP
April 2011	Post-meeting press conferences
January 2012	Addition of federal funds rate to the SEP
January 2012	Statement on Longer-Run Goals and Policy Strategy



Figure 1
Number of Words in FOMC Press Releases
(Average per release, by year)





Nontraditional Policy Tools

- Forward guidance
- Large-scale asset purchases



Forward Guidance

- Qualitative forward guidance
- Date-based forward guidance
- State-based forward guidance
 - In current circumstances, thresholds can help improve economic outcomes relative to simple rules



Figure 2
Implications of alternative unemployment threshold values
 (Inertial Taylor rule; Baseline conditions)

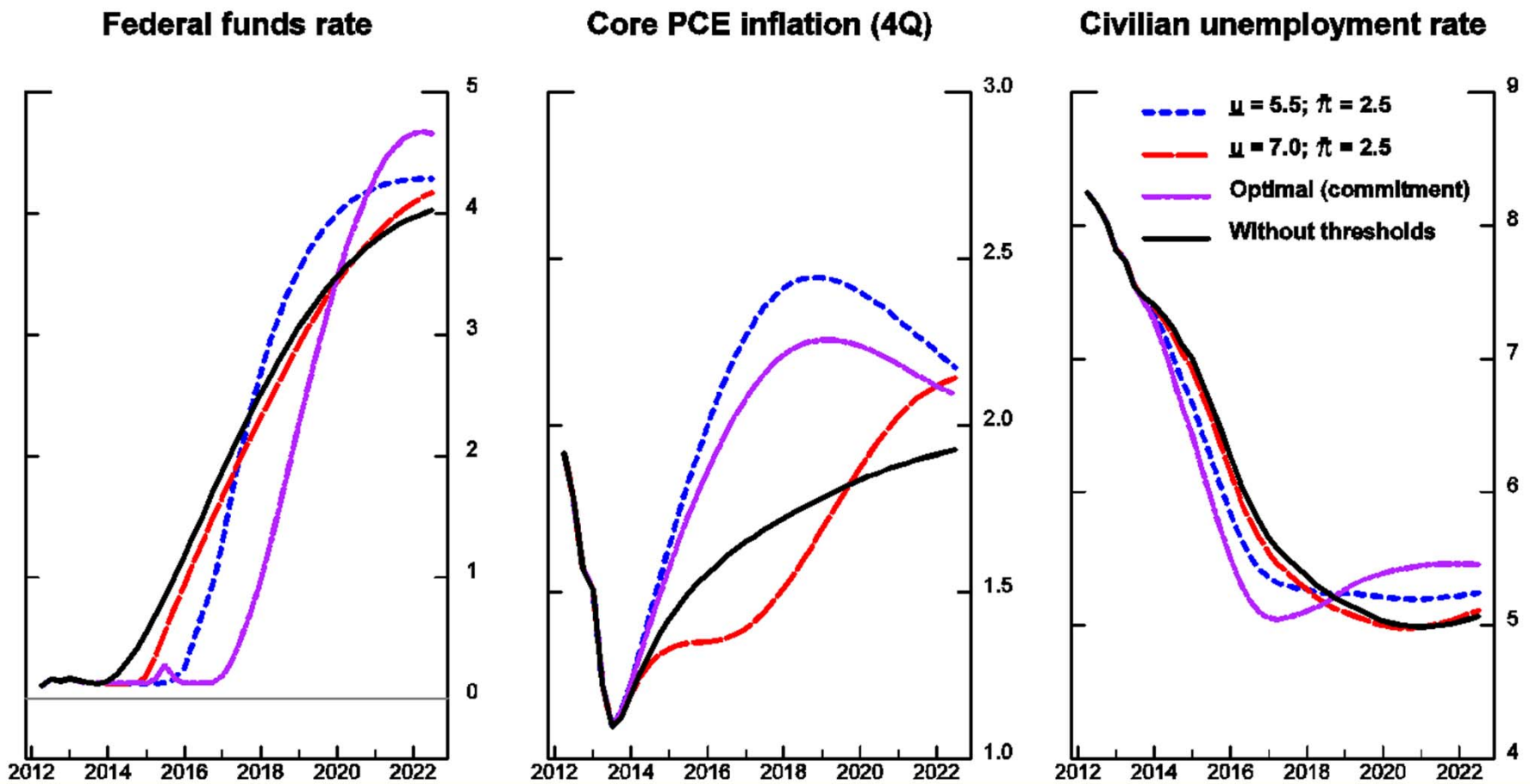




Figure 3
Probability of liftoff from the effective lower bound by calendar date
(Stochastic simulations under inertial Taylor (1999) rule, with and without thresholds)

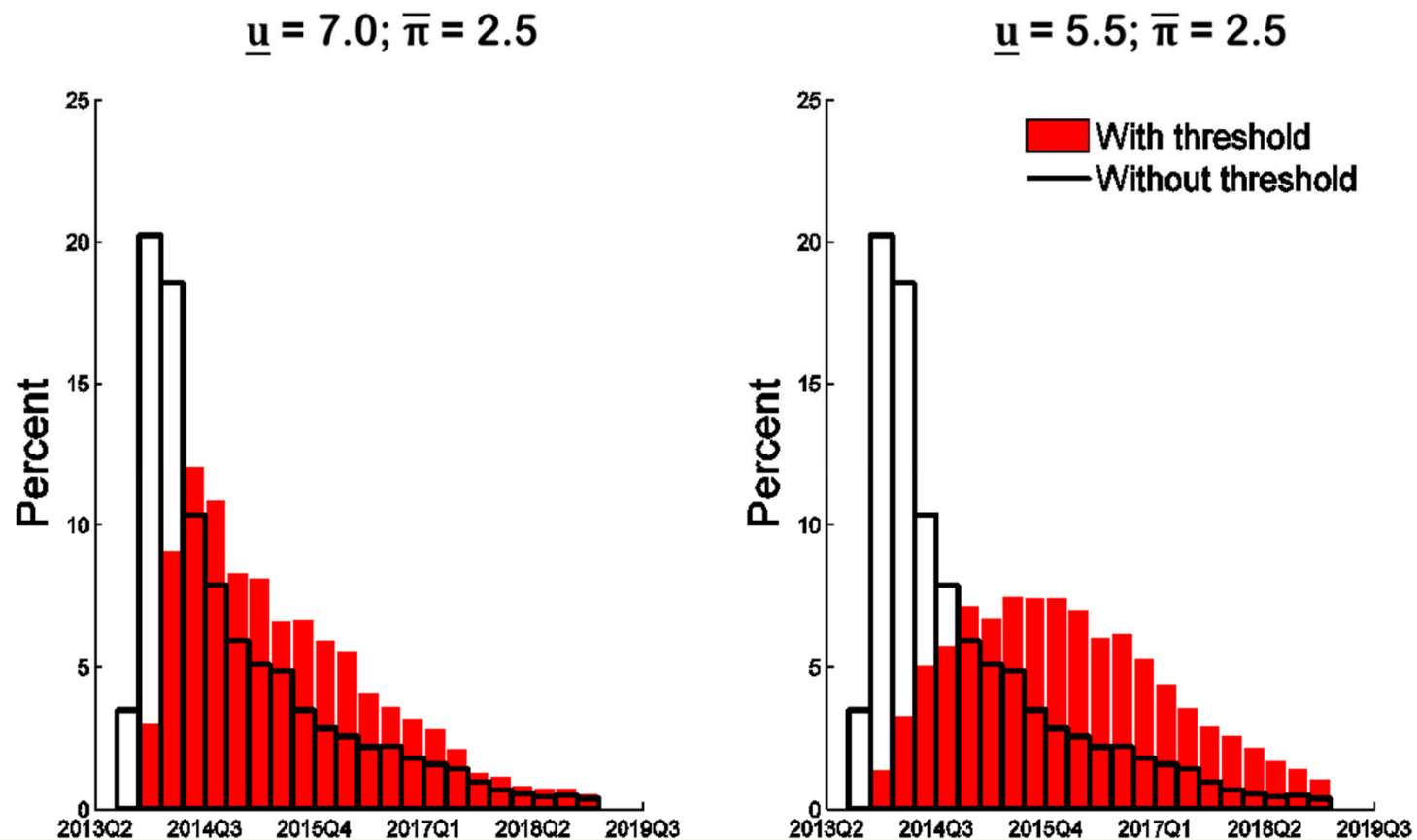
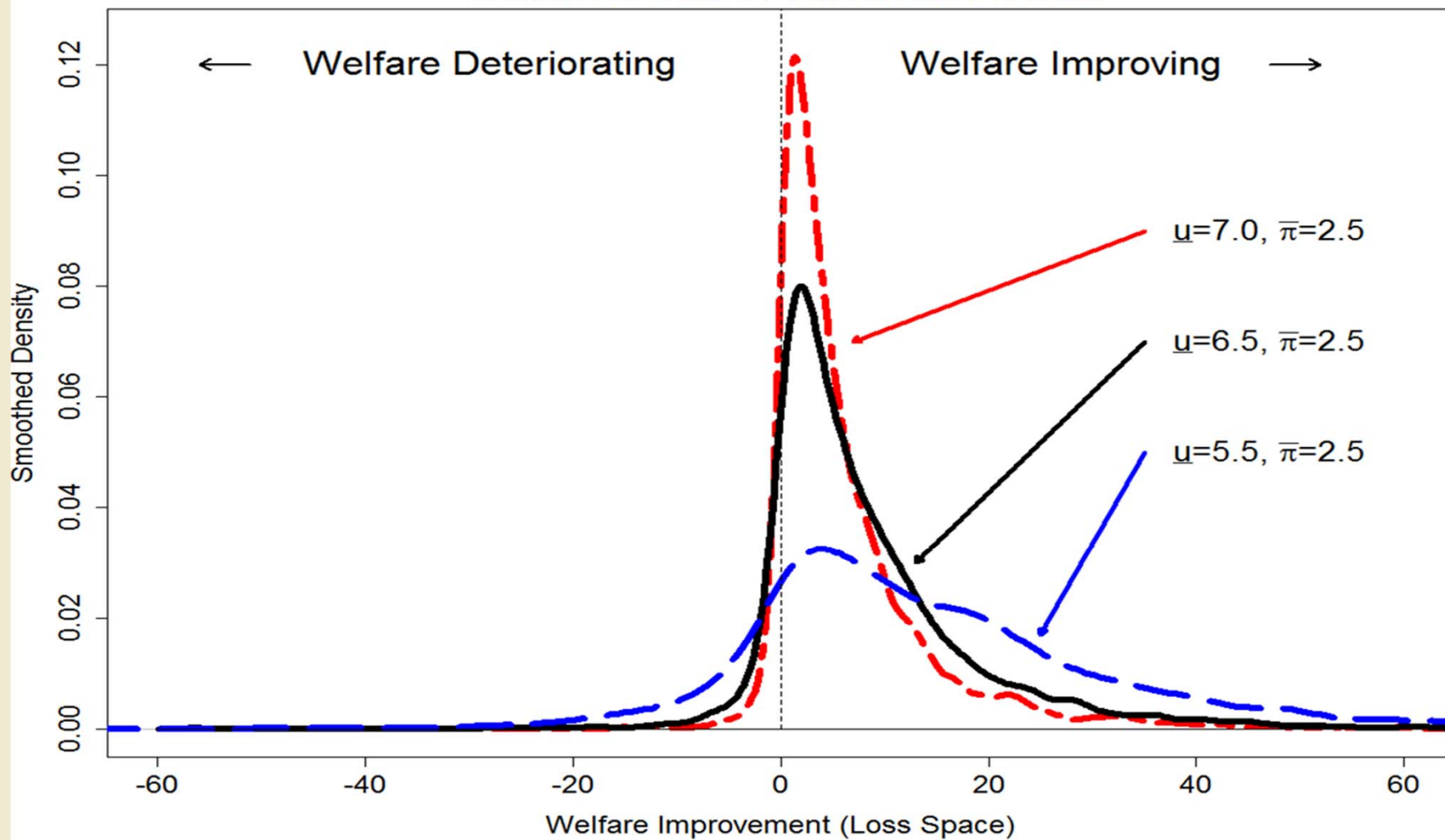




Figure 4
Welfare Effects of Threshold Policies





Strong Assumptions:

- Rational expectations
- Thresholds understood
- Credibility
- Model uncertainty



Large-scale Asset Purchases

- Simple, static model
 - Benefits of purchases depend on their efficacy and the economic outlook
 - Costs are increasing in purchases



Large-scale Asset Purchases (contd.)

- Model suggests that:
 - Purchases need to take account of efficacy and costs
 - Uncertainty makes it difficult to be clear about the economic outcomes that will guide purchases
 - Policymakers may learn over time about the efficacy and costs of purchases



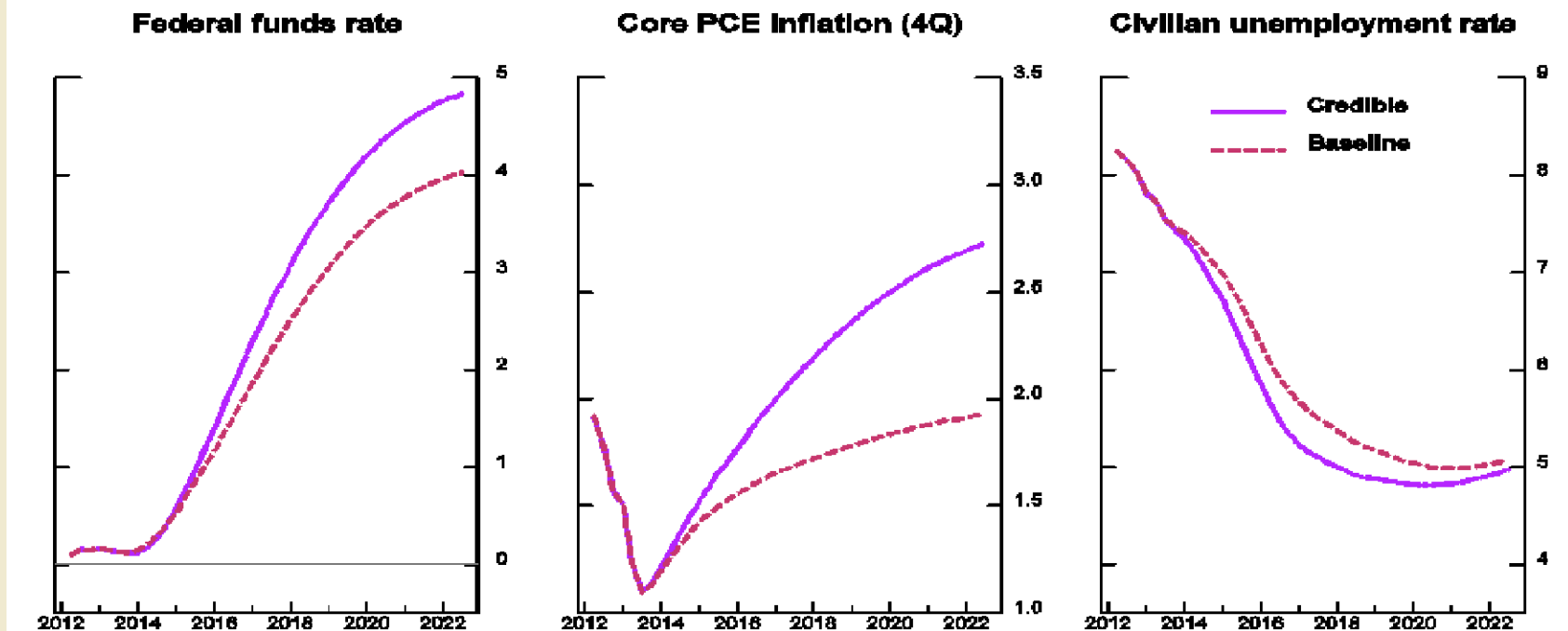
Additional Questions:

1. Alternative objectives?
 - Different inflation goal
 - Nominal income target
2. Monetary policy and financial stability



Alternative Objectives: Possible Benefits

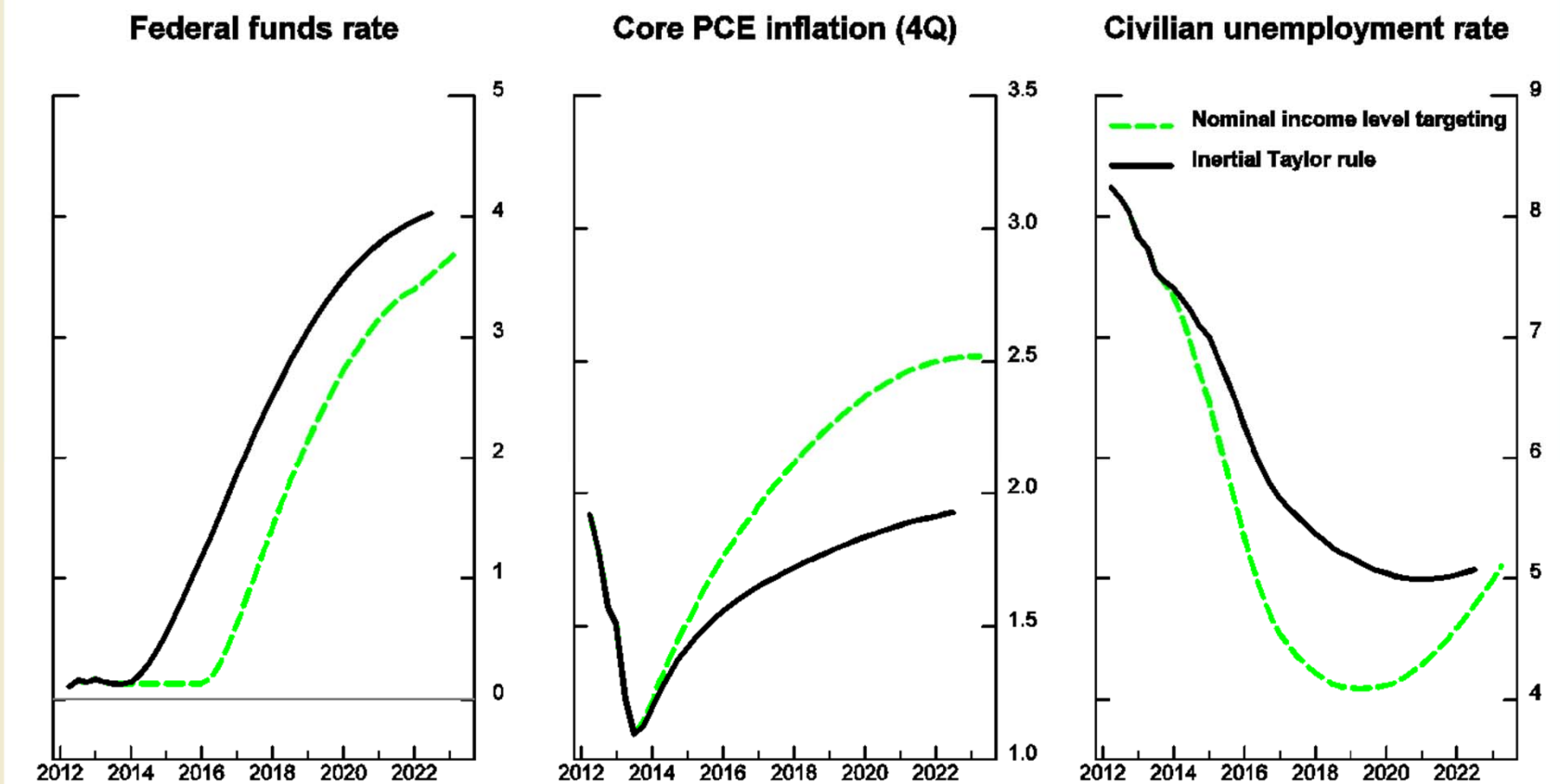
Figure 5
Increase in Inflation target with policy credibility
(Inertial Taylor rule; Baseline conditions)





Alternative Objectives: Possible Benefits

Figure 6
Nominal income level targeting
(Baseline conditions)





Alternative Objectives: Possible Problems

- Credibility of the change
- Confusion about the goals of policy
- Data revisions
- Alternative model features
- Model uncertainty



Monetary Policy and Financial Stability

- To the extent possible, use regulatory and supervisory tools to limit systemic risks
- Need to balance potential benefits of using monetary policy against possible costs
 - Deviations could be in either direction
- Careful monitoring of financial developments
 - Improved data collection



Concluding Remarks

- Greatly improved communications regarding objectives
- Use of threshold-based forward guidance
- Communications regarding asset purchases
- Alternative objectives may be costly
- Need for additional work on the integration of monetary policy and financial stability
- Need to remain humble