
Making Monetary Policy at the Fed

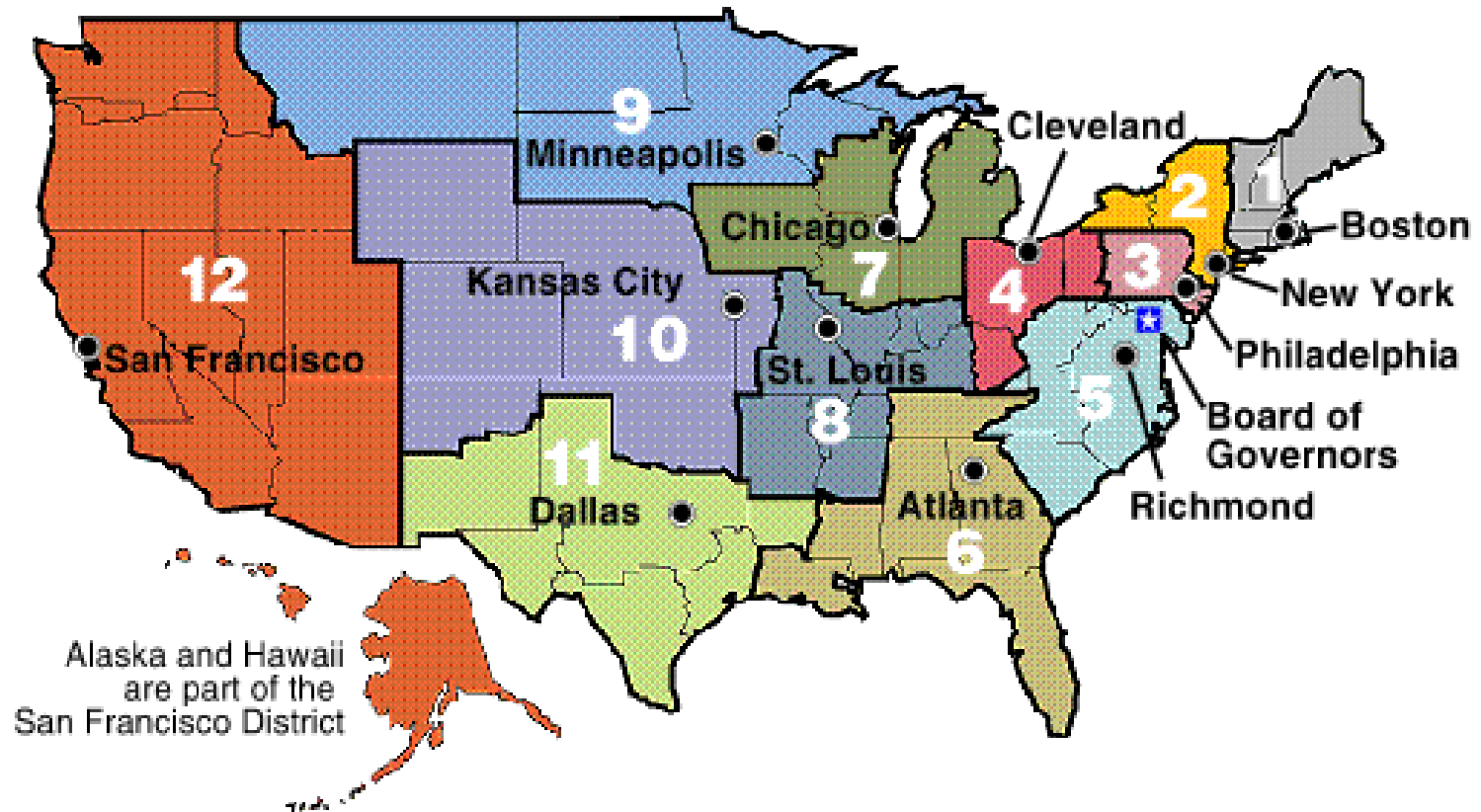
Ohnward Bank and Trust Board of Directors
August 25, 2016

Spencer Krane
Senior Vice President, Economic Research

The views expressed are my own and not those of the Federal Reserve
Bank of Chicago or the Federal Reserve System

Overview of the Federal Reserve and Monetary Policy

Federal Reserve Districts



Nice Marble

Board of Governors



Chicago Fed





The Federal Reserve Board of Governors*



Janet L. Yellen



Stanley Fischer



Daniel K. Tarullo



Lael Brainard



Jerome H. Powell

** Two seats currently vacant*

Presidents of the District Reserve Banks

* 2016 voting FOMC member



*Eric S. Rosengren**
First District - Boston



*William C. Dudley**
Second District - New York



Patrick T. Harker
Third District - Philadelphia



*Loretta J. Mester**
Fourth District - Cleveland



Jeffrey M. Lacker
Fifth District - Richmond



Dennis P. Lockhart
Sixth District - Atlanta



Charles L. Evans
Seventh District - Chicago



*James B. Bullard**
Eighth District - St. Louis



Neel Kashkari
Ninth District - Minneapolis



*Esther L. George**
Tenth District - Kansas City



Robert S. Kaplan
Eleventh District - Dallas



John C. Williams
Twelfth District - San Francisco

Monetary Policy: The Fed's Dual Mandate

- **Federal Reserve Act: Section 2a. Monetary Policy Objectives**
- ... the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates **commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.**

Long Run Goals and Policy Strategy Principles

■ Price stability

- Goal: 2% inflation in price index for total personal consumption expenditures (PCE)
- Target is symmetric: an average over medium term, not a ceiling

■ Full employment

- Employment goal may change over time for non-monetary reasons
- Most FOMC participants see 4.7-5.0% unemployment as consistent with mandate (current forecast of long-run “normal” unemployment)
- Seek an economy operating at its level of potential output

■ Balanced approach

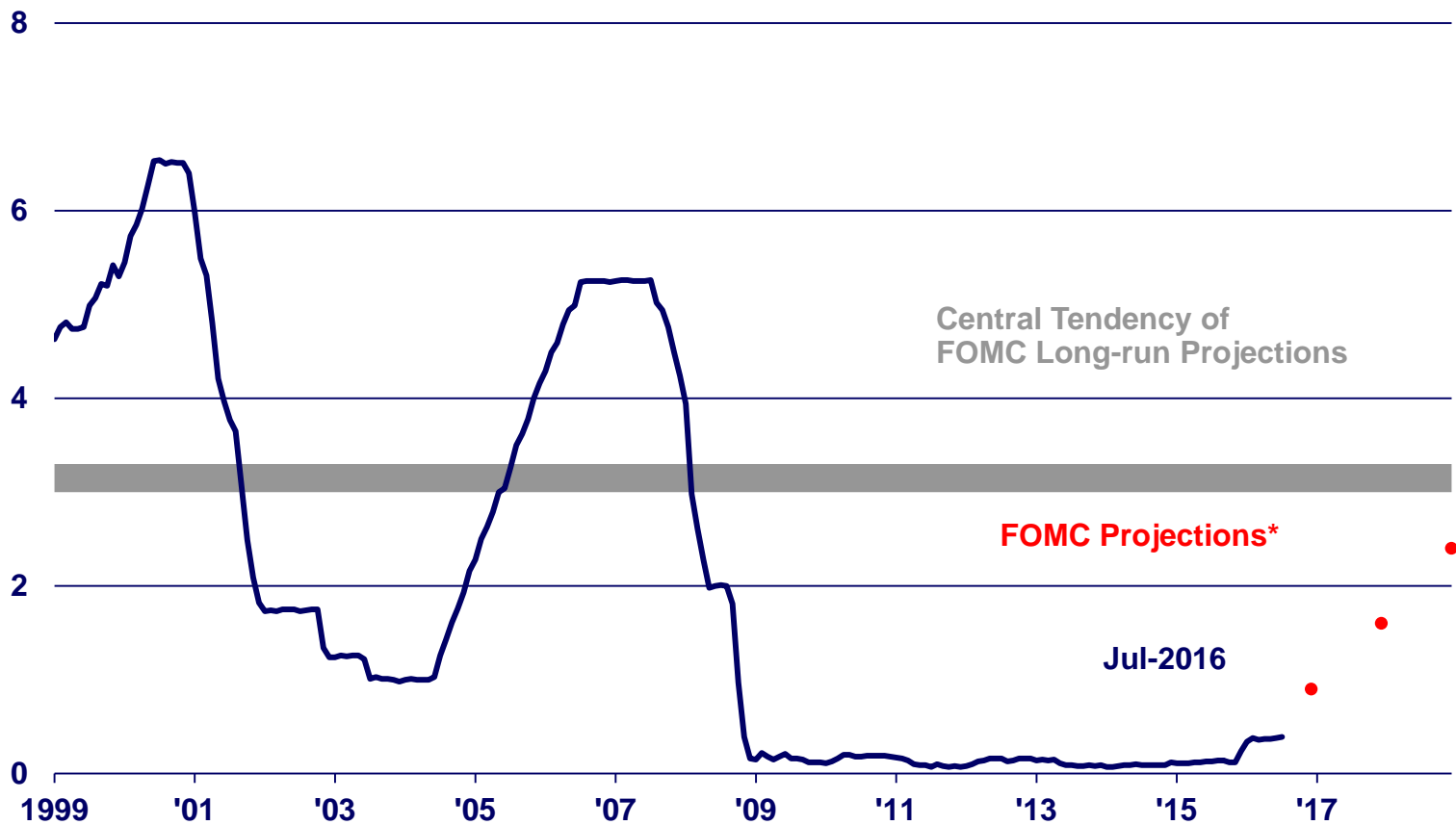
- Balanced approach to achieving both goals if they are in conflict
- Takes account of lags and other limits in effects of monetary policy

Monetary Policy In Usual Times

- **Target the federal funds rate**
- **Changes in fed funds rate move other short-term interest rates**
- **Changes in short-term interest rates influence**
 - Medium and longer-term interest rates
 - Exchange rates
 - Asset values
- **These then affect saving and investment decisions, which in turn influence employment and output**
- **Inflation influenced by these and other factors**

Policy Rate Constrained By Zero Lower Bound

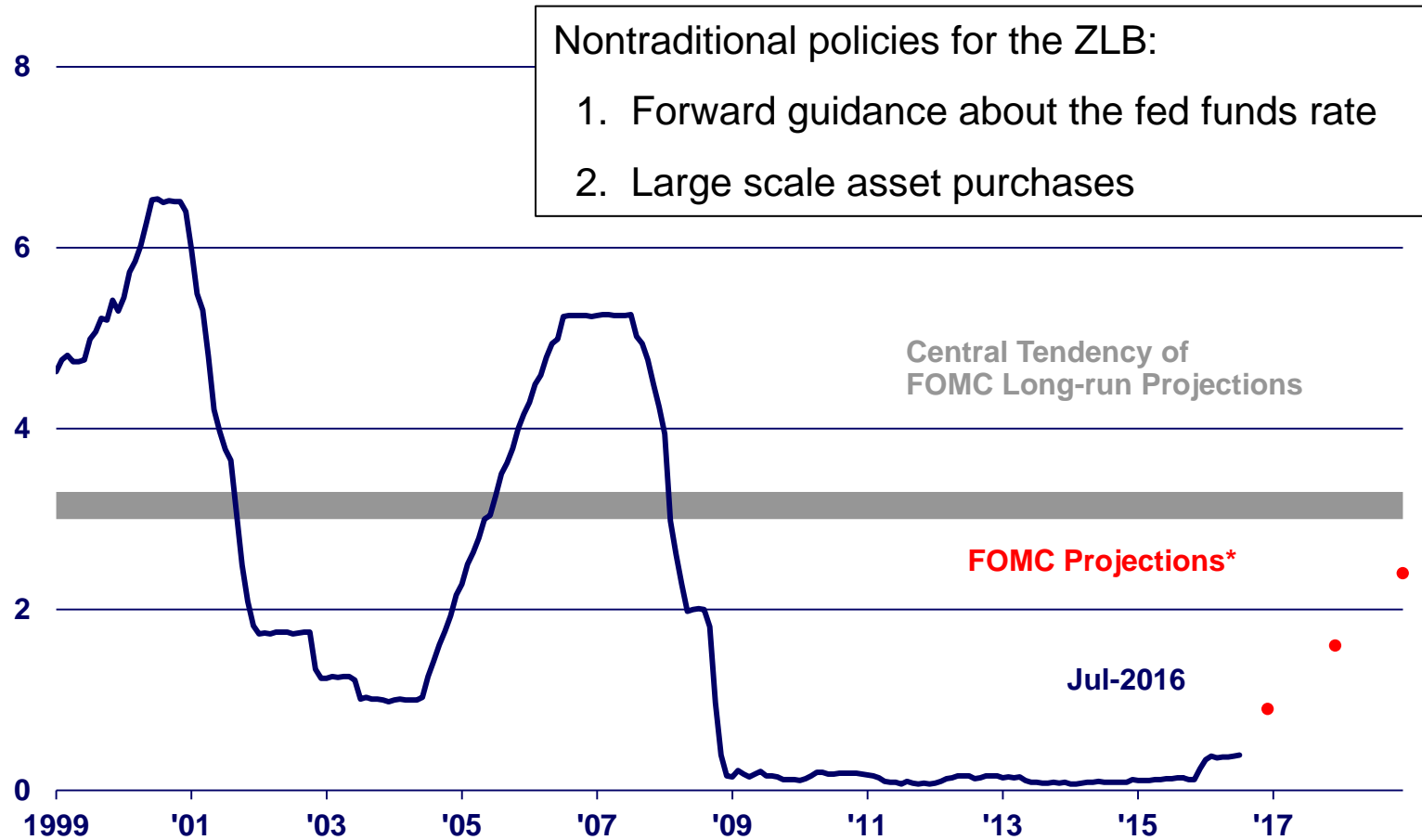
Federal Funds Rate (percent)



Source: FOMC projections are median projections from the June 15, 2016 Summary of Economic Projections.

Policy Rate Constrained By Zero Lower Bound

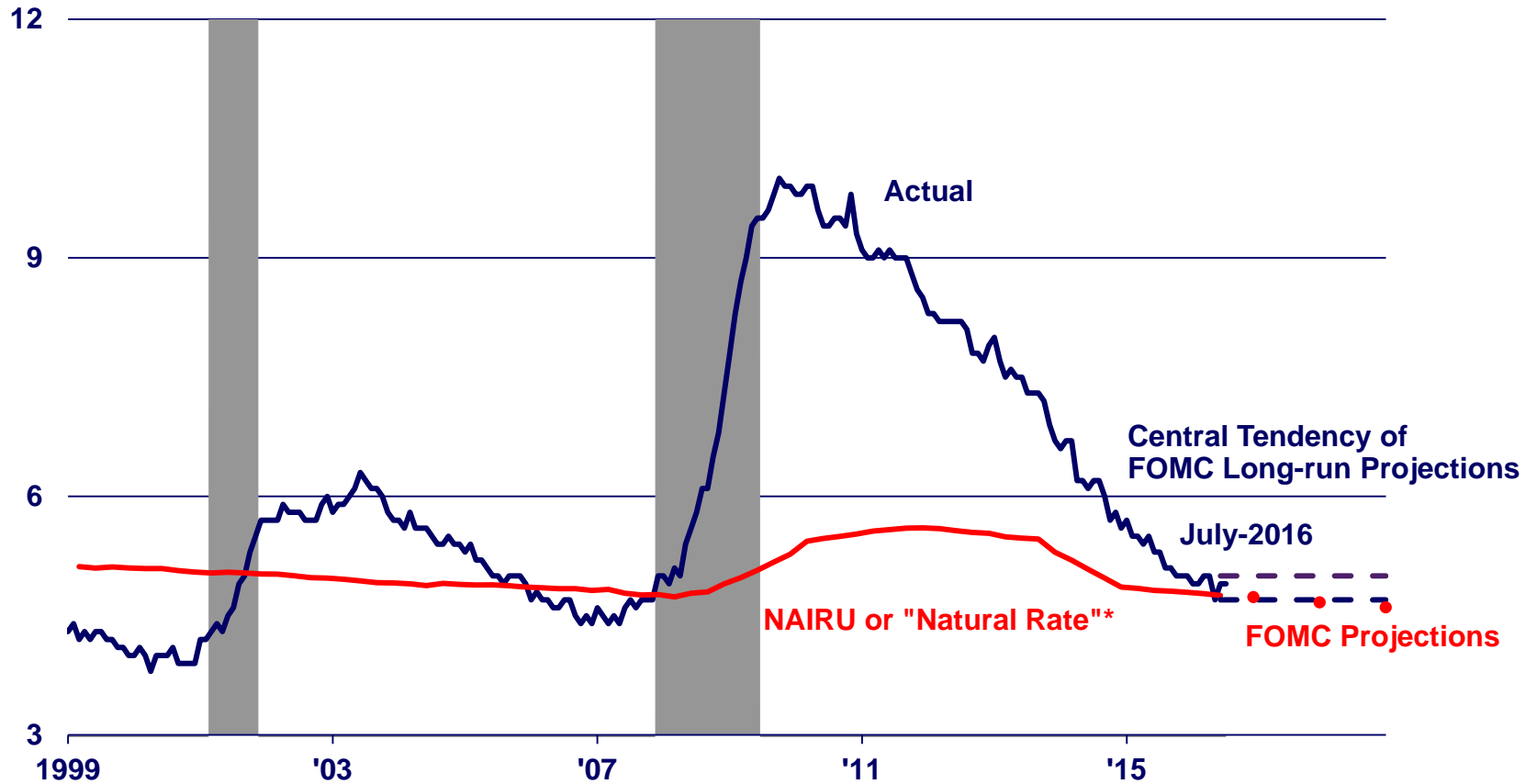
Federal Funds Rate (percent)



Source: FOMC projections are median projections from the June 15, 2016 Summary of Economic Projections.

Unemployment Rate

Unemployment Rate (percent)



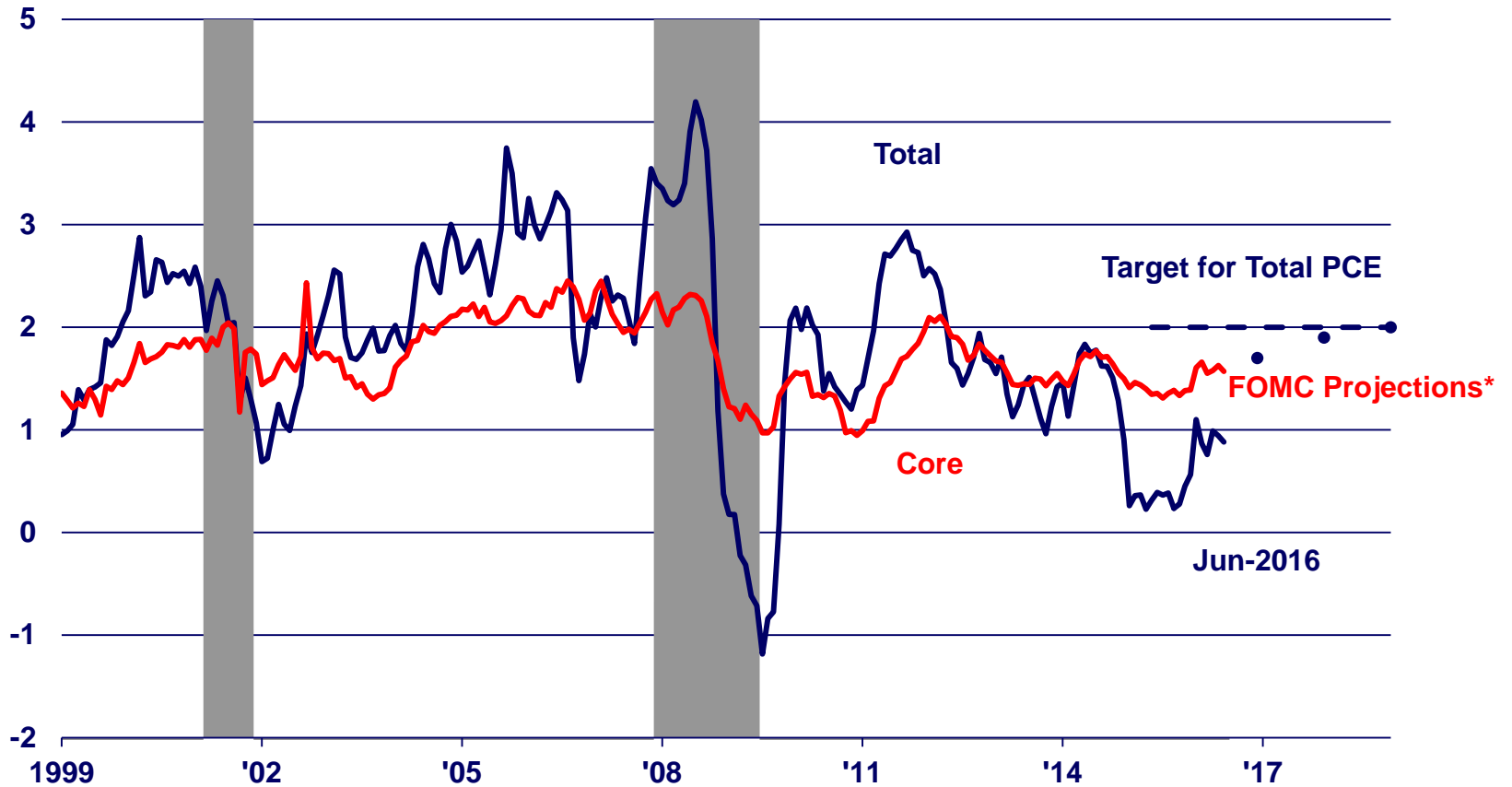
*FRBCHI staff estimate.

FOMC projections are median projections from the June 15, 2016 Summary of Economic Projections.

Inflation

PCE Price Index

(12-month percent change in the price index for personal consumption expenditures)



FOMC projections are the median projections from the June 15, 2016 Summary of Economic Projections.

What Happens at an FOMC Meeting

What Happens Before the FOMC Meeting?

- **Board staff prepare and distribute to entire FOMC:**
 - Economic forecast (Tealbook Part A)
 - Monetary policy alternatives (Tealbook Part B)
 - Other analyses

- **Regional bank staffs prepare their bank presidents:**
 - Internal forecasts and analyses
 - ◆ Analyze reports from contacts
 - Study Board staff documents
 - Help bank president prepare commentary on
 - ◆ Board staff materials
 - ◆ Personal economic outlook and policy views

The Board Room



What Happens at an FOMC Meeting?

- **Preliminaries**
 - Administrative matters
 - Often presentation on special topic
- **Report from the “Desk”**
 - NY Fed Markets Group: What’s up in financial markets
- **Tealbook Part A presentation**
 - The economic outlook
- **Financial stability report (quarterly)**
- **“First Go-Around”**: Participants present views on regional and national outlook

What Happens at an FOMC Meeting?

- **Tealbook Part B presentation: The policy options**
- **“Second Go-Around”:** Policy discussion
 - Participants give views of appropriate policy
- **The Vote: The Chair gives sense of the consensus**
 - Sometimes “word-smith” the FOMC statement
 - Only members vote
- **Post-decision activities**
 - Lunch
 - Sometimes presentation of a special topic
 - The Chair’s press conference (quarterly)

Communicating Policy Rationale to the Public

- **Immediately following the FOMC meeting**
 - Statement
 - Press conference and forecasts (quarterly)
- **Soon after meeting**
 - Minutes (3 weeks after meeting)
 - Speeches and testimony
- **Biannually -- Monetary policy report**
- **With a longer lag, meeting documents become public**
 - 5-years: Tealbook
 - 10-years: Transcripts

Current Economic Conditions and Outlook

GDP Growth: History and Forecasts

History and current-quarter forecasts

2015

1.9

2016:Q1

0.8

2016:Q2

1.2

2016:Q3

2-1/2 – 3-1/2

FOMC Summary of Economic Projections (June 15) (central tendency)

2016

1.9 – 2.0

2017

1.9 – 2.2

2018

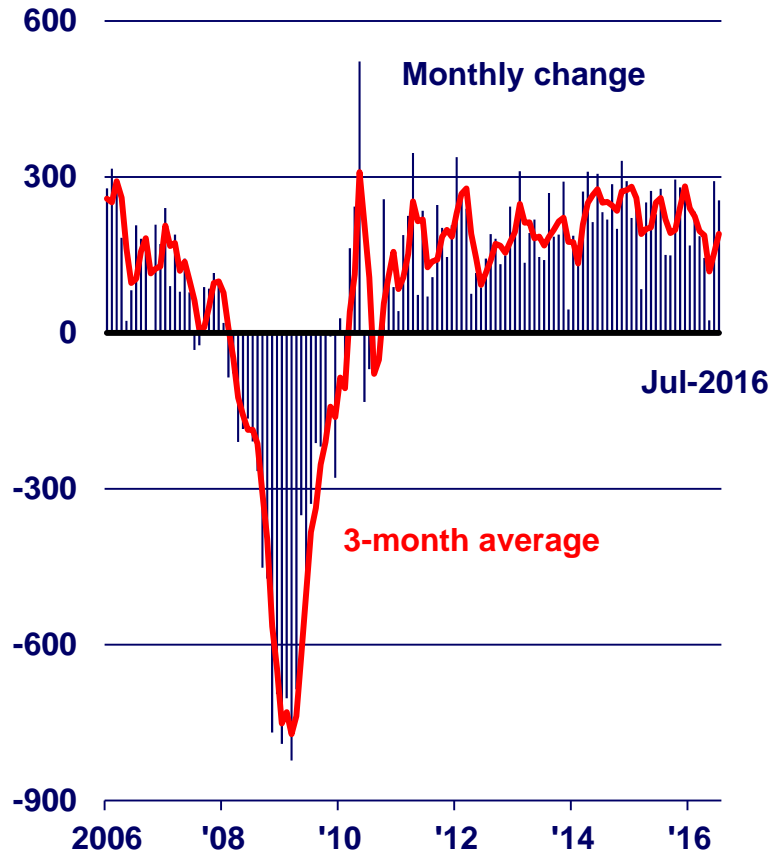
1.8 – 2.1

Long-Run

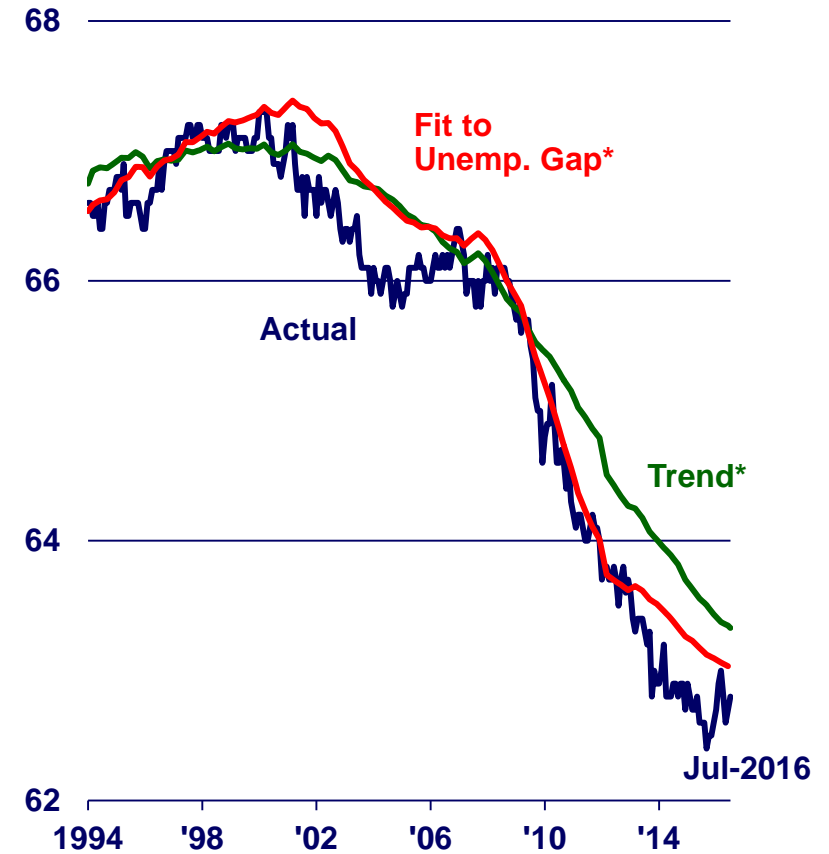
1.8 – 2.0

Labor Market

Total Nonfarm Payroll Employment (change, thousands)



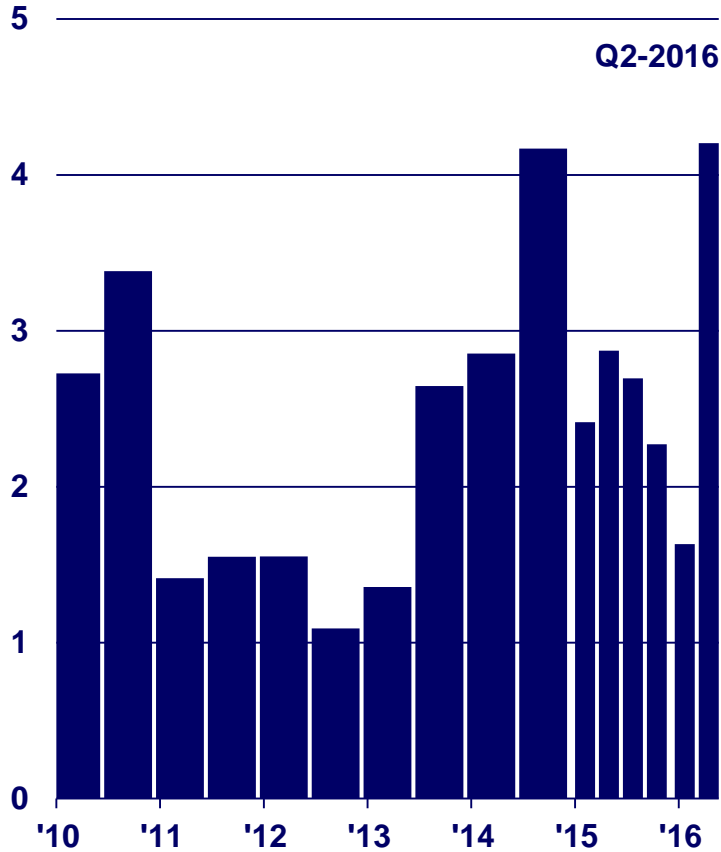
Labor Force Participation Rate (percent)



Consumer Spending and Income Expectations

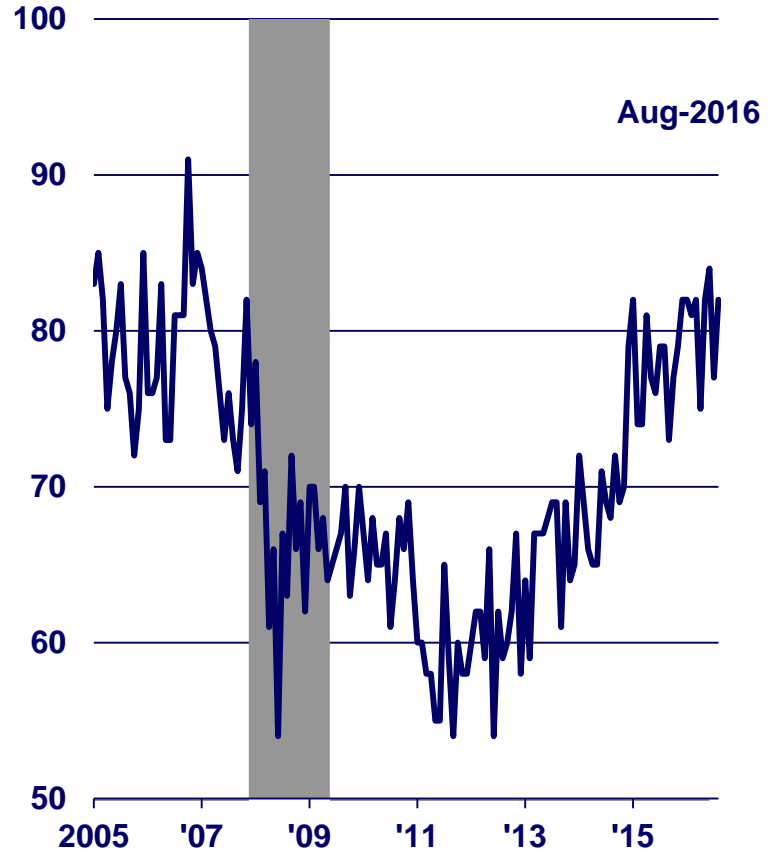
Real PCE

(percent change, annual rate)



Real Income Expectation

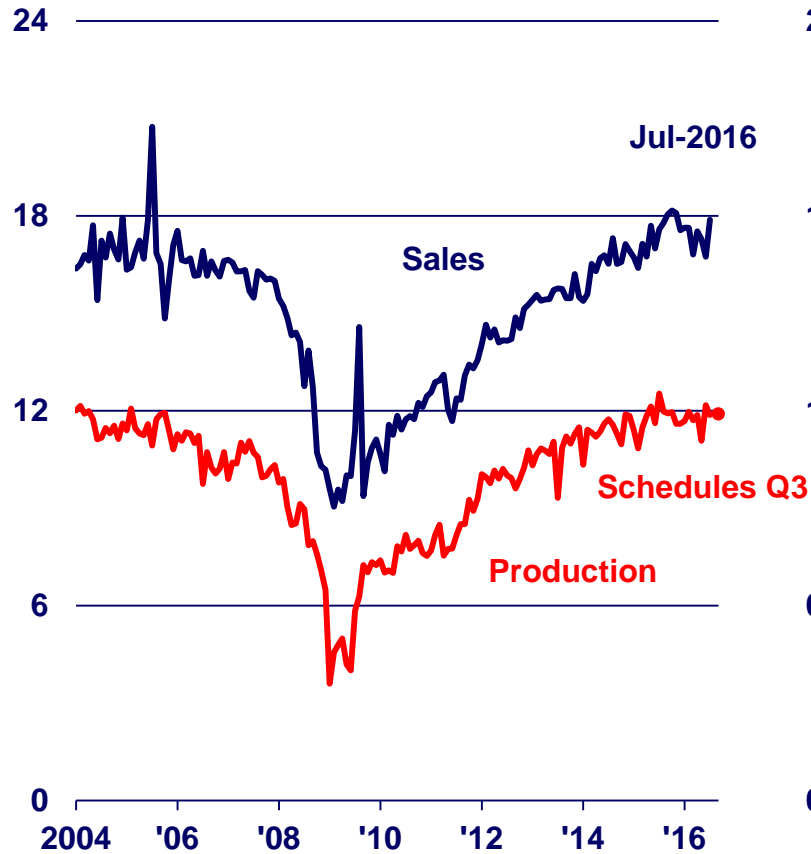
(University of Michigan Consumer Survey; Diffusion index of 1 to 2-year ahead expectations)



Light Vehicle Sales and Housing

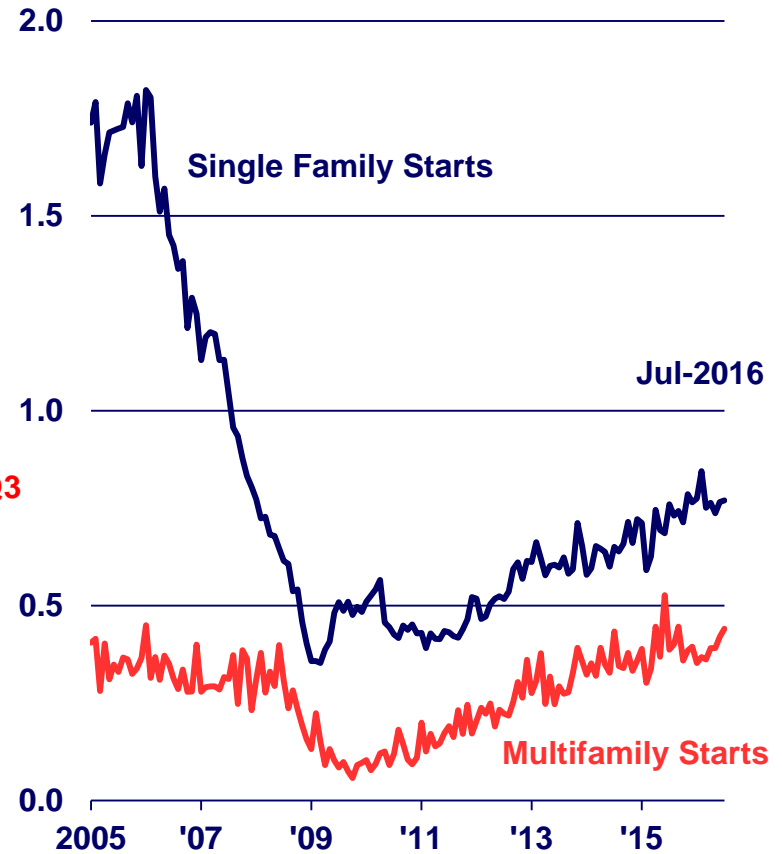
Light Vehicle Sales

(millions of autos and light trucks, SAAR)



Housing Market

(millions of units, annual rate)

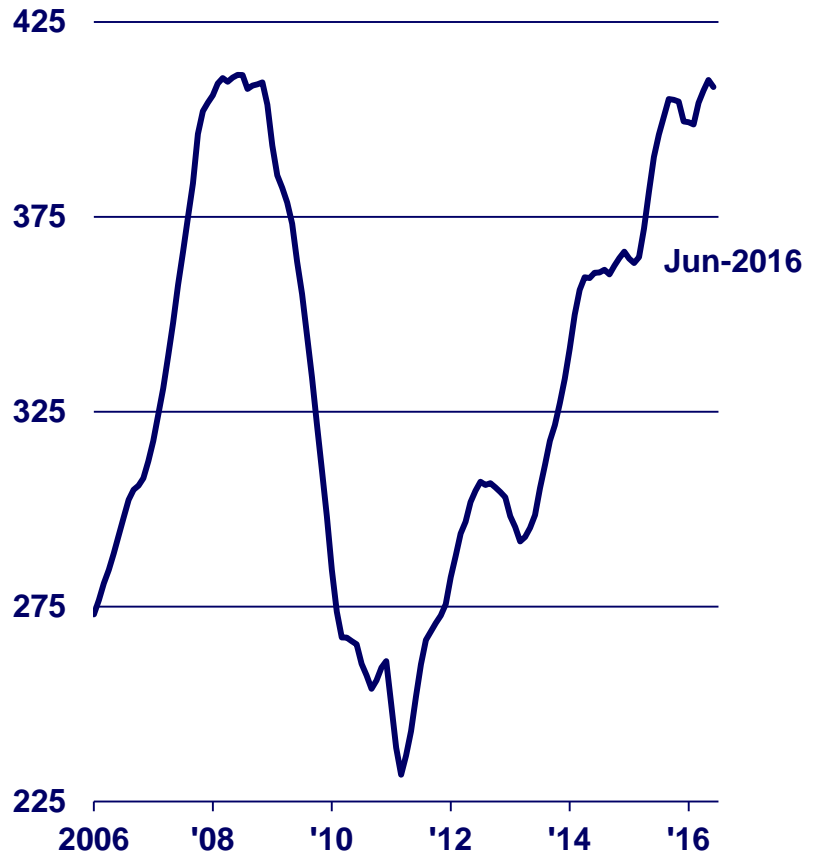


Business Investment

Nondefense Capital Goods ex. Aircraft
(Bils. \$, 3-month MA)

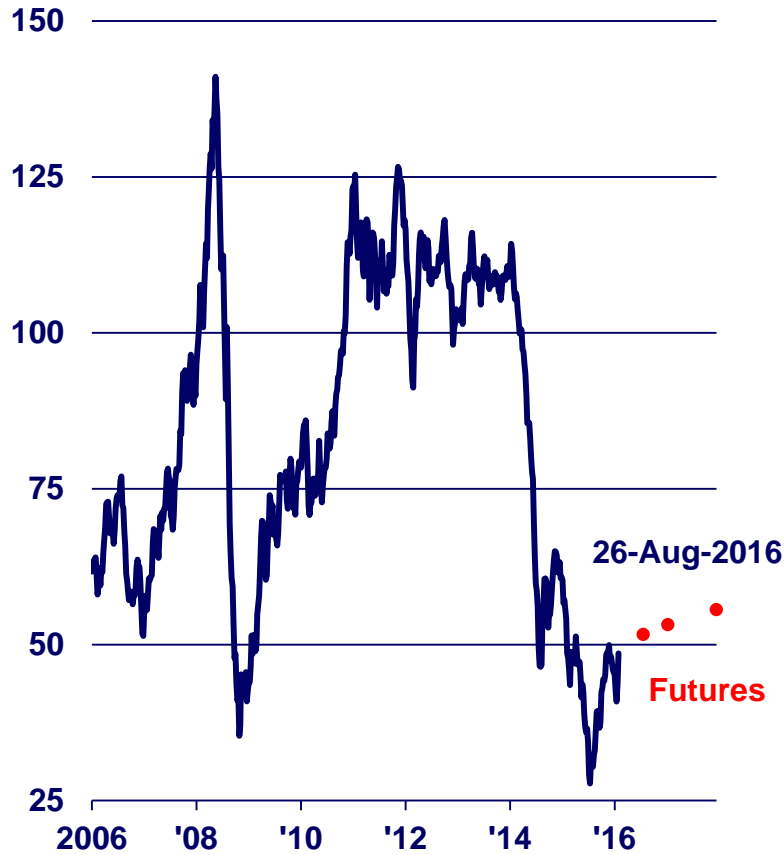


Private Non-residential Construction
(Bils. \$, 3-month MA)

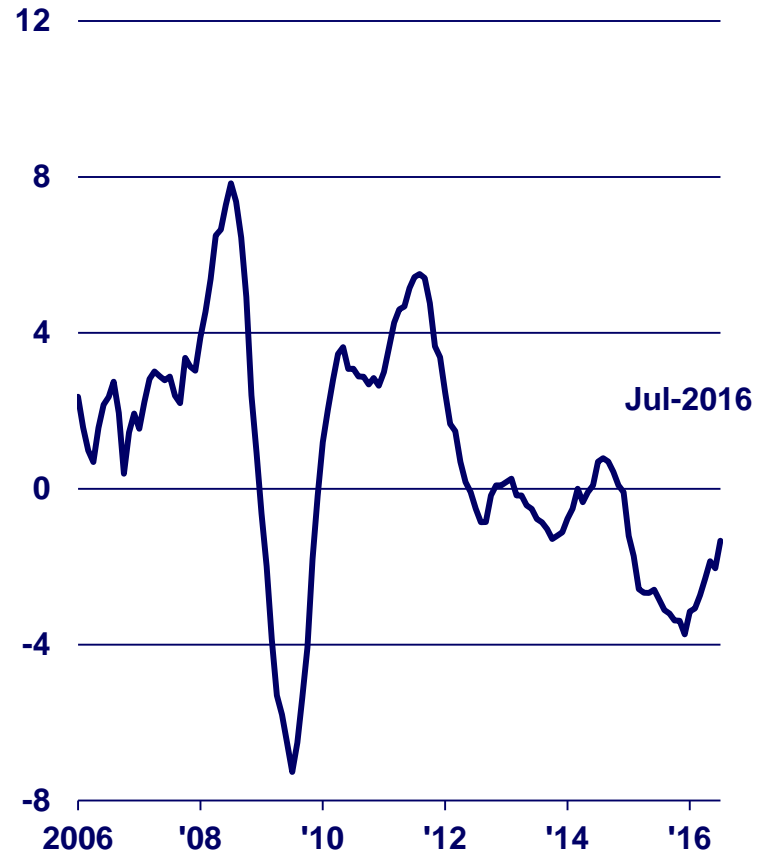


Oil and Import Prices

Brent Crude Oil Prices and Futures
(dollars)



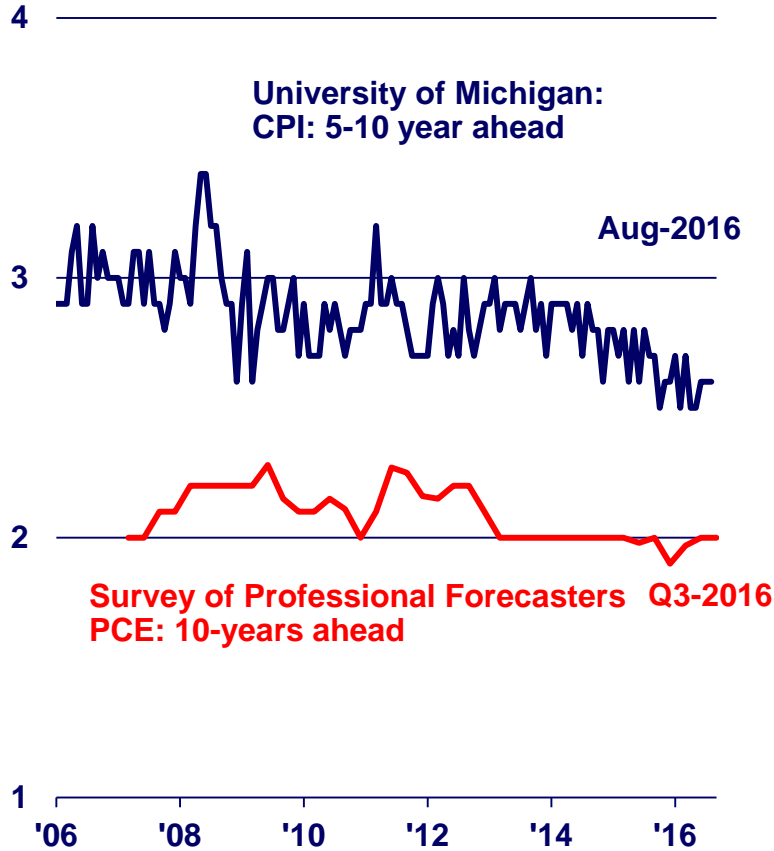
Non-Petroleum Import Prices
(12 month percent change)



Inflation Expectations

Inflation Surveys

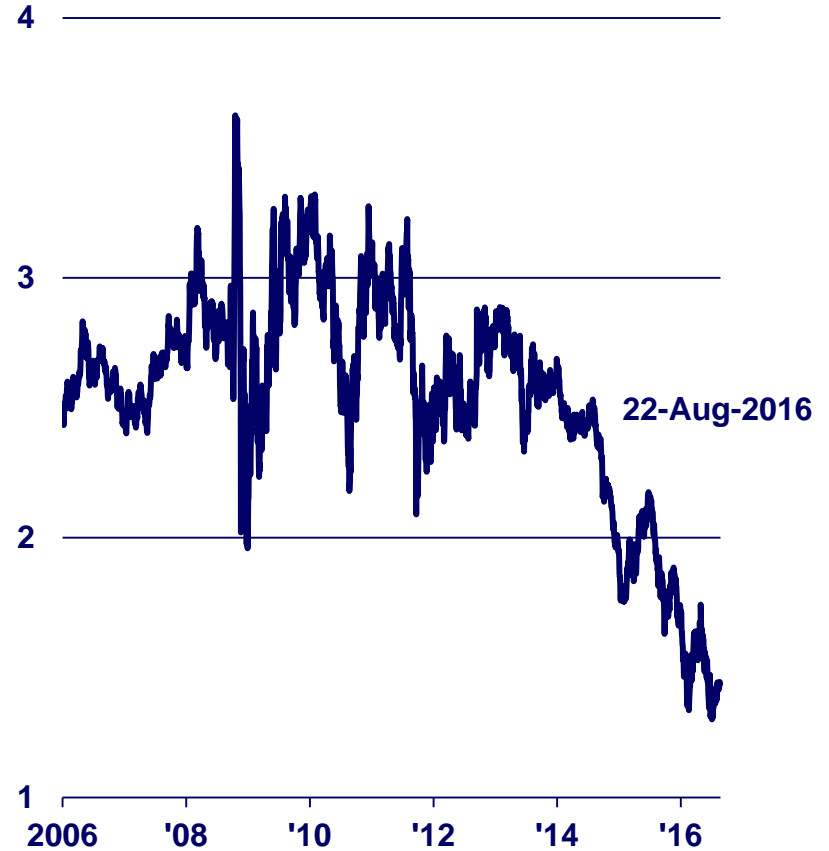
(percent)



TIPS Inflation Compensation for CPI

5-10 years ahead

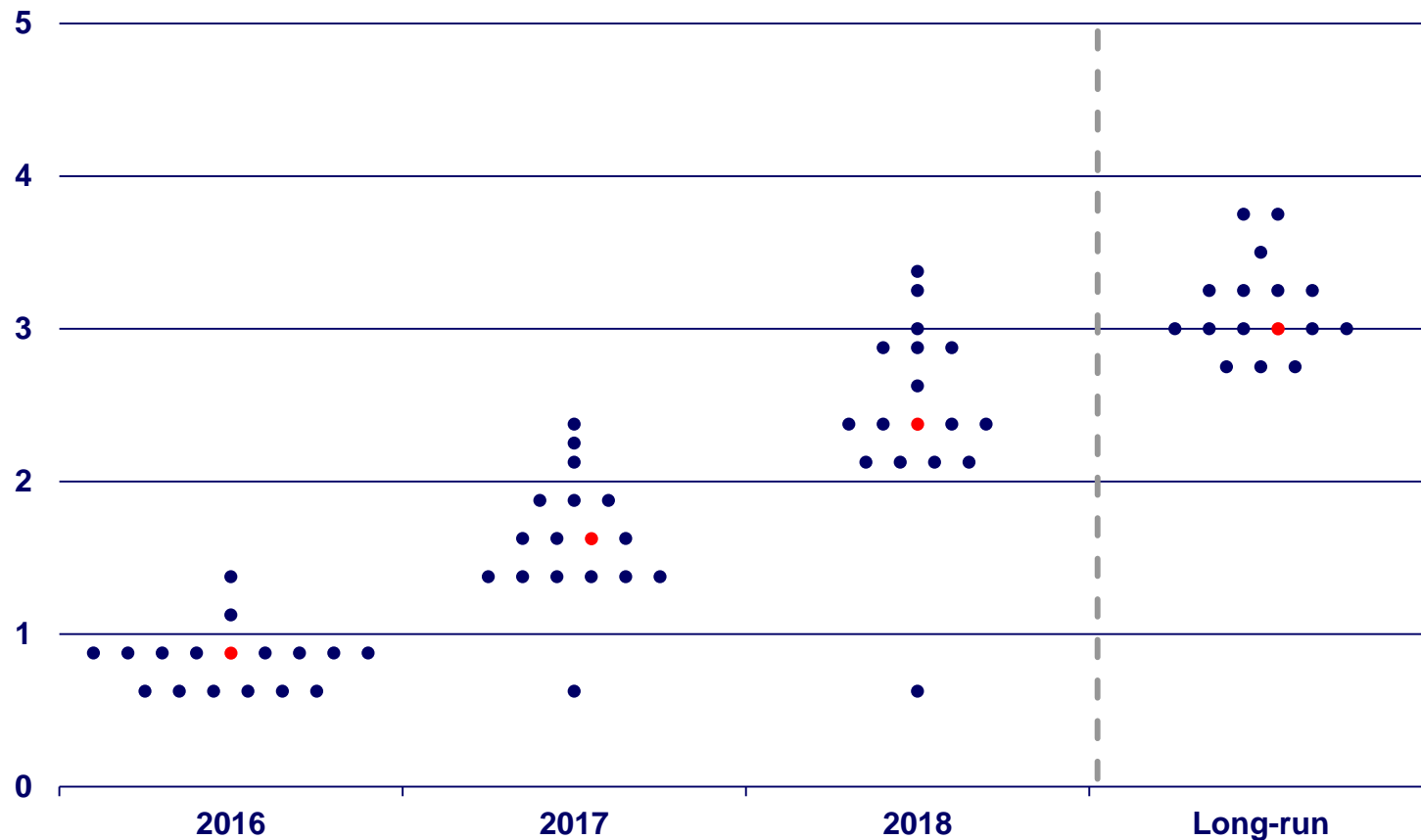
(percent)



Current Monetary Policy Guidance

Appropriate Pace of Policy Normalization

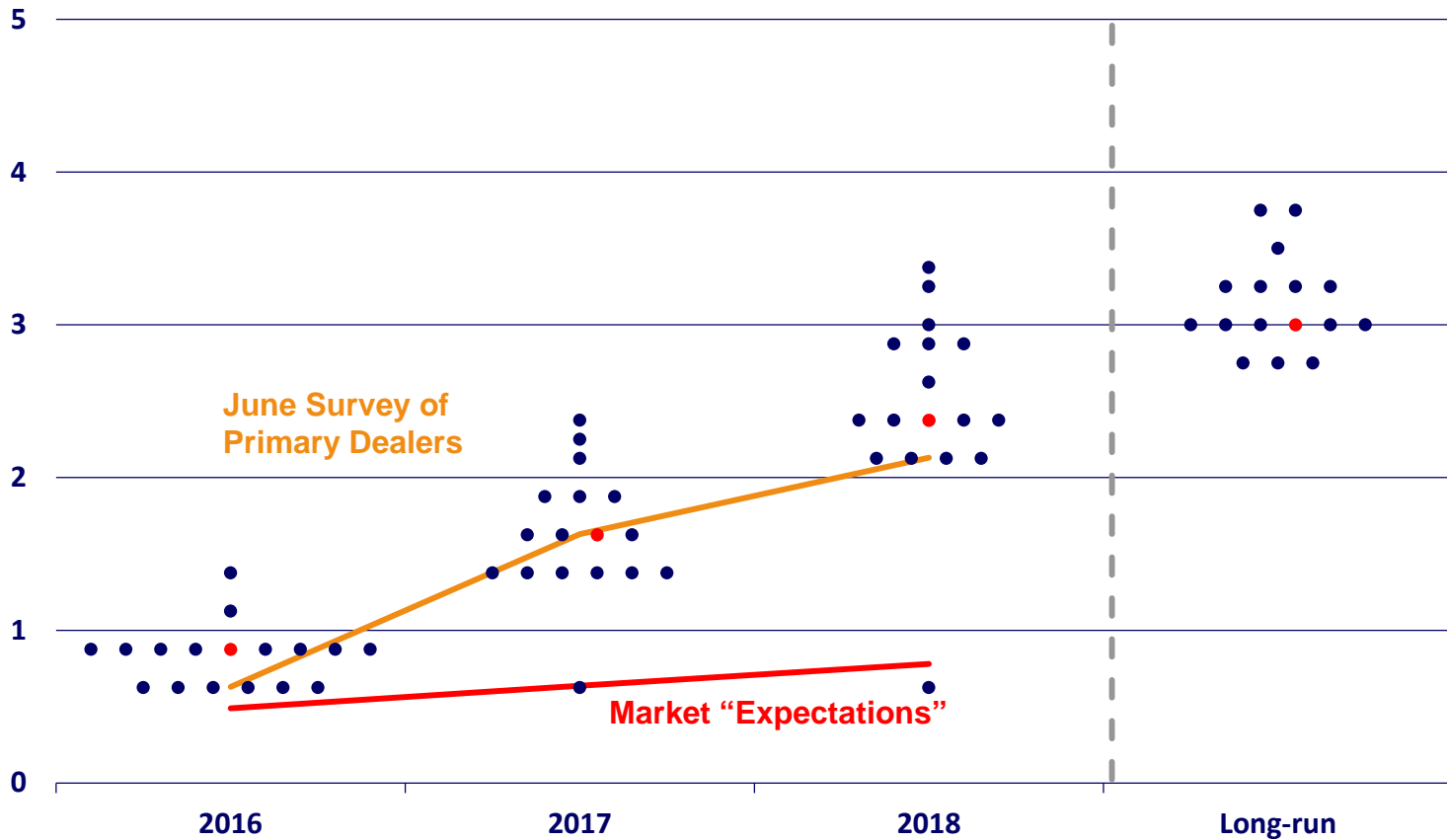
Federal Funds Rate at Year-End (percent)



Source: Interest rate projections are from the June 15, 2016 FOMC Summary of Economic Projections.

Appropriate Pace of Policy Normalization

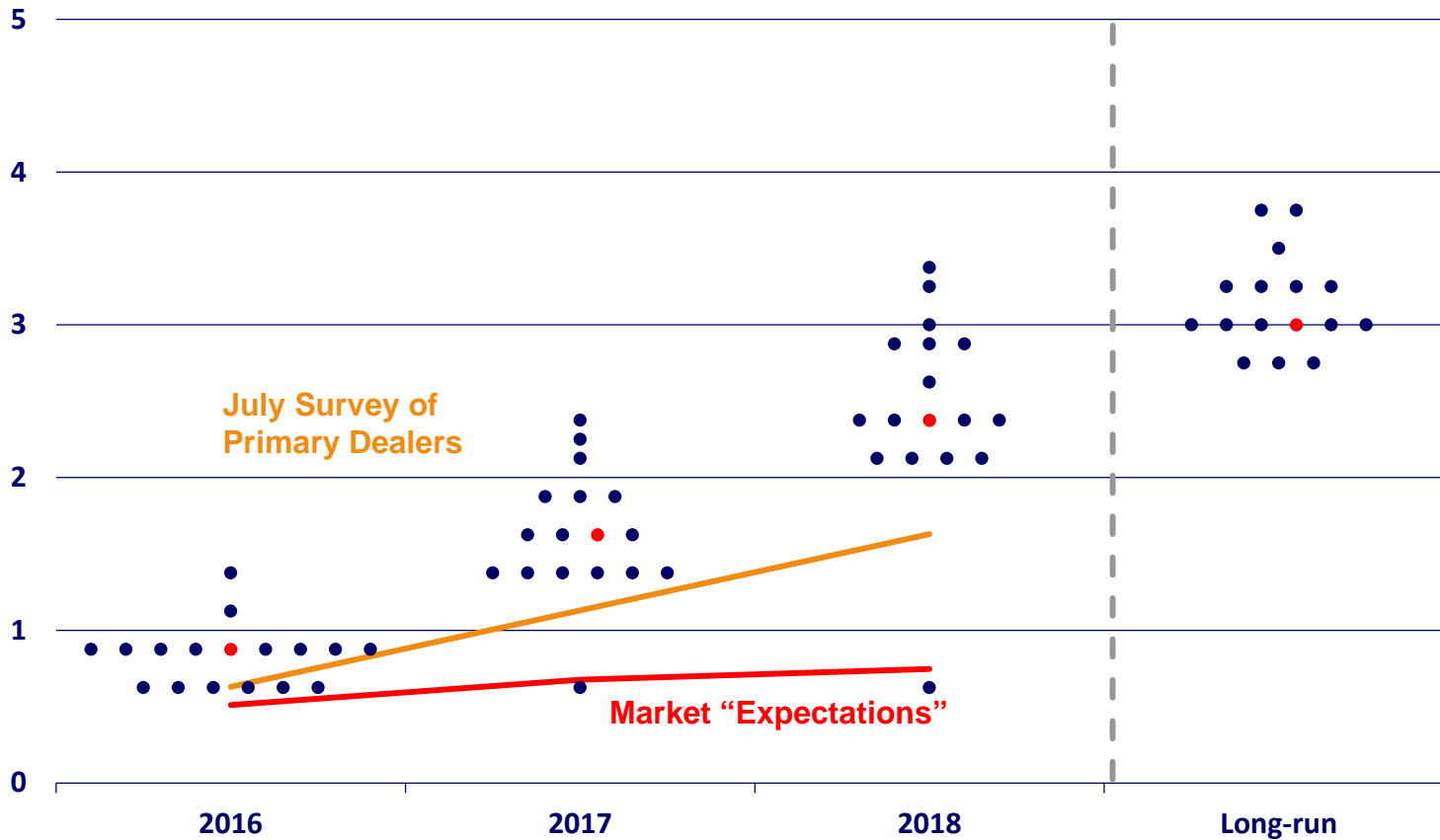
Federal Funds Rate at Year-End (percent)



Source: Interest rate projections are from the June 15, 2016 FOMC Summary of Economic Projections. Market expectations are from OIS futures as of June 13, 2016.

Appropriate Pace of Policy Normalization

Federal Funds Rate at Year-End (percent)



Source: Interest rate projections are from the June 15, 2016 FOMC Summary of Economic Projections. Market expectations are from OIS futures as of August 22, 2016.

FOMC Communications: Data Dependence

- **The actual path of the federal funds rate will depend on the economic outlook as informed by incoming data**
- **Realized and expected conditions relative to maximum employment and 2 percent inflation**
- **Take account a wide range of information**
 - Labor market conditions, inflation pressures and inflation expectations, and financial and international developments

FOMC Communications: Path Likely Gradual

- **The Committee expects:**
- **That economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate;**
- **The federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run.**