Monetary Policy: A Brave New World

Liftoff and Normalization

Presented By:
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Vice President and Senior Economist

The views presented here are my own and do not necessarily reflect the views of the Federal Reserve Bank of Atlanta or the Federal Reserve System.
To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress—both realized and expected—toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy. However, if incoming information indicates faster progress toward the Committee’s employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.

The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction.
• The Committee intends to reduce the Federal Reserve's securities holdings in a gradual and predictable manner primarily by ceasing to reinvest repayments of principal on securities held in the SOMA.

• The Committee expects to cease or commence phasing out reinvestments after it begins increasing the target range for the federal funds rate; the timing will depend on how economic and financial conditions and the economic outlook evolve.

• The Committee currently does not anticipate selling agency mortgage-backed securities as part of the normalization process, although limited sales might be warranted in the longer run to reduce or eliminate residual holdings. The timing and pace of any sales would be communicated to the public in advance.

• The Committee intends that the Federal Reserve will, in the longer run, hold no more securities than necessary to implement monetary policy efficiently and effectively, and that it will hold primarily Treasury securities, thereby minimizing the effect of Federal Reserve holdings on the allocation of credit across sectors of the economy.
The Committee will determine the timing and pace of policy normalization—meaning steps to raise the federal funds rate and other short-term interest rates to more normal levels and to reduce the Federal Reserve's securities holdings—so as to promote its statutory mandate of maximum employment and price stability.

- When economic conditions and the economic outlook warrant a less accommodative monetary policy, the Committee will raise its target range for the federal funds rate.

- During normalization, the Federal Reserve intends to move the federal funds rate into the target range set by the FOMC primarily by adjusting the interest rate it pays on excess reserve balances.

- During normalization, the Federal Reserve intends to use an overnight reverse repurchase agreement facility and other supplementary tools as needed to help control the federal funds rate. The Committee will use an overnight reverse repurchase agreement facility only to the extent necessary and will phase it out when it is no longer needed to help control the federal funds rate.
“In determining how long to maintain this target range, the Committee will assess progress—both realized and expected—toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations.”

FOMC Press Release (December 17th, 2014)
## Real GDP Estimates and Tracking Projections

<table>
<thead>
<tr>
<th>Change in GDP Component (annualized % change)</th>
<th>Actual GDP Growth Q3</th>
<th>Actual GDP Growth Q4</th>
<th>Current Q4 Tracking Estimates (Feb 17)</th>
<th>Current Q1 Tracking Estimate (Feb 17)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption</td>
<td>3.2</td>
<td>4.3</td>
<td>4.3</td>
<td>3.6</td>
</tr>
<tr>
<td>Business Structures</td>
<td>4.8</td>
<td>2.6</td>
<td>5.1</td>
<td>0.8</td>
</tr>
<tr>
<td>Business Equipment</td>
<td>11.0</td>
<td>-1.9</td>
<td>-2.5</td>
<td>4.9</td>
</tr>
<tr>
<td>Intellectual Property Products (IPP)</td>
<td>8.8</td>
<td>7.1</td>
<td>7.1</td>
<td>5.0</td>
</tr>
<tr>
<td>Residential Investment</td>
<td>3.2</td>
<td>4.1</td>
<td>3.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Exports</td>
<td>4.5</td>
<td>2.8</td>
<td>2.6</td>
<td>2.4</td>
</tr>
<tr>
<td>Imports</td>
<td>-0.9</td>
<td>8.9</td>
<td>11.1</td>
<td>4.1</td>
</tr>
<tr>
<td>Change in Net Exports (billions $2009)</td>
<td>+29</td>
<td>-13</td>
<td>-15</td>
<td>-14</td>
</tr>
<tr>
<td>Government</td>
<td>4.2</td>
<td>-2.2</td>
<td>1.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Annualized Final Sales Growth</td>
<td>5.0</td>
<td>1.8</td>
<td>1.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Change in inventory investment (billions $2009)</td>
<td>-3</td>
<td>+113</td>
<td>+92</td>
<td>-17</td>
</tr>
<tr>
<td>Annualized Real GDP Growth</td>
<td><strong>5.0</strong></td>
<td><strong>2.6</strong></td>
<td><strong>1.8</strong></td>
<td><strong>2.4</strong></td>
</tr>
</tbody>
</table>
Low Oil Prices = Net Positive for Growth

Experiment: $50/bbl thru 2015, relative to forecast in 2014Q2

Impact of the Cumulative Decline in Oil Prices Since 2014Q2

Real GDP
(percentage point deviation from baseline level)

Real Business Fixed Investment (BFI)
(percentage point deviation from baseline level)

Consumer Energy Prices
(percentage point deviation from baseline level)

Real Personal Consumption Expenditures
(percentage point deviation from baseline level)

Sources: Bureau of Economic Analysis, FRBA calculations through Q4 2017
Labor Market Strengthening

Finally!

Payroll Employment Changes

thousands of jobs, SA

Monthly change

12-month average

Source: Bureau of Labor Statistics through January 2015
Maximum Employment?
Headline Unemployment is only Part of the Picture

Unemployment Rate & Forecast
percent

<table>
<thead>
<tr>
<th>Percent</th>
<th>U-3 “Official”</th>
<th>U-6</th>
<th>PTER (as a % of LF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 2014</td>
<td>5.7</td>
<td>11.3</td>
<td>4.3</td>
</tr>
<tr>
<td>December 2014</td>
<td>5.6</td>
<td>11.2</td>
<td>4.4</td>
</tr>
<tr>
<td>December 2013</td>
<td>6.7</td>
<td>13.1</td>
<td>5.0</td>
</tr>
<tr>
<td>2005-07 average</td>
<td>4.8</td>
<td>8.5</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Central tendency of FOMC participants’ long-run unemployment rate estimate

Source: Bureau of Labor Statistics; FOMC SEP Projections
Data through January 2015, forecasts through 2017
Wage Measures
year-over-year change, SA

Wage growth (3.4%) = Inflation (2%) + Real Wage growth (1.4%)

Source: Bureau of Labor Statistics

ECI data through Q4 2014, AHE data through December 2014
Inflation

Below FOMC Objective and Headline #'s Under Pressure

PCE Price Index
year-over-year percent change, monthly

Sources: Bureau of Economic Analysis; staff calculations
So....What Would You Do If Janet Called You?
Diversity of Opinion on the FOMC
Data Dependency, Forecasts and Risk Assessment

Fed Fund Rate Projections
percent

Dots correspond to an FOMC participant’s projection based on “appropriate monetary policy”

Median FOMC participant (December)

Source: Federal Open Market Committee, December 2014 Summary Economic Projections;
Financial Market Opinions are Diverse As Well

![Graph showing implied distributions for Eurodollar rates as of Feb 09 2015](image)

- Probability Density
- Contracts:
  - Mar 15
  - Jun 15
  - Sep 15
  - Dec 15
- Forward rates shown as dashed lines

**No liftoff**

**Liftoff**

**Percent**

0.0

0.5

1.0

1.5

2.0

0

2

4

6

8

10

12

14
The waiting is the hardest part
Every day you see one more card
You take it on faith, you take it to the heart
The waiting is the hardest part
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