Macroeconomic Effects of FOMC Forward Guidance

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Taxonomy of Forward Guidance

\[ FF_t = g(\text{Economic Conditions}) + \text{Deviations from Interest Rate Rule} \]

\[ \uparrow \quad \text{Delphic Forward Guidance} \quad \uparrow \quad \text{Odyssean Forward Guidance} \]

- **Odyssean** forward guidance changes private expectations by publicly committing the FOMC to future deviations from its underlying policy rule.

- **Delphic** forward guidance encompasses statements that forecast only the economic outlook and typical monetary policy stance.
FOMC Experience with Forward Guidance

- Experience before the crisis
  - Kohn and Sack (2003)
  - Gürkaynak, Sack, and Swanson (2005)

- Experience since the crisis
  - Gagnon, Raskin, Remache, and Sack (2010) (QE1)
  - Krishnamurthy and Vissing-Jorgenson (2011) (QE1 & QE2)
  - Our extension of Gürkaynak, Sack, and Swanson.
\[ FF_t = g(\text{Current Economic Conditions}) + \sum_{j=0}^{4} \nu_{t-j,j} \]
Forecasts from FRB Chicago New Keynesian DSGE Model

- Business cycles are primarily demand determined.
- Continue 2012 with unusually patient households. (Asset accumulation/Deleveraging)
- Odyssean forward guidance delays lift-off until late 2014.
Inflation and Unemployment in the Baseline Scenario
Risk Assessment

- Assess upside risks to the outlook with the “late 2014” guidance in place.
  - Shorter deleveraging period
  - Higher expected inflation
- Compare outcomes with 7/3 thresholds for launch from ZLB.
Shorter Deleveraging or Higher Expected Inflation

**GDP Growth**
- Shorter Deleveraging
- Higher Expected Inflation

**Federal Funds Rate**

**PCE Core Inflation**

**Log Per Capita Hours**
Inflation and Unemployment in the Alternative Scenarios

- **Shorter deleveraging period**
  - Graph showing the relationship between core inflation and the unemployment rate, highlighting the baseline path.

- **Higher expected inflation**
  - Graph showing the relationship between core inflation and the unemployment rate, highlighting the baseline path.
Takeaways

- Odyssean forward guidance delivers beneficial accommodation.
- Conservative central bankers will be tempted to renege on promised stimulus once its desired (anticipatory) effects have been achieved.
- Bright-line economic thresholds, like the 7/3 rule, provide conditions for an extended period of exceptionally low federal funds rates while providing some insurance against unfavorable outcomes and risks.