
The Fed's Updated Monetary Policy Strategy

Federal Reserve Bank of Chicago
Economic Outlook Symposium
December 4, 2020

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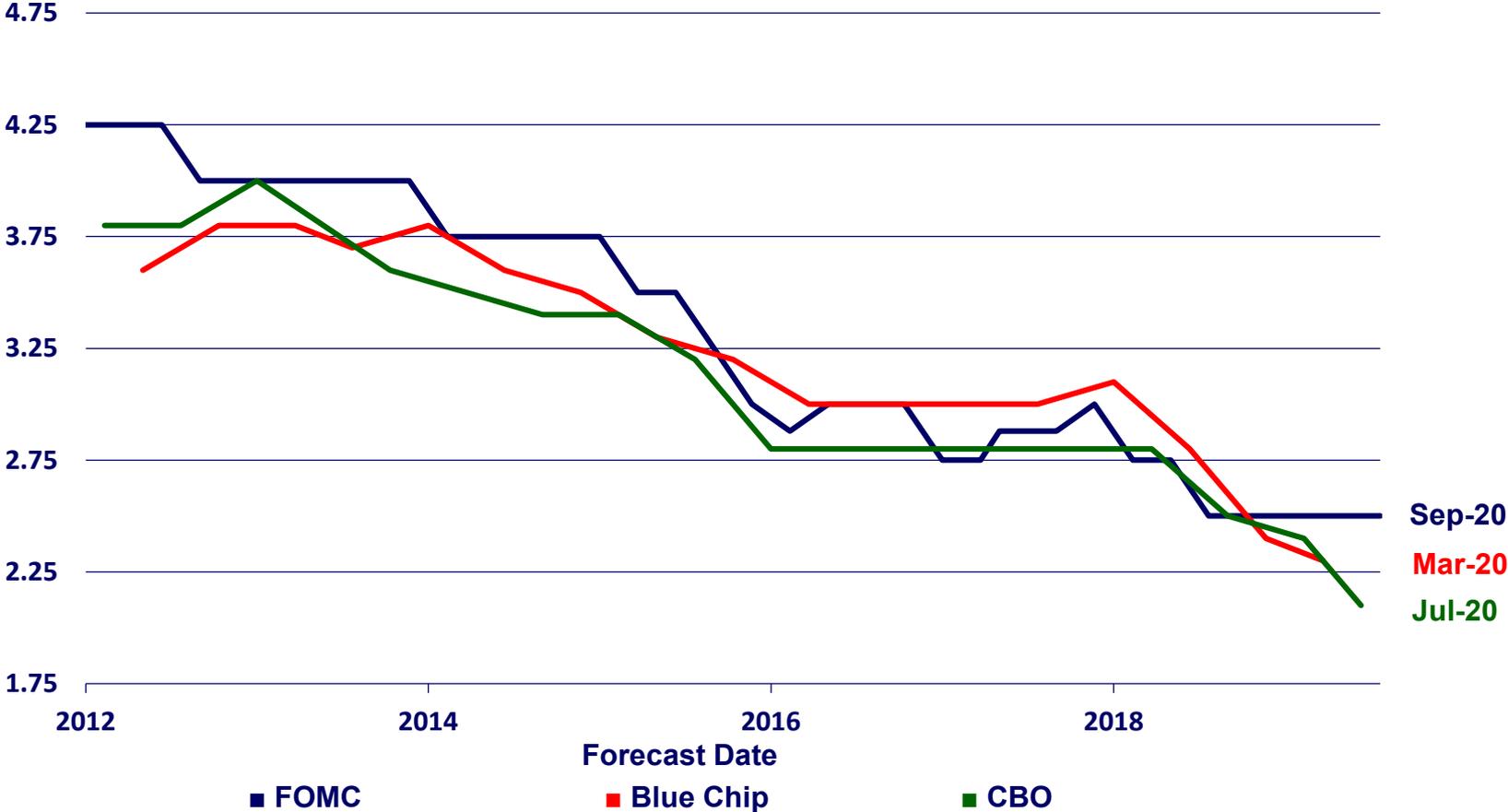
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Outline

- **A new economic environment requires a new strategy to achieve the same goals**
- **Strategy review process**
- **August Statement On Longer-Run Goals and Monetary Policy**
- **Current application: September and November FOMC statements**

Environment: Lower General Level Of Interest Rates

Real-Time Projections of Longer-Run Federal Funds Rate
(Percent)



Note: The Federal Open Market Committee (FOMC) data are quarterly, extend through June 2020, and are median projections of longer-term normal; for 2015:Q1 and 2015:Q2, the data are central tendency midpoints. The Blue Chip data are biannual, extend through March 2020, and are consensus projections for 6 to 10 years in the future. The Congressional Budget Office (CBO) data are biannual, extend through July 2020, and are baseline projections for the calendar year 10 years ahead.
 Source: FOMC, Summary of Economic Projections, available on the Board's website at <https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>; for Blue Chip, Wolters Kluwer, Blue Chip Economic Indicators; for CBO, Congressional Budget Office (The Budget and Economic Outlook, 10-Year Economic Projections).

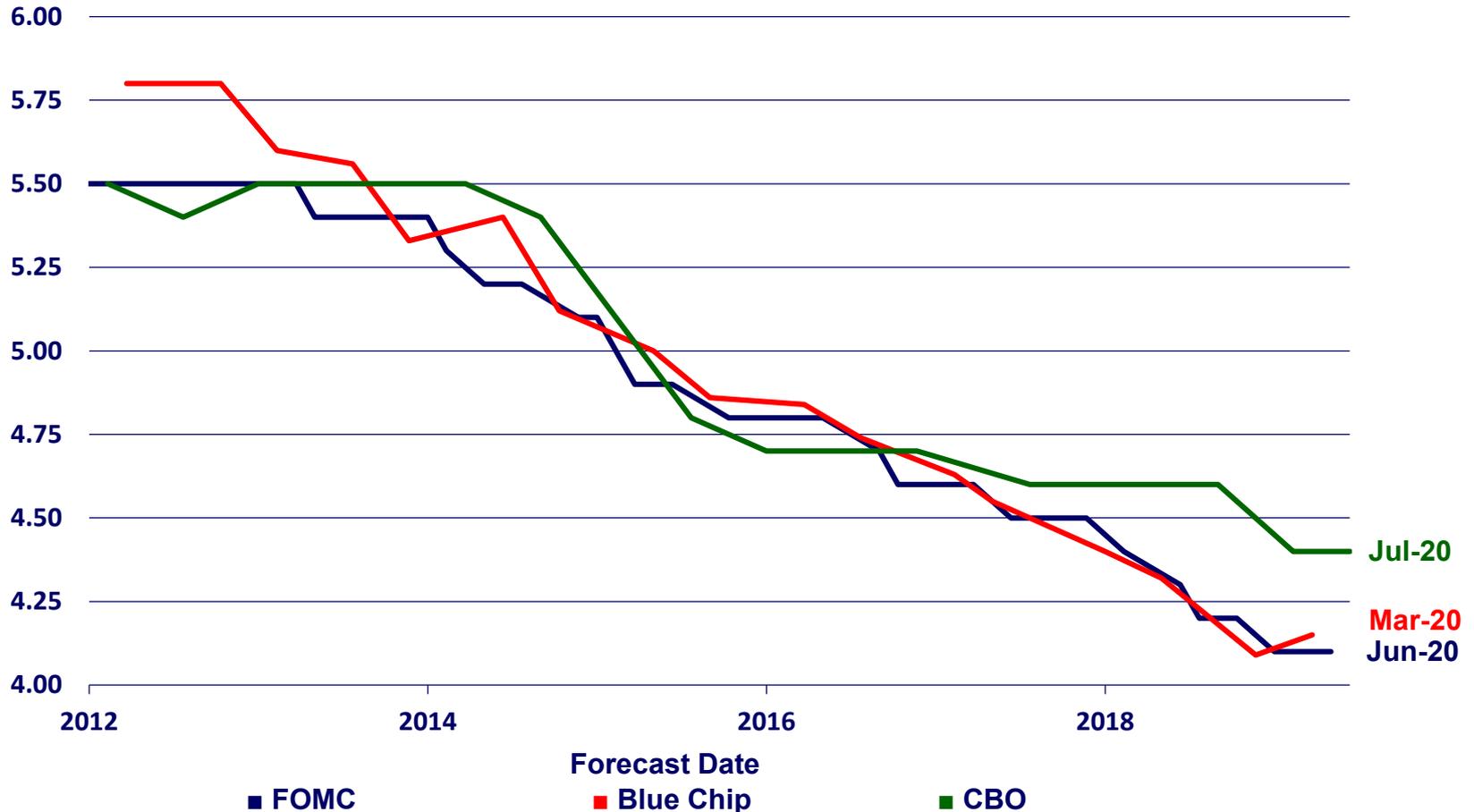
Fed Funds Rate Cuts By Recession

Recession	Starting Inflation	Starting Real Rate	Starting Nominal Rate	Nominal Rate Cut
1960-61	2.0	2.0	4.0	2.0
1969-70	4.7	4.3	9.0	5.3
1973-75	4.6	5.4	10.0	4.5
1980	7.9	5.8	13.8	4.2
1981-82	8.9	10.2	19.1	10.2
1990-91	4.0	4.3	8.3	2.4
2001	1.9	4.6	6.5	4.8
2007-09	2.0	3.3	5.3	5.1
2020	1.9	-0.3	1.6	1.8

Environment: Lower Natural Rate Of Unemployment

Real-Time Projections of Longer-Run Unemployment Rate

(Percent)

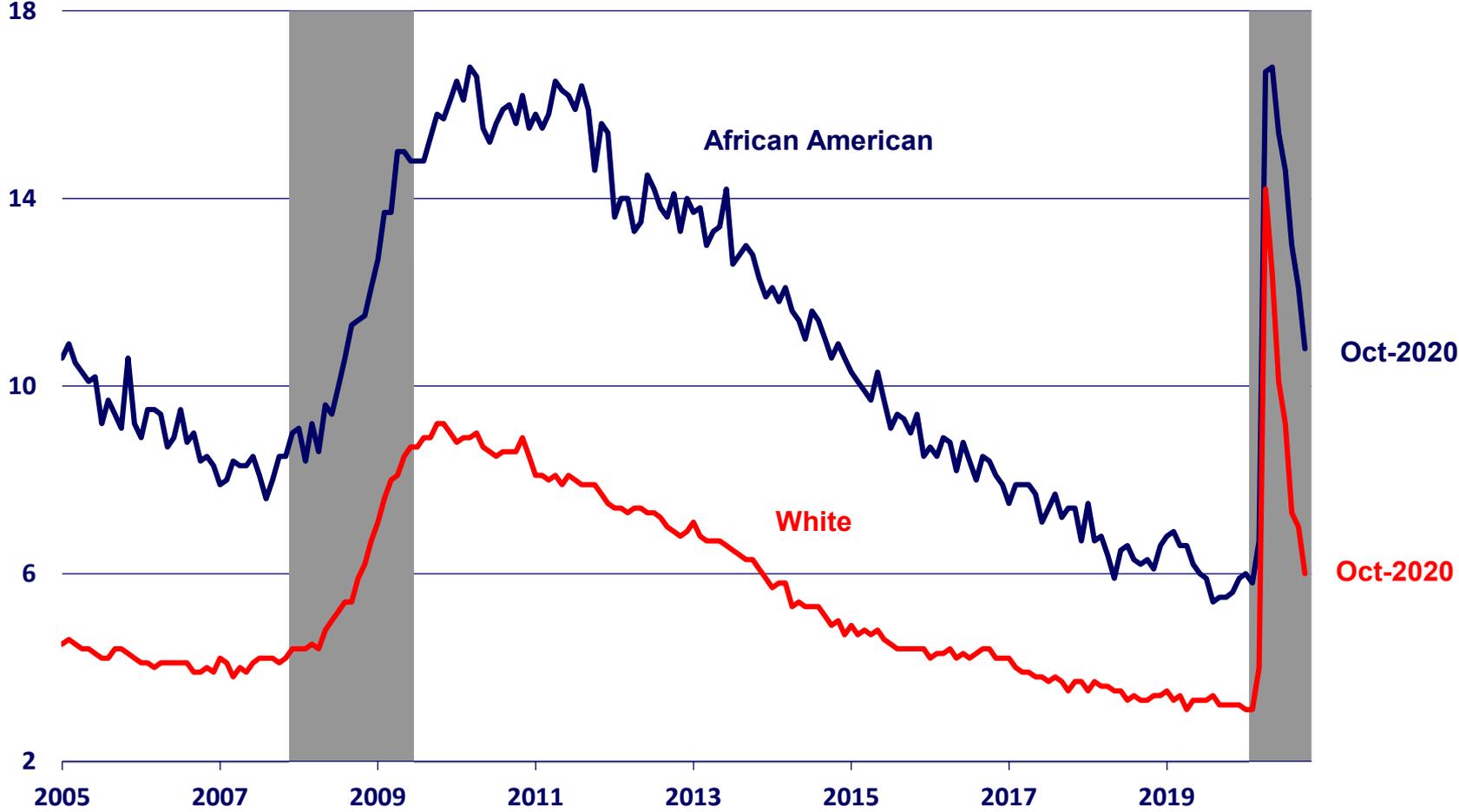


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Environment: More Inclusive Employment Possible

Unemployment Rates by Race
(percent, SA)



Source: Bureau of Labor Statistics from Haver Analytics

New Environment

■ Rate environment

- “Neutral” federal funds rate is lower
- Effective Lower Bound (ELB) is closer
- Ordinary shock can require setting funds rate at zero
- ELB constraint => policy accommodation will frequently be inadequate for substantial periods of time
- Without further adjustments, have a downward bias on inflation

■ Employment and inflation environment

- Have had what historically seemed like low unemployment without high inflation
- Can we be confident that unemployment is “too low” if we don’t see inflation?
- Potential for “maximum employment” to be more inclusive

2019-20 Strategy Review

- **Major goals of monetary policy were not part of review**
 - 2% PCE inflation
 - Maximum sustainable employment
- **June 2019 Fed Listens Research Conference in Chicago**
- **15 Fed Listens events across the country**
- **Fed System analytical work**
 - 12 memos to the FOMC that are now public
- **FOMC discussions**

August 2020 Strategy Statement

- **Acknowledges increased ELB risk**
 - Greater downward risks to inflation and employment
 - Prepared to use its full range of tools to achieve its goals

- **Maximum employment goal is broad based and inclusive**
 - Emphasizes “shortfalls of employment from its maximum level” rather than the previous “deviations from its maximum level”
 - Wide range of indicators to assess maximum employment

- **Anchoring longer-term inflation expectations at 2% fosters achievement of goals**
 - Seek to achieve inflation that averages 2 percent over time
 - If inflation is persistently below 2%, likely will be appropriate to aim for inflation above 2% for some time

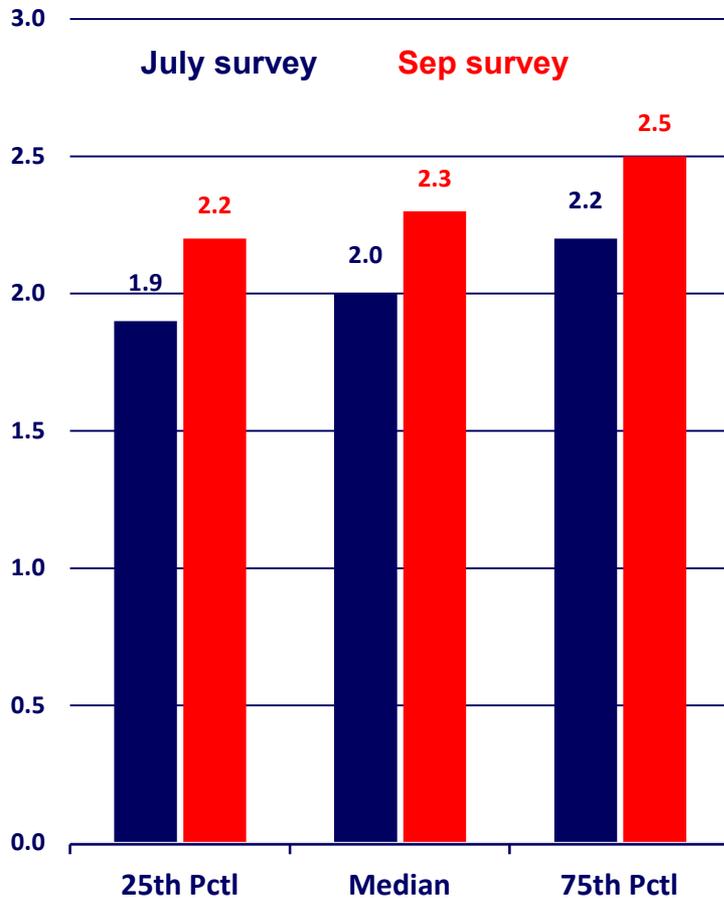
- **Review again every 5 years**

Implications For Monetary Policy

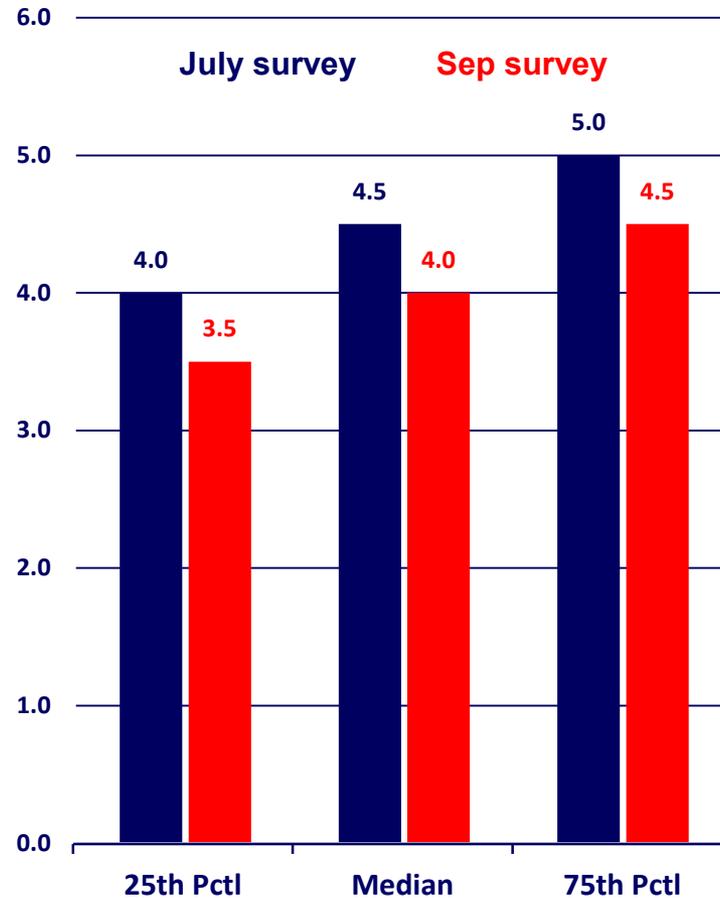
- **Policy will seek to counteract impact of ELB risks to achievement of inflation and employment goals**
- **Committee would not be concerned with what might look like very tight labor markets, so long as they were not generating unwanted inflation or other risks**
- **Flexible Average Inflation Targeting (FAIT): Following a period when inflation is below 2%, monetary policy will seek to achieve inflation moderately above 2% to achieve inflation averages 2 percent over time**

New Strategy Statement Moved Policy Expectations

Expected Inflation at Lift-off (percent)



Expected Unemployment Rate at Lift-off (percent)



Source: Federal Reserve Bank of New York, Survey of Market Participants

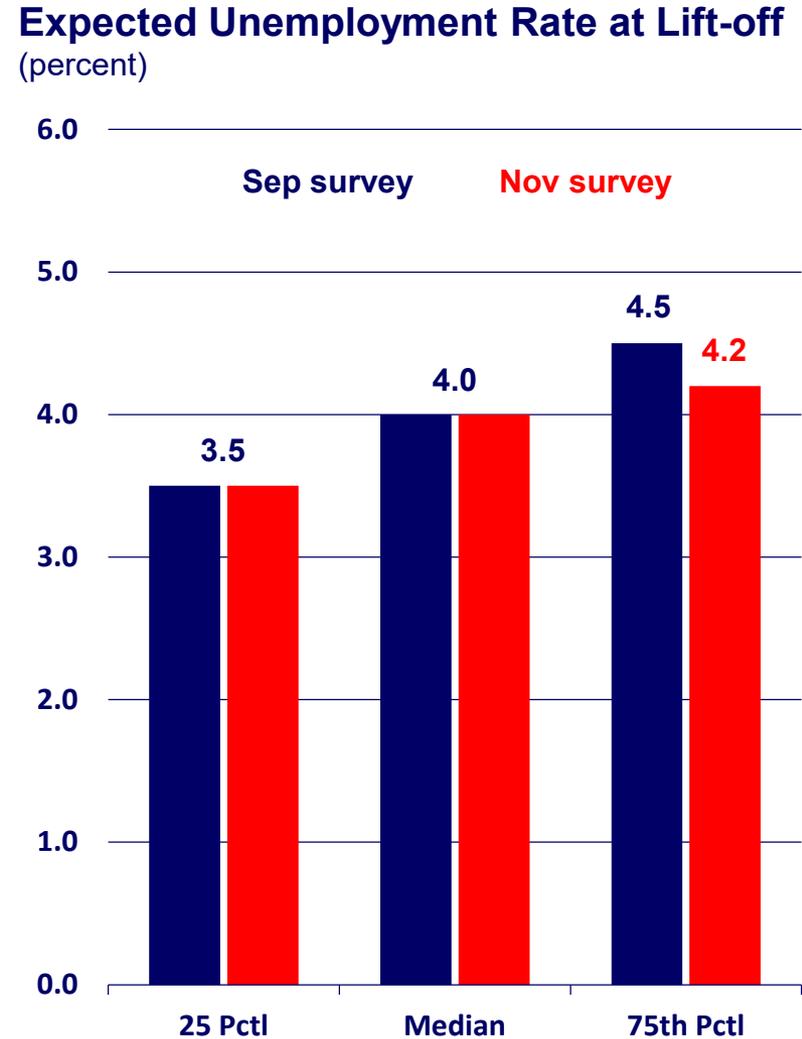
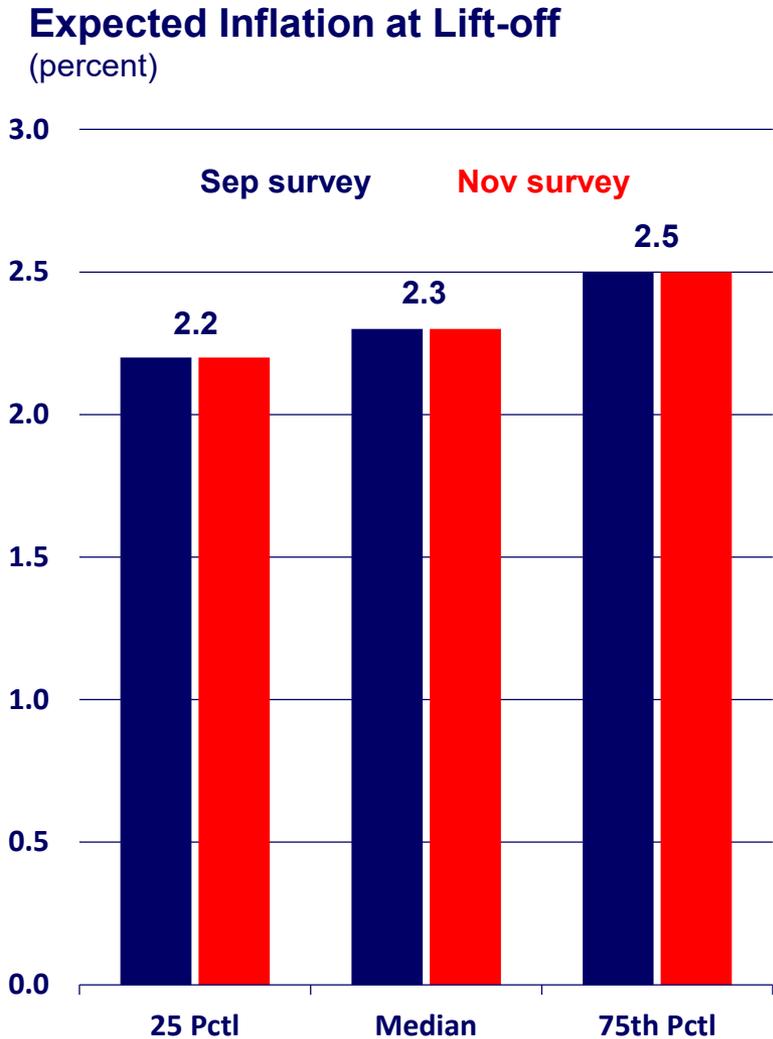
September And November FOMC Statements

- **Implements the principles of the new Strategy Statement**
 - Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent

- **Maintain the current FFR target range until**
 - Labor market conditions are consistent with maximum employment goal
 - And inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time

- **Recognizes that lift-off might happen before reaching goals**
 - Maintain accommodative policy until the job is done

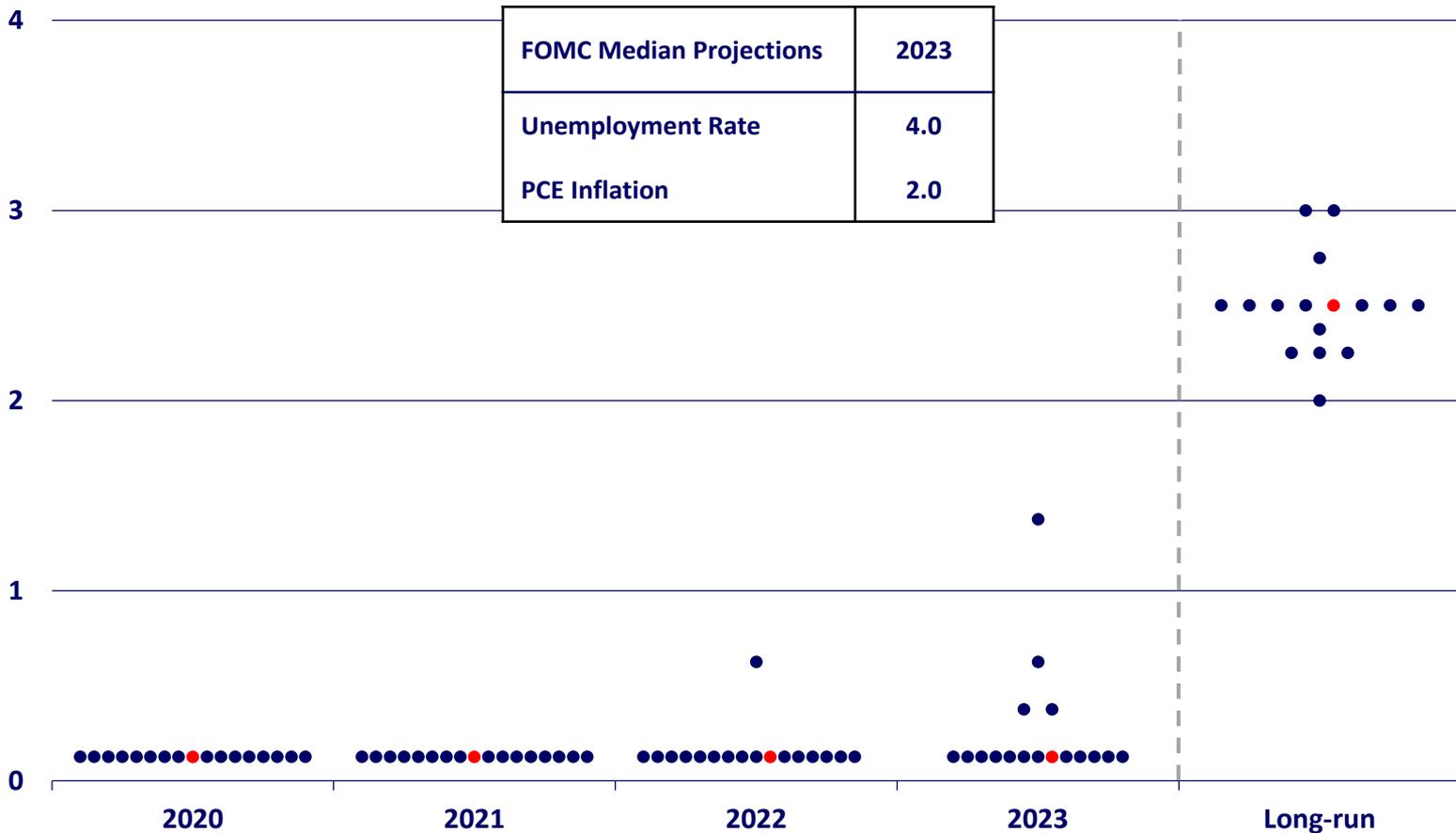
November Statement Consistent With Expectations



Source: Federal Reserve Bank of New York, Survey of Market Participants

September FOMC Dot Plot

Target Federal Funds Rate at Year-End (percent)

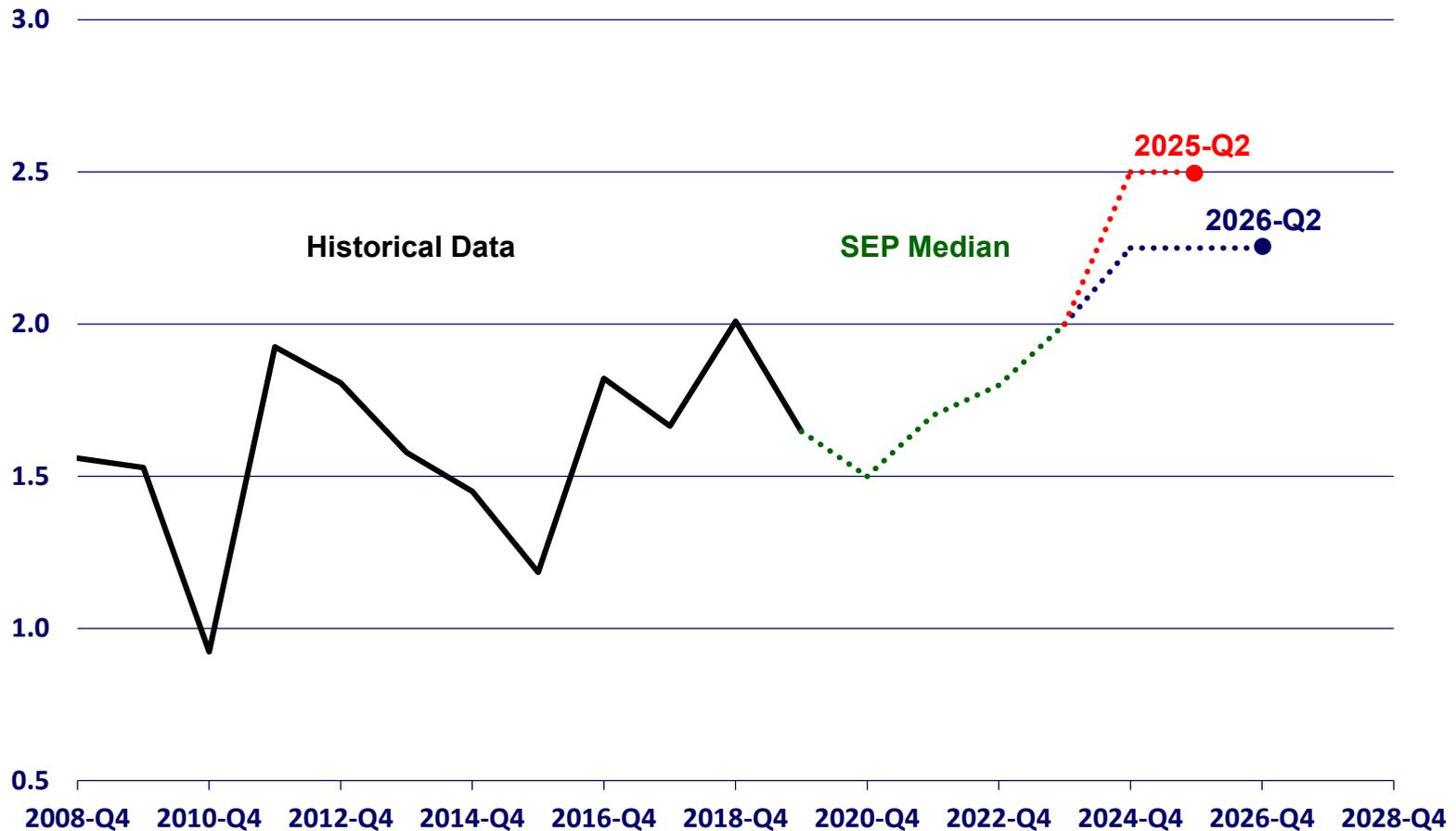


Source: September 2020 FOMC Summary of Economic Projections. Red points indicate the median projection.

Getting Inflation To Average 2%

Alternative Future Inflation Paths: Core PCE Inflation

(Q4/Q4, percent)



**The two possible future inflation paths have the median forecast for core PCE inflation for 2020-2023 from the September 2020 Summary of Economic Projections (SEP).*

The blue line assumes inflation is constant at 2.25% thereafter; the red line assumes inflation is constant at 2.5% thereafter.

The square marker on each path shows the quarter in which inflation will average 2%, with averaging starting in 2020.

Source: FOMC SEP, September 16, 2020; and Haver Analytics

Summing Up

■ **New strategy**

- Addresses increased ELB risk in the new environment
- Inclusive employment; minimize employment shortfalls
- FAIT: If inflation has been below 2%, FOMC will seek inflation moderately above 2% for some time so that inflation averages 2 percent over time

■ **Implementation: September and November FOMC statements**

- Rate guidance consistent with new strategy

■ **Gauging success**

- Framework moved expectations about policy in a good way
- But achieving 2% average inflation is likely still a while off

■ **Questions**