

Perspectives on Monetary Policy and the Fed's Framework Review

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* These slides are based on a paper entitled "Challenges Around the Federal Reserve's Monetary Policy Framework and Its Implementation" with William English (Yale School of Management) that will appear in the upcoming volume of Brookings Papers on Economic Activity.

Statement on Monetary Policy Strategy (2020)

- Focus on “shortfalls” from maximum employment
 - “In setting monetary policy, the Committee seeks over time to mitigate shortfalls of employment from the Committee’s assessment of its maximum level”
 - This language replaced “deviations” from full employment
- Adoption of Flexible Average Inflation Targeting (FAIT)
 - The FOMC “judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time”
 - This is a make-up strategy of the type that appears effective in models
 - The amount of intended inflation overshooting was not specified

Implementation of the Policy Framework

- Guidance on the path for the federal funds rate
 - In September 2020, the FOMC indicated that it “expects it will be appropriate to maintain this target range [0 to ¼ percent] until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.”
- Large-scale asset purchases
 - The FOMC conducted rapid purchases for several months beginning March 2020
 - In December 2020, it stated that it will increase its holdings of Treasury securities by \$80 bn per month and agency mortgage-backed securities by \$40 bn per month “until substantial further progress has been made toward the Committee's maximum employment and price stability goals.”
 - Net purchases continued until March 2022, totaling \$4.5 trillion

Views on the Fed's 2020 Policy Framework

Statement on Strategy

Framework was aimed too narrowly at the specific set of circumstances the Fed had faced through 2019

- The strategy document should be more “constitutional”

Specific suggestions:

- Drop indication that policy will only respond to “shortfalls”
- Move from FAIT to more traditional inflation targeting

Implementation of Framework

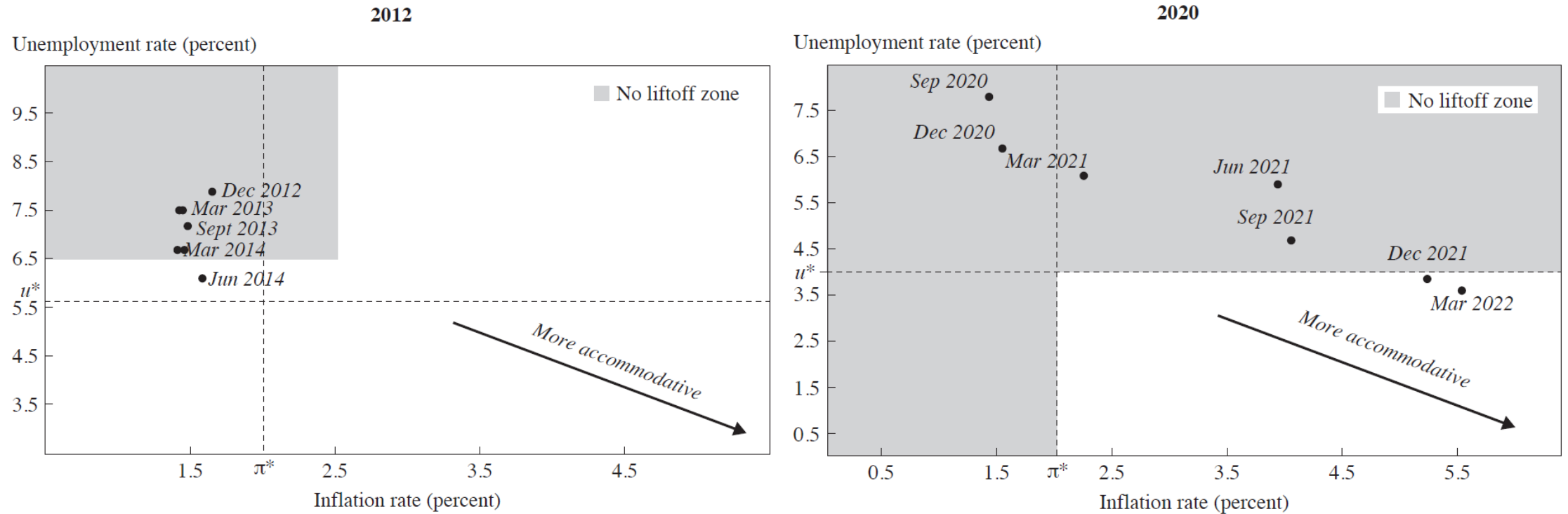
Ensure that conditioning of federal funds rate guidance on economic outcomes is appropriate

More carefully calibrate asset purchases and communicate more extensively about their path

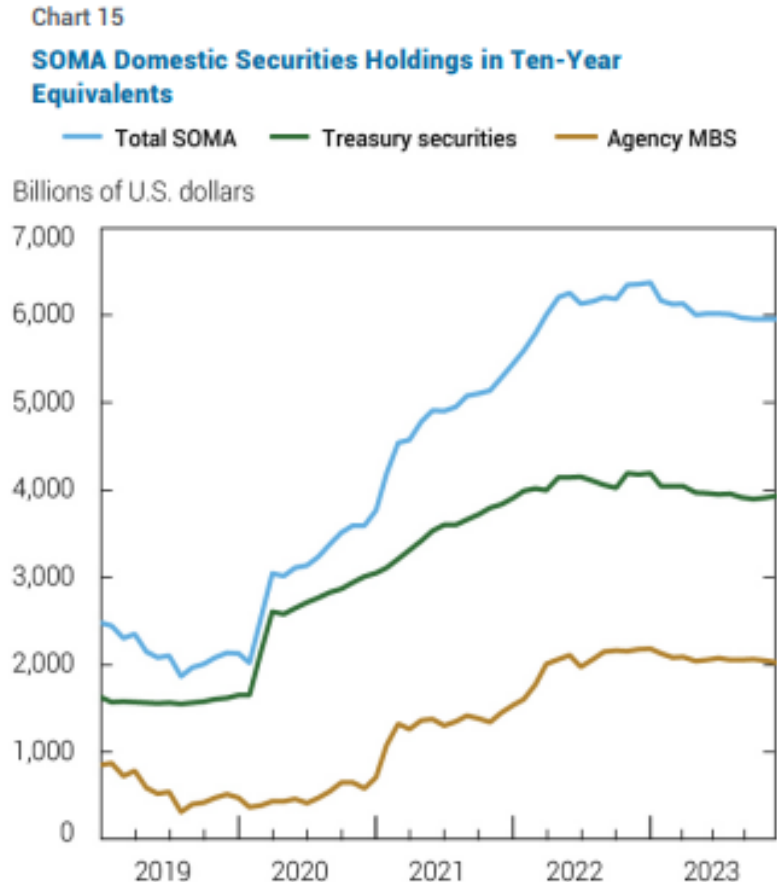
More clearly separate monetary-policy asset purchases from market-functioning asset purchases

Effective Conditioning of Policy Rate Guidance

Figure 2. Guidance on Policy Rate Liftoff



Appropriate Calibration and Structure of QE



- QE4 totaled about 15% of GDP in terms of ten-year equivalents
 - Effective policy rules did not call for that much additional accommodation over 2021H2 and 2022H1
- The maturity structure of QE4 was much shorter than QE3
 - About 50% of purchases for QE4 were at maturities <4.5 years, versus 6% for QE3
 - Probably not the optimal structure once moved past market-functioning purchases