

Figures for “Considerations for the Federal Reserve’s Upcoming Framework Review”

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Remarks for the Panel on How Should the Fed’s Monetary Policy Framework Change?

66th NABE Annual Meeting:

“Finding Harmony in the Noise: Transitioning to a New Normal”

National Association for Business Economics (NABE)

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Figure 1. FOMC's Monetary Policy Framework

- Summarized in its statement on longer-run goals and monetary policy strategy
 - First published in 2012
 - Set explicit numerical goal for inflation of 2 percent
 - Framework was reviewed and changed in 2019-2020
- FOMC planning to review framework starting later this year
 - Strategy, tools, communications
- Current framework was put to test during the pandemic and post-pandemic period
- Economic environment now differs from environment during last framework review in 2019-2020
 - Then: Low r^* , low inflation, low u
 - Now: High inflation, low u , r^* may have risen

Figure 2. Lessons for the Framework Review

Overarching principle:

- Monetary policy framework should be effective across a wide variety of economic circumstances.
 - Unwise to over-index on recent history
 - Robust to different possible scenarios

Figure 3. Goals

Price stability

- Reaffirm 2 percent inflation target
- Assess factors that affect trend inflation: changes in globalization, expectations, automation, labor market trends
- Consider establishing a operating range around point inflation target
- Retain language that inflation over longer run is largely determined by monetary policy

Maximum Employment

- Retain language explaining why FOMC cannot set an explicit numerical employment goal
- Add language saying that maximum employment is the highest level that is consistent with price stability.

Figure 4. Strategy

More symmetric approach

- Recognize inflation can run persistently **above** target as well as persistently **below** target
- Recognize that employment that is unsustainably above maximum employment can contribute to price pressures: use labor market conditions to help forecast inflation
- Change “shortfalls” back to “deviations”
- Reaffirm 2 percent inflation target

More forward-looking and pre-emptive approach

- Policy necessarily entails forecasts, even though there is uncertainty and risks to the forecast

Figure 5. Communications

FOMC should “use its words”

- Take control of the narrative and better explain the reaction function
 - Economic developments → outlook and risks → policy

Scenario analysis

- Somewhat less emphasis on modal outlook and a bit more on risks to the modal outlook and plausible alternative scenarios
- Can improve communications and policymaking

Improve SEP

- “Connect the dots”: Link policy paths to the economic forecasts
- Consider consensus forecast or publishing staff forecast

Figure 6. Tools

Balance sheet

- Purpose of asset purchases – monetary policy or financial stability
- How and when to exit

Forward guidance

- During pandemic: FOMC “expects it will be appropriate to maintain [the 0-1/4 percent] target range 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”
- More flexibility (escape clauses) so easier to change policy when needed

Figure 7. Financial Stability

How should financial stability considerations be incorporated into the monetary policy framework?

- Intertemporal tradeoffs between monetary policy and financial stability goals
- How to limit tradeoffs
- How to respond when such tradeoffs arise

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