



EMBARGOED UNTIL MONDAY , JANUARY 8, 2018 AT 4:25 P.M.; OR UPON DELIVERY

Reviewing Monetary Policy Frameworks

Eric S. Rosengren
President & CEO
Federal Reserve Bank of Boston

January 8, 2018

Brookings Forum on the Federal Reserve's Inflation Target
Hutchins Center on Fiscal & Monetary Policy
Washington, DC

bostonfed.org



United States Monetary Policy Framework

- ▶ Dual Mandate – maximum sustainable employment and stable prices
 - ▶ Explicitly defined stable prices as 2 percent PCE inflation
 - ▶ Maximum employment does not have a numerical target – given that the natural rate can move over time
 - ▶ Balanced approach – gives equal weight to deviations from both targets
 - ▶ Each January the Committee reaffirms the framework
 - ▶ Potential to make changes each January – to date changes have been relatively modest
 - ▶ No mechanism equivalent to the five-year review done by Bank of Canada with outside comments and a public process
-



Why Should the Framework Potentially Change, if the Congressional Mandate Does Not?

- ▶ The 2 percent inflation target reflected a commonly used target of other central banks, and was consistent with a literature that viewed a 2 percent target as likely to be in the neighborhood of optimal
 - ▶ That research significantly underestimated the real-world probability of hitting the effective lower bound
 - ▶ Current characteristics of slow productivity growth, slow population growth, and aging demographics increase the probability of hitting the lower bound
 - ▶ In fact, the optimal rate of inflation may move around just as does the natural rate of unemployment
-



Difficulty in Achieving Inflation Targets

- ▶ The U.S., Euro Area, and Japan have all fallen short of their inflation targets since the onset of the financial crisis
 - ▶ Undershooting on inflation has occurred despite aggressive use of less-traditional monetary policy tools in the aftermath of the financial crisis, Great Recession, and very slow recovery
-



Other Factors Need to be Considered

- ▶ Fiscal policy constrained by rising debt-to-GDP ratios
 - ▶ The potency of nontraditional monetary policy tools in generating robust recoveries is a topic of debate
 - ▶ The trade-offs between the goals – and even the optimal level of the goals – may be different now than when the FOMC adopted the framework
-



Periodic Reassessment, Like that of the Bank of Canada, Would be Useful

- ▶ Federal Reserve led assessment that includes input from a variety of sources inside and outside the central bank
 - ▶ Consider whether changed economic fundamentals (such as the equilibrium real interest rate) should alter how best to satisfy mandate
 - ▶ Consider whether alternative frameworks would better meet the mandate
 - ▶ Evaluate the costs and benefits of transitioning to a new framework and the longer-run implications
-



What Would be Reassessed?

- ▶ For example, a reassessment might include discussion of whether an inflation range, nominal GDP targeting, or price-level targeting would help the Fed better achieve its Congressionally-mandated goals
 - ▶ In fact, my own view is that we should be focused on an inflation range, with the potential to move within the range as the optimal inflation rate changes
 - ▶ This will be the topic of a talk I am giving later this week, when I will have an opportunity discuss the suggestion more fully
-



Process Should Reflect Unique Central Bank Features

- ▶ Appropriately balance the central bank's accountability to Congress for the mandate with its independence to pursue policymaking and technical refinements
 - ▶ Would need to focus on the structural changes that have reduced the efficacy of the Fed's monetary policy framework, not the injection of short-term partisan political influence
 - ▶ While any significant change in the framework should involve active consultation with Congress, the review should be focused on the technical framework
-



Process Should Reflect Unique Central Bank Features (Continued)

- ▶ My own personal preference would be to conduct a full review with a specified frequency – possibly longer than the five years used by the Bank of Canada
 - ▶ However make it possible to call for an earlier review when warranted
 - ▶ Clearly, however, this is just one approach and there are a variety of other permutations that could be considered by the FOMC
-



Concluding Observations

- ▶ The Bank of Canada provides a process which I view as quite instructive
 - ▶ In my own view, the costs of hitting the effective lower bound for a prolonged period should cause a reassessment of the 2 percent inflation target
 - ▶ Having a process that can fully and more transparently examine the monetary policy framework would be a process improvement
-