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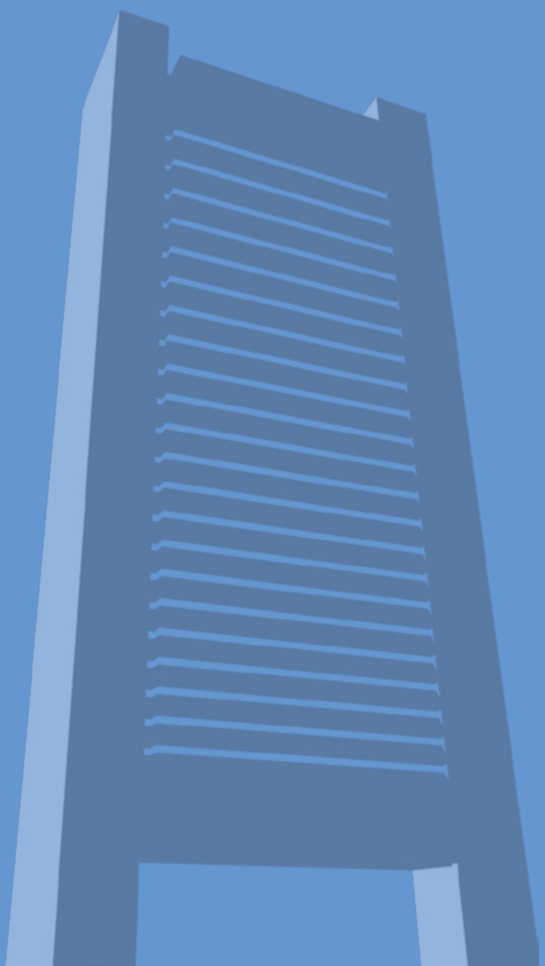
Comments on "A Skeptical View of the Impact of the Fed's Balance Sheet"



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

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bostonfed.org

Overview

The paper:

- Provides a nice overview of the literature on large scale asset purchases (LSAPs)
- Provides a careful historical description of the various LSAP programs
- Expands on the empirical literature
- Concludes that:
  - Previous literature may overstate reliability and effectiveness of LSAPs
  - LSAPs are not a full replacement for conventional policies

Why Should We Care, Now That the LSAP Program is Winding Down?

- How likely is it that we will need the LSAP Program in the future?
- My view is that it is quite likely that we will, because:
  - U.S. is likely to have low real rates for some time, due to slow productivity and slow labor force growth
  - The median long-run federal funds rate in the most recent SEP is only 2.8 percent
  - Almost all recessions have resulted in the Fed lowering nominal rates by much more than 2.8 percentage points
- But if LSAPs are indeed not effective, then the Fed may need to take other measures
  - Might entail altering the monetary policy framework, in a way that would be more likely to avoid short-term rates hitting zero

LSAP versus Conventional Policy Efficacy

- Central bank policymakers have a much better understanding of the impact of short-term interest rates, developed over 30 years
  - Compared to LSAPs, policymakers have navigated many more episodes of short-rate tightening and easing
  - Still, appropriate identification is non-trivial, and we still experience puzzles
    - Proverbial "long and variable lags"
    - Long rate "conundrums" – the expected response of long rates does not materialize
- For LSAP analysis, assessment is much more difficult – in part, due to very limited historical experience
  - Basically just three observations – three LSAP programs during and post crisis
  - Only one exit from LSAP program – and it has barely begun

The Paper’s Empirical Approach

- Identifies days where the 10-year Treasury moves more than one standard deviation and uses Reuters news reports to identify “Fed News” versus other events
- 1125 event days, 161 Fed event days, 348 economic data event days, 191 Europe event days
- Assumptions
  - Fed events are accurately identified and non-Fed events are not due to Fed actions
  - Events captured in one day – no lingering impact

Are the Paper's Assumptions Actually Innocuous?

- Speeches by FOMC participants often referred to policy as "data dependent"
- Note: 348 economic data event days, 191 Europe days, but 161 Fed days – third party identification does not necessarily make it more accurate
- "Data dependence" implies meaningful economic data have implications for monetary policy
  - Weak economic data in the study viewed as having no implications for monetary policy
  - However, weak data likely to also imply more LSAPs and longer period before raising rates
  - Similarly, Europe days have implications for both LSAPs in Europe and future strength in U.S., from international impact

10-Year Treasury Rate

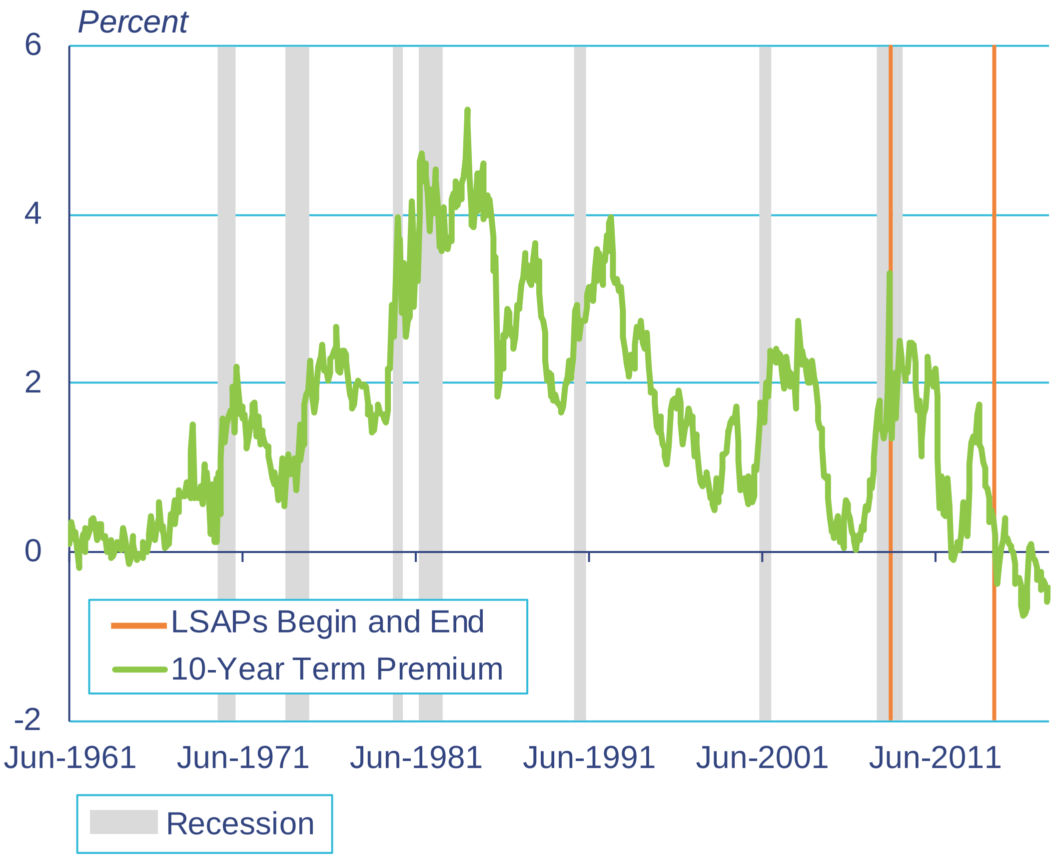
- Potential confounding events?
  - Fiscal policy
    - Changes in government deficit expectations
    - Government shutdowns, debt ceilings, Treasury debt management changes
  - International: LSAP programs and interest rate changes in Japan and Europe likely influence U.S. Treasuries – global arbitrage in sovereigns
  - Inflation surprises (because of focus on nominal rates) – what happened to real rates?

Alternative Focus on Enduring Impact

- I suggest more focus on term premia… potentially providing better measure of effects of LSAPs?
- Term premia in U.S. and countries that used LSAPs remain low by historical standards – could this, in part, be the enduring impact from LSAPs?
- Did LSAP programs lower the volatility of financial markets?
- Consider suggestive evidence – using other than event study techniques

Figure 1: Ten-Year Treasury Term Premium

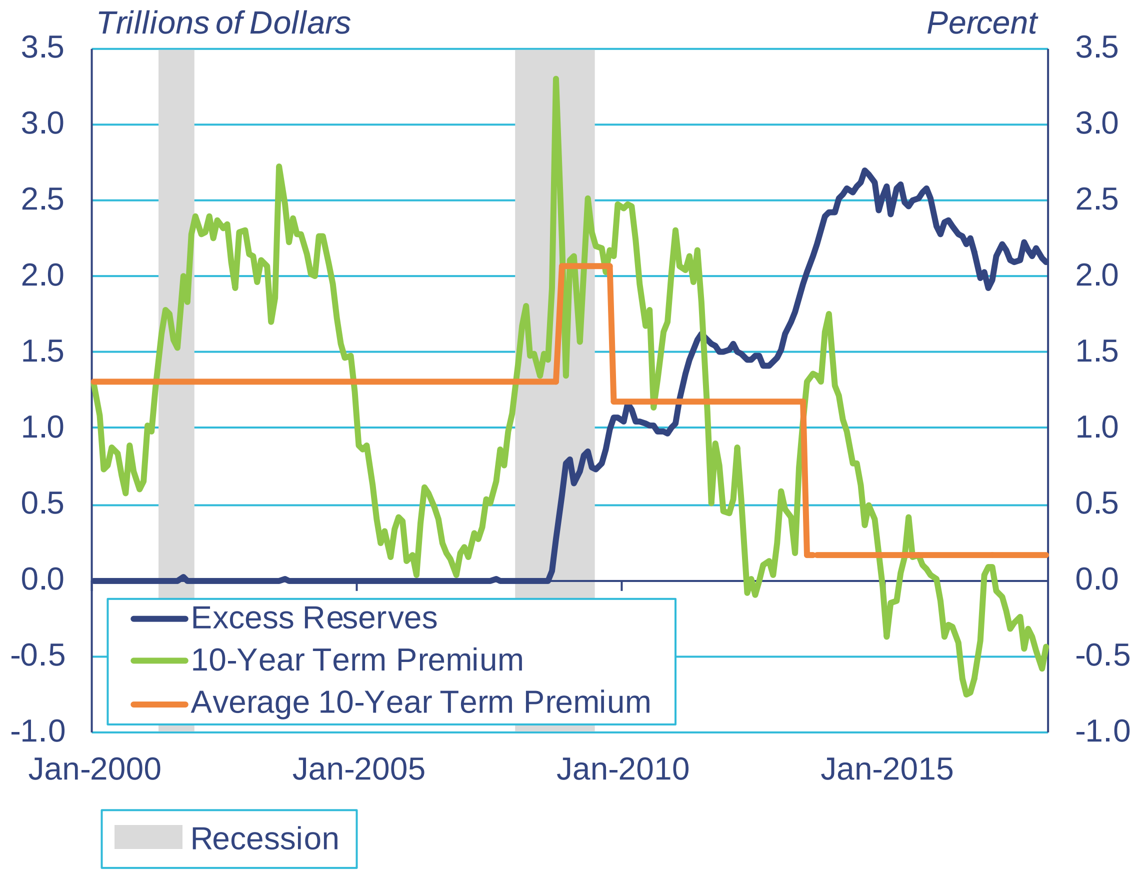
June 1961 - January 2018



Source: Federal Reserve Bank of New York, Adrian, Crump and Moench (ACM) Treasury Term Premia Estimates; NBER; Haver Analytics

Figure 2: Ten-Year Treasury Term Premium and Excess Reserves

January 2000 - January 2018

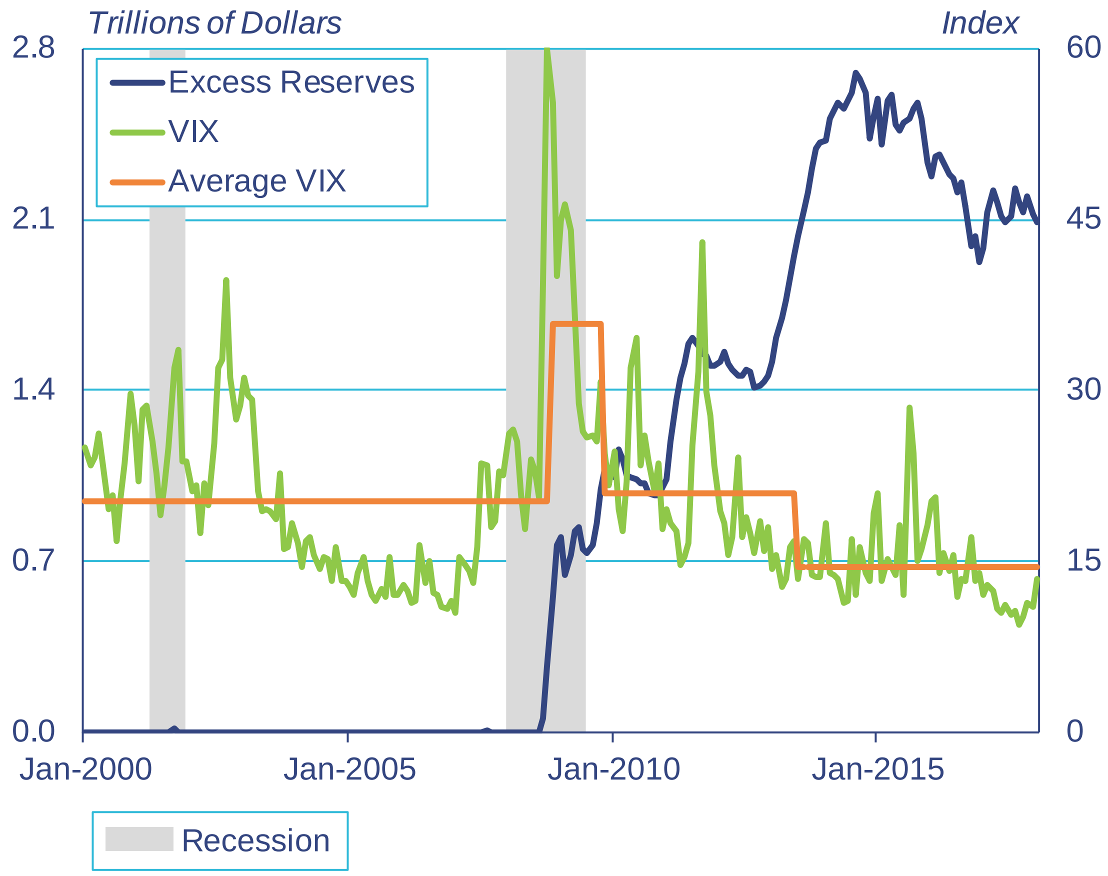


Note: The average term premium is calculated for four different periods – when excess reserves are less than $500 billion, $500 billion to $1 trillion, $1-$2 trillion and $2 trillion or more.

Source: Federal Reserve Bank of New York, Adrian, Crump and Moench (ACM) Treasury Term Premia Estimates; Federal Reserve Board; NBER; Haver Analytics

Figure 3: CBOE Market Volatility Index and Excess Reserves

January 2000 - January 2018



Note: The average VIX is calculated for four different periods – when excess reserves are less than $500 billion, $500 billion to $1 trillion, $1-$2 trillion and $2 trillion or more.

Source: CBOE, WSJ, Federal Reserve Board, NBER, Haver Analytics

Overall Assessment

- It was a difficult empirical task to unravel the impact of limited programs with confounding effects
- With only 3 decisions, having so many events describing the decisions reduces the average effect, which is one reason why I have a more favorable assessment of LSAPs
- Might want to expand ways of determining enduring effects beyond event analysis
- Agree the evidence is consistent with some impact, of uncertain magnitude
- While not tested in this paper – agree that short-term rates are the better understood and tested way to conduct monetary policy

Implications for Next Recession, in My View

- Should avoid hitting effective lower bound with short-term rates
- Fiscal policy represents one alternative
  - Difficult to depend on given political pressures and uncertainties
  - Large deficits now may make future actions difficult
- Could alter the Fed's monetary policy framework to reduce probability of hitting zero lower bound
  - There are many possible alternative frameworks – I personally view inflation range with varying inflation target as promising