Lael Brainard: "Fed Listens" in Cincinnati- how does monetary policy affect your community?

Speech by Ms Lael Brainard, Member of the Board of Governors of the Federal Reserve System, at the Policy Summit 2019 "Connecting People and Places to Opportunity", Federal Reserve Bank of Cleveland, Cincinnati, Ohio, 21 June 2019.

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It is good to be here in Cincinnati. I want to thank my colleague, Loretta Mester, for inviting me to participate today, and it is a pleasure to participate in the Federal Reserve Bank of Cleveland's Policy Summit.[1]

Today's session is part of a series called *Fed Listens.* The Federal Reserve is reaching out to communities around the country to hear how Americans are experiencing the economy day to day and to make sure we are carrying out the monetary policy goals assigned to us by the Congress in the most effective way we can.[2]

The Congress has assigned the Federal Reserve to use monetary policy to achieve maximum employment and price stability. These two goals are what we refer to as our dual mandate. By price stability, we mean moderate and stable inflation. The Federal Open Market Committee (FOMC)—the group at the Fed responsible for determining monetary policy—has announced that our goal is to keep inflation around 2 percent over time. The maximum-employment part of our dual mandate means that the Congress has directed us to achieve the highest level of employment that is consistent with price stability.

The Outlook

Earlier this week, President Mester and I participated in the meeting of the FOMC, where we had the opportunity to share our views on the economy and policy. My own assessment is that the most likely path for the economy remains solid. The latest data suggest that consumer spending is robust, and consumer confidence is high. Although the pace of payroll gains has moderated recently, unemployment is at a 50-year low, wages are growing, participation in the labor force has expanded, and unemployment insurance claims are at cycle lows. Despite recent volatility, financial conditions overall remain supportive.

Recent weeks, however, have seen important downside risks. Crosscurrents from policy uncertainty have risen since early May, crimping business investment plans, raising concerns in some financial market segments, and weighing on global growth prospects. Foreign authorities are seeking additional policy space to address growth and inflation shortfalls. In addition, recent indicators of inflation and inflation expectations have been disappointing, making it all the more important to sustain the economy's momentum.

The downside risks, if they materialize, could weigh on economic activity. Basic principles of risk management in a low neutral rate environment with compressed conventional policy space would argue for softening the expected path of policy when risks shift to the downside.[3]

Our Review

With recent indicators suggesting the expansion is continuing at a solid pace and unemployment at a 50-year low, inflation has not yet moved to our goal on a sustained basis. In many ways, that can be viewed as an opportunity, with the sustained expansion providing critical job opportunities to a broader set of applicants. In parallel, it is also vital that a central bank meets its inflation target on a sustained basis, which will provide more capacity to buffer the economy if it encounters headwinds.

We are undertaking our review to ensure we are well positioned to meet our goals for many years to come, especially in light of the way the economy is changing, which I have been referring to as the "new normal."[4] There are a few key features of that new normal. First, interest rates have stayed very low in recent years in the United States and in many other advanced economies, and it seems likely that equilibrium interest rates will remain low in the future. Low interest rates present a challenge for traditional monetary policy in recessions. In the past, the Federal Reserve has typically cut interest rates 4 to 5 percentage points in order to support household spending and business investment. However, when equilibrium interest rates are low, we have less room to cut interest rates and less room to buffer the economy using our conventional tool.

Another big change in the economy is that inflation does not move as much with economic activity and employment as it has in the past, which is what economists mean when they say the Phillips curve is very flat. A flat Phillips curve has important advantages: The labor market can strengthen a lot and pull many workers who may have been sidelined back into productive employment without an acceleration in inflation, unlike what we saw in the 1960s and 1970s.

On the other hand, today's low sensitivity of inflation to slack, along with the limited ability to cut interest rates in a recession, means it can be more difficult to achieve our 2 percent inflation objective on a sustainable basis. The limited ability to cut interest rates could provide less ability to buffer the economy in a downturn, while the very flat Phillips curve could make it harder to boost inflation during an expansion. And that could further compress policy space in a negative spiral.

As we have seen in other countries, if inflation consistently falls short of the central bank's objective, consumers, workers, and businesses start to expect lower inflation to continue. Expectations of low inflation can create a self-fulfilling dynamic with actual inflation, making it even more difficult for the central bank to boost inflation. And because inflation is reflected in nominal interest rates, that, in turn, can reduce the amount of policy space the central bank has available to prevent the economy from slipping into recession. In fact, in recent years, central banks around the world have had to use a larger variety of policy tools than they have traditionally used to support the recovery.

Some Issues to Explore

Given the new normal of low equilibrium interest rates and low sensitivity of inflation to slack, it is prudent to assess how well various approaches worked both here and around the world, with a view to identifying the best ways to promote the goals the Congress assigned to us. Earlier this month, we held a conference in Chicago where we heard from experts as well as community organizations, small businesses, labor organizations, and retirees. We are looking at our tools and strategies, assessing not just the various approaches that were undertaken, but also approaches that have been proposed but not tried.

One of the ideas discussed in Chicago is that the Federal Reserve should explicitly promise to "make up" for misses on inflation during a downturn. The Federal Reserve could hold interest rates lower after a recession is over, perhaps by promising not to raise interest rates until inflation or the unemployment rate have reached particular levels.[5] A related idea discussed in Chicago is average inflation targeting, meaning the Federal Reserve would aim to achieve its inflation objective, on average, over a longer period of time—perhaps over the business cycle.[6] This approach could also have aspects of a makeup policy, depending on how it is designed. While such approaches sound quite appealing on their face, they have not yet been implemented in practice. There is some skepticism that a central bank would in fact prove able to support above-target inflation over a sustained period without becoming concerned that inflation might accelerate, and inflation expectations might rise too high.

At the Chicago conference, we also heard how difficult it can be to estimate with any precision the "maximum employment" leg of our dual mandate.[7] There is no fixed destination point for maximum employment—no single number where we can be sure we are "there." Maximum employment is something that we must learn about by seeing how the job market is operating. That is very different from the longer-run level of inflation, which central banks are presumed able to determine over time.

At our conference in Chicago, we also asked the panelists about our communications with the public, and the responses were humbling. The Federal Reserve communicates with the public about monetary policy through a variety of channels. At each of our policy-setting meetings, the FOMC issues a statement, and Chair Jerome Powell holds a press conference. Three weeks after the meeting, the minutes of the meeting are published. Twice a year, the Federal Reserve submits a *Monetary Policy Report* to the Congress.

We heard in Chicago that most members of the public care a lot about the job market and the cost of credit, but they are not aware of our communications about monetary policy.[8] Of course, the media plays an important role in communicating our monetary policy actions and how they affect the economy. And the Congress, which plays an important role in overseeing the Fed, is a key audience as well. Nonetheless, considering how we can provide greater visibility to the public about what we do will be one of the issues we will be considering as our policy review continues.

Listening

Now, how does today's event fit into all of this? Since I arrived at the Fed, I have derived tremendous benefit from visiting communities all over the country to hear from them how they are experiencing the economy. Today President Mester and I want to hear from you. How is your community experiencing today's economy? Is everyone who wants a job able to get one? Can they get the necessary training? Are businesses finding it relatively easy to hire the workers they need? How does price inflation and wage growth affect you? What about the availability and cost of credit—whether to start or expand a small business, buy a car to get to work, or invest in owning a home or getting a degree? And are there ways we can better communicate with you? I look forward to hearing your views on these and other questions.

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1 I am grateful to John Roberts of the Federal Reserve Board for his assistance in preparing this text. These remarks represent my own views, which do not necessarily represent those of the Federal Reserve Board or the Federal Open Market Committee.

2 See Richard H. Clarida (2019), "The Federal Reserve's Review of Its Monetary Policy Strategy, Tools, and Communication Practices," speech delivered at the 2019 U.S. Monetary Policy Forum, sponsored by the Initiative on Global Markets at the University of Chicago Booth School of Business, New York, New York, February 22; and Jerome H. Powell (2019), "Monetary Policy: Normalization and the Road Ahead," speech delivered at the 2019 SIEPR Economic Summit, Stanford Institute of Economic Policy Research, Stanford, California, March 8.

3 One reason for caution is the risk of building financial market imbalances, such as currently elevated levels of risky corporate debt. In my view, it is better to address such financial imbalances by activation of our countercyclical capital buffer, rigorous use of stress tests, and beefed-up monitoring of leveraged lending than by monetary policy.

4 See Lael Brainard (2016), "The 'New Normal' and What It Means for Monetary Policy," speech delivered at the Chicago Council on Global Affairs, Chicago, Illinois, September 12.

5 5. See Sharon Kozicki (2019), "Monetary Policy Strategies for the Federal Reserve: Discussion of Practical Considerations (PDF)," presentation at the Conference on Monetary Policy Strategy, Tools, and Communications Practices, Federal Reserve Bank of Chicago, June 5.

6 See Lars E.O. Svensson (2019), "Monetary Policy Strategies for the Federal Reserve (PDF)," paper prepared for the Conference on Monetary Policy Strategy, Tools, and Communications Practices. Federal Reserve Bank of Chicago, June 5.

[7] See Katharine G. Abraham and John C. Haltiwanger (2019), "How Tight is the Labor Market? (PDF)" paper prepared for the Conference on Monetary Policy Strategies, Tools, and Communications Practices, Federal Reserve Bank of Chicago, June 5.

[8] See Board of Governors of the Federal Reserve System (2019), "Panel 1: What Does Full Employment Look Like for Your Community or Constituency?" at the Conference on Monetary Policy Strategy, Tools, and Communications Practices, Federal Reserve Bank of Chicago, June 5; and Board of Governors of the Federal Reserve System (2019), "Panel 2: Transmission of Monetary Policy to the Economy: Beyond the Headlines," at the Conference on Monetary Policy Strategy, Tools, and Communications Practices, Federal Reserve Bank of Chicago, June 5.