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The Federal Reserve's Review of Its Monetary Policy Strategy, Tools, and
Communication Practices

Remarks by

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at

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I am pleased to attend this *Fed Listens* event providing the New York perspective for the Federal Reserve’s review of our monetary policy strategy, tools, and communication practices.¹ We are bringing open minds to our review and are seeking a broad range of perspectives. To us, it simply seems like good institutional practice to engage with a wide range of interested individuals and groups as part of a comprehensive approach to enhanced transparency and accountability.²

Motivation for the Review

The Congress charged the Federal Reserve with achieving a dual mandate—maximum employment and price stability—and this review will take this mandate as given. We will also take as given that a 2 percent rate of inflation in the price index for personal consumption expenditures is the operational goal most consistent with our price-stability mandate. While we believe that our existing strategy, tools, and communications practices have generally served the public well, we are eager to evaluate ways they might be improved.

With the U.S. economy operating at or close to our maximum-employment and price-stability goals, now is an especially opportune time for this review. The unemployment rate is at a 50-year low, and inflation is running close to our 2 percent objective. We want to ensure that we continue to meet our statutory goals in coming years. In addition, we will evaluate the new policy tools and enhanced communication practices the Federal Reserve deployed in response to the Global Financial Crisis and the

¹ Additional information about *Fed Listens*, including background information on the initiative and a listing of events around the country, is available on the Board’s website at <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-fed-listens-events.htm>.

² Fuhrer and others (2018) explore the desirability of comprehensive reviews of the monetary policy framework. They argue that such reviews may help the Fed more effectively identify and implement needed changes.

Great Recession. Furthermore, the U.S. and foreign economies have evolved significantly since before the crisis.

Perhaps most importantly, neutral interest rates appear to have fallen in the United States and abroad.³ This global decline in neutral rates is widely expected to persist for years and likely reflects several factors, including aging populations, changes in risk-taking behavior, and a slowdown in technology growth. These factors' contributions are highly uncertain, but, irrespective of their precise role, the policy implications of the decline in neutral rates are important. All else being equal, a fall in neutral rates increases the likelihood that a central bank's policy rate will reach its effective lower bound in future economic downturns. That development, in turn, could make it more difficult during downturns for monetary policy to support household spending, business investment, and employment and keep inflation from falling too low.⁴

Another key development in recent decades is that inflation appears less responsive to resource slack, implying a change in the dynamic relationship between inflation and employment.⁵ This change is, in a sense, a proverbial double-edged sword. It permits the Federal Reserve to support employment more aggressively during downturns—as was the case during and after the Great Recession—because a sustained inflation breakout is less likely when inflation is less responsive to employment

³ For evidence of a fall in neutral rates of interest in the United States and abroad, see, among several contributions, King and Low (2014); Holston, Laubach, and Williams (2017); Rachel and Smith (2017); and Brand, Bielecki, and Penalver (2018).

⁴ For assessments of the risks that U.S. monetary policy will be constrained by the effective lower bound and its implications for economic activity and inflation, see Kiley and Roberts (2017), Erceg and others (2018), Swanson (2018), and Chung and others (2019).

⁵ The apparent diminished responsiveness of inflation to resource slack is known in economic research as a flattening of the short-run Phillips curve. For evidence of this flattening in the slope of the Phillips curve in the United States and abroad, see, among others, Simon, Matheson, and Sandri (2013); Blanchard, Cerutti, and Summers (2015); and Bank for International Settlements (2017).

conditions.⁶ However, that dynamic also increases the cost, in terms of economic output, of reversing unwelcome increases in longer-run inflation expectations. Thus, it is all the more important that longer-run inflation expectations remain anchored at levels consistent with our 2 percent inflation objective.⁷

Finally, the strengthening of the labor market in recent years has highlighted the challenges of assessing the proximity of the labor market to the full employment leg of the Federal Reserve's dual mandate. The unemployment rate, which stood at 3.6 percent in April, has been interpreted by many observers as suggesting that the labor market is currently operating beyond full employment. However, the level of the unemployment rate that is consistent with full employment is not directly observable and thus must be estimated. The range of plausible estimates likely extends at least as low as the current level of the unemployment rate. For example, in the March Blue Chip economic outlook survey, the average estimate of the natural rate of unemployment for the bottom 10

⁶ One potential contributor to the flattening of the Phillips curve is a change in the conduct of monetary policy since the 1980s toward greater stabilization of inflation and economic activity; for evidence of such a change, see Clarida, Galí, and Gertler (2000); Boivin and Giannoni (2006); and Boivin, Kiley, and Mishkin (2010). As discussed in Roberts (2006) and Bullard (2018), greater stabilization on the part of a central bank can lead to the estimation of flatter Phillips curves in reduced-form regressions. Similarly, the adoption of an explicit inflation objective, along with greater certainty regarding the conduct of monetary policy, can help anchor longer-term inflation expectations and stabilize actual inflation in response to shocks.

⁷ See Yellen (2015) for a discussion of inflation dynamics and monetary policy; see Erceg and others (2018) for a quantitative exploration of the monetary policy implications of a flat Phillips curve in an uncertain economic environment. Since the mid-1980s, movements in both realized inflation and measures of longer-term inflation expectations have been somewhat muted, complicating the task of extracting the precise role of inflation expectations as a determinant of realized inflation. Faust and Wright (2013) review the literature on inflation forecasting and present evidence in support of the conclusion that measures of inflation expectations help predict the trend in inflation. Cecchetti and others (2017) showed that while the level of realized inflation and four-quarter-ahead inflation expectations are positively correlated, changes in these variables have been largely uncorrelated since the mid-1980s. These authors suggest that, in a low and stable inflation environment, policymakers should pay attention to a wide array of other indicators in determining the implications of movements in realized inflation and measures of inflation expectations.

respondents was 3.9 percent, as compared with 4.7 percent for the highest 10 respondents.⁸

The decline in the unemployment rate in recent years has been accompanied by a pronounced increase in labor force participation for individuals in their prime working years.⁹ These increases in participation have provided employers with a significant source of additional labor input and may be one factor restraining inflationary pressures. As with the unemployment rate, whether participation will continue to increase in a tight labor market remains uncertain.

The strong job gains of recent years also has delivered benefits to groups that have historically been disadvantaged in the labor market. For example, African Americans and Hispanics have experienced persistently higher unemployment rates than whites for many decades.¹⁰ However, those unemployment rate gaps have narrowed as the labor market has strengthened, and there is some indication of an extra benefit to these groups as the unemployment rate moves into very low territory.¹¹ Likewise, although unemployment rates for less-educated workers are persistently higher than they are for their more-educated counterparts, these gaps appear to narrow as the labor market

⁸ The average estimate from the Blue Chip respondents was 4.3 percent. The box “How Tight Is the Labor Market?” in the Board’s February 2018 *Monetary Policy Report* contains a discussion of some indicators that can be used to assess labor market tightness; see Board of Governors (2018a, pp. 8-9).

⁹ The box “The Labor Force Participation Rate for Prime-Age Individuals” in the Board’s July 2018 *Monetary Policy Report* contains a discussion of recent developments in labor force participation rates for prime-age individuals; see Board of Governors (2018b, pp. 8-10).

¹⁰ See Cajner and others (2017) for a careful examination of how labor market differentials by race and ethnicity have evolved over time.

¹¹ See Aaronson and others (2019) for evidence on the relative behavior of unemployment rates by race and ethnicity in a strong labor market. The authors find similar patterns for labor force participation rates and for employment-to-population ratios.

strengthens.¹² And wage increases in the past couple of years have been strongest for less-educated workers and for those at the lower end of the wage distribution.¹³

Activities and Timeline for the Review

Our monetary policy review will have several components.¹⁴ The Board and the Reserve Banks are hosting *Fed Listens* events—such as this one in New York—in which we are hearing from, among others, business and labor leaders, community development advocates, and academics. Next month, we are holding a System research conference at the Federal Reserve Bank of Chicago, with speakers and panelists from outside the Fed. The program includes overviews by academic experts of themes that are central to the review.

Building on the perspectives we hear and on staff analysis, the Federal Open Market Committee will perform its own assessment of how it conducts monetary policy, beginning around the middle of the year. We expect to make our conclusions public in the first half of 2020.

Concluding Thoughts

The economy is constantly evolving, bringing with it new policy challenges. So it makes sense for us to remain open minded as we assess current practices and consider ideas that could potentially enhance our ability to deliver on the goals the Congress has

¹² Disparities in labor market outcomes are also evident between urban and rural areas of the United States. However, these gaps have not narrowed as the labor market has strengthened. The box “Employment Disparities between Rural and Urban Areas” in the Board’s February 2019 *Monetary Policy Report* examines these disparities in more detail; see Board of Governors (2019, pp. 10-12). See also Weingarden (2017).

¹³ Wage gains for workers with different wage levels and with different levels of education can be calculated using data from the Current Population Survey from the Bureau of Labor Statistics. The Economic Policy Institute (2019) provides convenient tabulations of these data.

¹⁴ Information about the review and the events associated with it are available on the Board’s website at <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications.htm>.

assigned us. For this reason, my colleagues and I do not want to preempt or to predict our ultimate finding. What I can say is that any changes to our conduct of monetary policy that we might make will be aimed solely at improving our ability to achieve and sustain our dual-mandate objectives in the world we live in today.

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