Minutes of the MONETARY POLICY ADVISORY PANEL[1]

Meeting of March 25, 2016

Present: William Dudley, Michael Strine. Guest: James Bullard. Panelists: Markus Brunnermeier, Peter Diamond, Gauti Eggertsson, Takatoshi Ito, Frederick Mishkin, Thomas Philippon, Christopher Sims. FRBNY Staff: Tobias Adrian, Sarah Bell, Nina Boyarchenko, Richard Crump, Marco Del Negro, Stefano Eusepi, Linda Goldberg, Jamie McAndrews, Jonathan McCarthy, Paolo Pesenti, Simon Potter, Aysegul Sahin, Argia Sbordone, Giorgio Topa.

The meeting began with a discussion of negative interest rates, followed by a discussion of FOMC communications and panelists' views on the Summary of Economic Projections (SEP) "dot plots." Panelists then addressed the recurrent turbulence in financial markets and the recent behavior of inflation and inflation expectations.

On negative interest rates

Panelists were generally critical of the use of negative interest rates. It was pointed out that negative policy rates impose costs on banks that can lead to distortions and thus could have unintended contractionary effects on bank lending. Panelists also noted that the reluctance of banks to pass negative rates on to retail depositors could also reduce the efficacy of negative rates as economic stimulus. There was some discussion of the market response to the recent shift to a negative policy rate in Japan, with panelists pointing out the appreciation of the yen in the days after the announcement, contrary to expectations.

Some panelists noted that to judge the efficacy of negative policy rates in improving economic performance one should look at whether they are passed through to rates paid by private borrowers, for instance to mortgage rates. Other panelists pointed out that even with the possibility of negative rates, policymakers should be cautious in removing accommodation because there is still only limited room to ease policy if economic outcomes were to be weaker than anticipated by policymakers. It was also noted that negative rate policies by U.S. trading partners could tighten U.S. financial conditions because of the appreciation of the dollar that would likely result. In these circumstances the appropriate U.S. policy path in their view should be relatively shallow.

On communication and the dot plots

The discussion then turned to FOMC communications. Panelists discussed their views about the downward shift of the "dots" in the March SEP against the background of largely unchanged

[1] The views presented in these minutes are solely those expressed by the panelists, not by FRBNY officials or staff.

participants' economic outlooks. They generally saw the shift in the dots as FOMC participants exercising risk management, motivated by the uncertainty and risks in the global economy. There was some discussion of whether the dot plots provide an effective means of communication about policy. It was noted that because the dot plots are produced infrequently, they very often become "stale" quickly in the eyes of market participants. Nevertheless, panelists were generally against eliminating the dot plot, viewing such a move as a step back in the process of improving policy transparency. Indeed, panelists discussed whether it would be feasible to elicit projections at every FOMC meeting, and even whether the SEP could be enhanced to provide a consensus forecast. Panelists also discussed whether the data dependence of the policy stance could be made more concrete by illustrating appropriate policy paths under alternative economic scenarios.

On the recurrent turbulence in financial markets

The discussion of possible scenarios led to a discussion about the likely factors behind the financial market turbulence in early February. Panelists were asked to compare the more recent episode to the one of last summer; in both cases they agreed that the primary catalyst was the economic environment in China. Panelists pointed out the uncertainty created by recent policy measures in China, and tended to attribute the recent stabilization in financial markets to policy clarifications by Chinese authorities. Nevertheless, panelists noted the challenges faced by policymakers in China as its economy shifts toward greater domestic consumption.

Panelists returned to the issue of the policy divergence between the U.S. and its major trade partners, considering how further appreciation of the dollar could be a major risk to the U.S. outlook through a larger than intended tightening of U.S. financial market conditions.

Still, panelists noted that the policy lift-off in December likely was not an important source of distress for financial markets. Some panelists expressed the view that it could have had a salutary effect on markets by raising market participants' confidence in the Fed's ability to use its tools to normalize policy as appropriate.

On recent trends in inflation and inflation expectations

Panelists saw the recent uptick in both CPI and PCE core measures of inflation as positive developments, but noted the troubling decline in some survey measures of inflation expectations and market-based inflation compensation over the recent months. They generally viewed as positive the clarification in the FOMC consensus statement that its longer-run inflation objective is a symmetric goal. However, they also pointed out that pursuing more explicitly a policy targeting the price level (or nominal GDP) could facilitate the return of inflation to the FOMC's objective.