Federal Reserve System Conference on Monetary Policy Strategy, Tools, and Communication Practices (A Fed Listens Event)

Introduction to a Special Issue of the International Journal of Central Banking

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This special issue of the *International Journal of Central Banking* includes revisions of five of the papers presented at the Federal Reserve System's "Conference on Monetary Policy Strategy, Tools, and Communication Practices (A Fed Listens Event)."[1] This conference, which was held at the Federal Reserve Bank of Chicago on June 4–5, 2019, was part of the Federal Open Market Committee's 2019 review of the framework with which it pursues its monetary policy goals of price stability and maximum employment.[2] The five papers included in this volume cover some of the key issues pertinent in assessing whether, and in what ways, the Federal Reserve might refine its monetary policy strategy, tools, and communications to more effectively achieve its monetary policy goals, especially in an economic environment that has changed in a number of ways, including a higher likelihood that equilibrium interest rates will be lower than in past decades and that the policy rate will need to move to its effective lower bound more often than in the past.

Loretta J. Mester, managing editor of the *International Journal of Central Banking*, served as the editor for the papers in this volume. In the volume's first paper, Janice Eberly, James Stock, and Jonathan Wright begin with a review of the Federal Reserve's current monetary policy framework. They then use structural vector autoregression to assess how effective the current framework's monetary policy tools might have been under several counterfactual circumstances. These tools include changes in the federal funds

[1] See the conference program at https://www.federalreserve.gov/conferences/conference-monetary-policy-strategy-tools-communications-20190605.htm.

[2] For more about the review see https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications.htm.

rate and the nonconventional tools of large-scale asset purchases (LSAPs), forward guidance, and maturity extension. The authors call these nonconventional tools “slope policies,” as they are intended to affect the slope of the yield curve over and above what a change in the federal funds rate would normally do. One of the paper’s findings is that slope policies were effective but that they only partially made up for the fact that the federal funds rate was constrained by the zero lower bound.

In the volume’s second paper, Maurice Obstfeld discusses various ways in which global factors affect the setting of appropriate monetary policy in the United States and how these factors have changed over time. The paper studies the mechanisms through which international prices and global competition affect U.S. inflation; the effects of globally integrated financial markets; and the effect of U.S. monetary policy on other economies, with potential spillovers back to the U.S. economy. A key insight is that while domestic inflation over the long run is determined by domestic monetary policy, over shorter time horizons, global factors can affect the tradeoffs between price stability and maximum employment faced by U.S. monetary policymakers.

In the third paper, Lars Svensson describes and recommends forecast targeting as a particular strategy the Federal Reserve might use in setting monetary policy. This strategy involves choosing the monetary policy path that yields forecasts that best achieve the central bank’s monetary policy goals, and using communications, e.g., publication of forecasts under the chosen and alternative policy paths, to lend credibility to the policy. The paper then shows how forecast targeting could be implemented under various frameworks, including inflation targeting, price-level targeting, temporary price-level targeting, average-inflation targeting, and nominal-GDP targeting.

In the fourth paper, Eric Sims and Jing Cynthia Wu use a New Keynesian model with financial frictions to study the degree of substitutability between traditional interest rate policy and LSAPs. Based on their analysis, they conclude that the three LSAP programs that the Federal Reserve implemented during the Great Recession were equivalent to the stimulus that would have been achieved by lowering the federal funds rate to 2 percentage points below zero.

In the volume's final paper, Anil Kashyap and Caspar Siegert discuss the interlinkages between financial stability risks and monetary policy and review how monetary policymakers in the United States currently consider such risks. The authors analyze the tools that can be used by the Financial Stability Oversight Council, the U.S. body with formal responsibility for responding to emerging financial stability risks, and they conclude that these tools are not adequate. The authors offer several recommendations for addressing the current situation, including giving the Office of Financial Research enhanced powers to gather more granular data on the distribution of debt, extending the regulatory perimeter to allow for better monitoring and mitigation of financial stability risks that emerge outside of the regulated banking system, and having the U.S. Congress establish an expert commission to evaluate gaps in the macroprudential landscape in the United States.

The papers published in this volume provide very useful information that is relevant to the Federal Reserve System's review of its monetary policy framework and also to other central bankers and researchers who are interested in increasing their understanding of how monetary policy affects the economy and the tools available to implement monetary policy.