Fiscal-Monetary Policy Coordination: A U.S. Perspective

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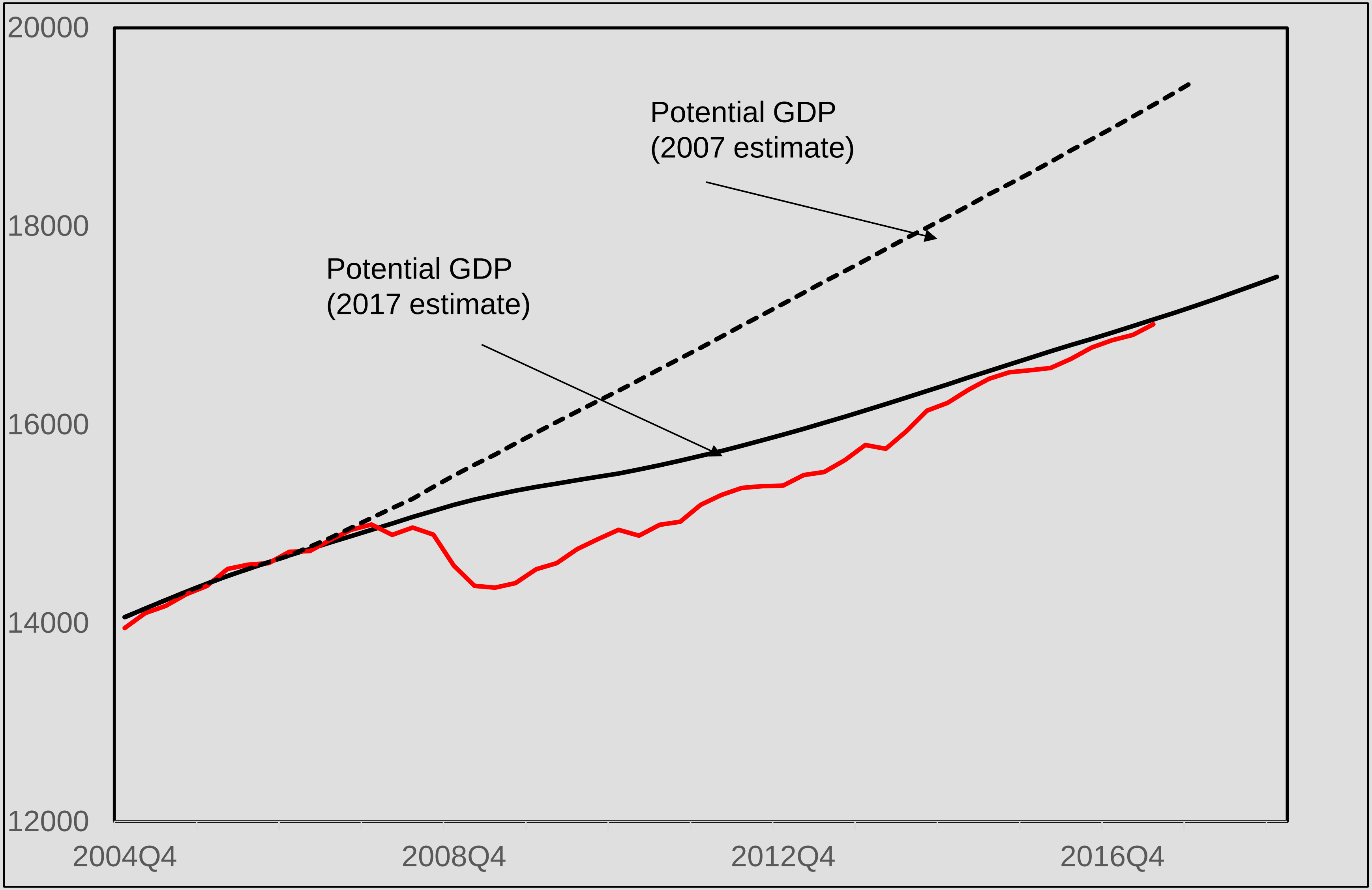
Economic Outlook

- Very balanced, but gradual expansion
- Nearing full employment
- Low inflation with few signs of acceleration
- Very modest supply-side growth
  - Limited productivity improvements
  - Aging of workforce
  - Some reentry of discouraged workers
  - Little room for real wage gains
- More stimulative fiscal policy
- Gradual normalization of monetary policy

Actual and Potential GDP, Nonfarm Business Sector, 2004-2018



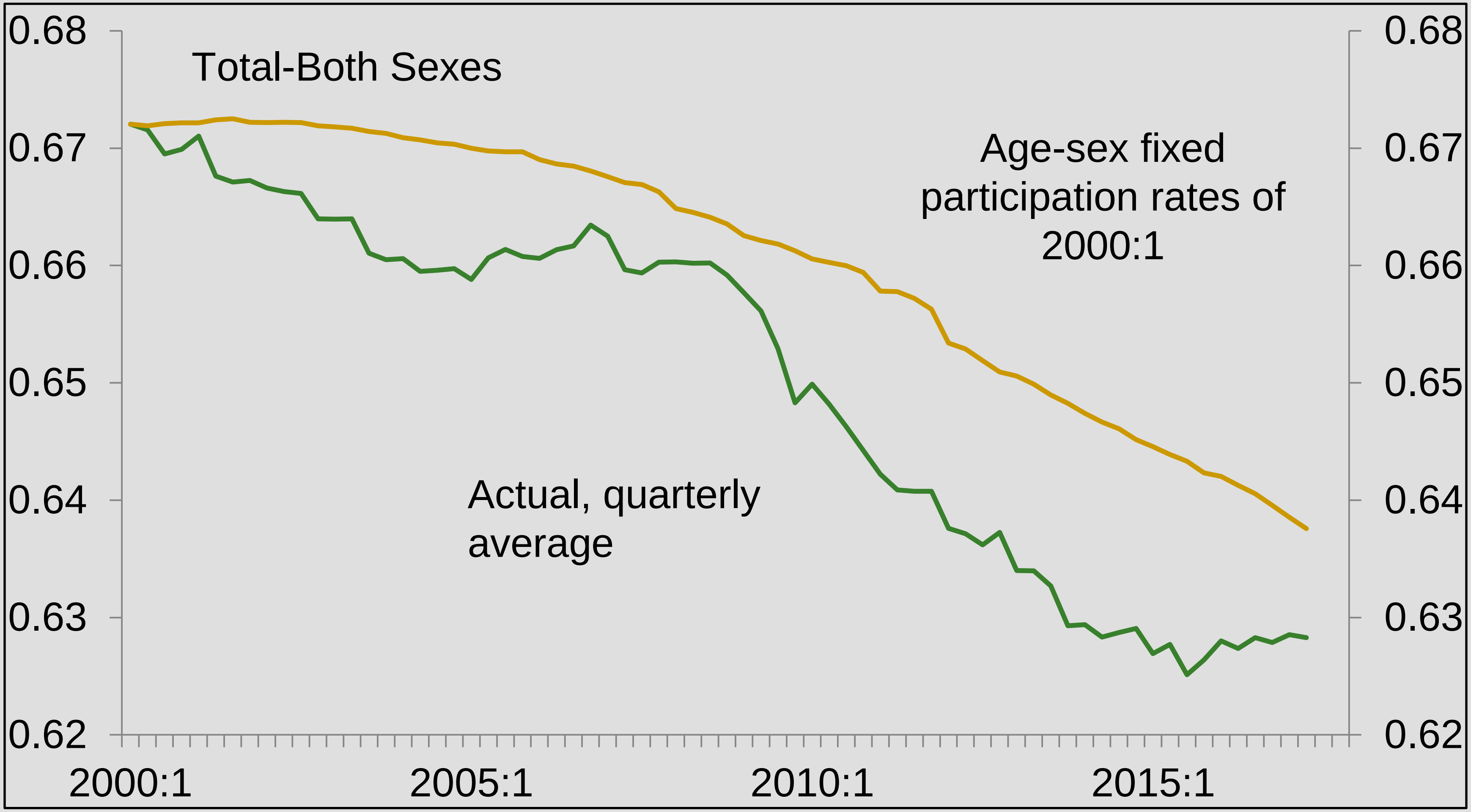
CBO Revisions to Potential GDP Growth

Annual Percent Change			
	2007 projections	2017 projections	
	2007-2017	2007-17	2017-27
	Total Economy		
Potential Output	2.6	1.4	1.8
Potential Labor Force	0.7	0.5	0.5
Potential Labor Productivity	2.0	0.9	1.3
	Nonfarm Business Sector:		
Contributon from:			
Potential Hours	0.6	0.3	0.3
Capital Services	1.1	0.6	0.8
Potential TFP	1.4	0.7	1.1
Total	3.1	1.6	2.1

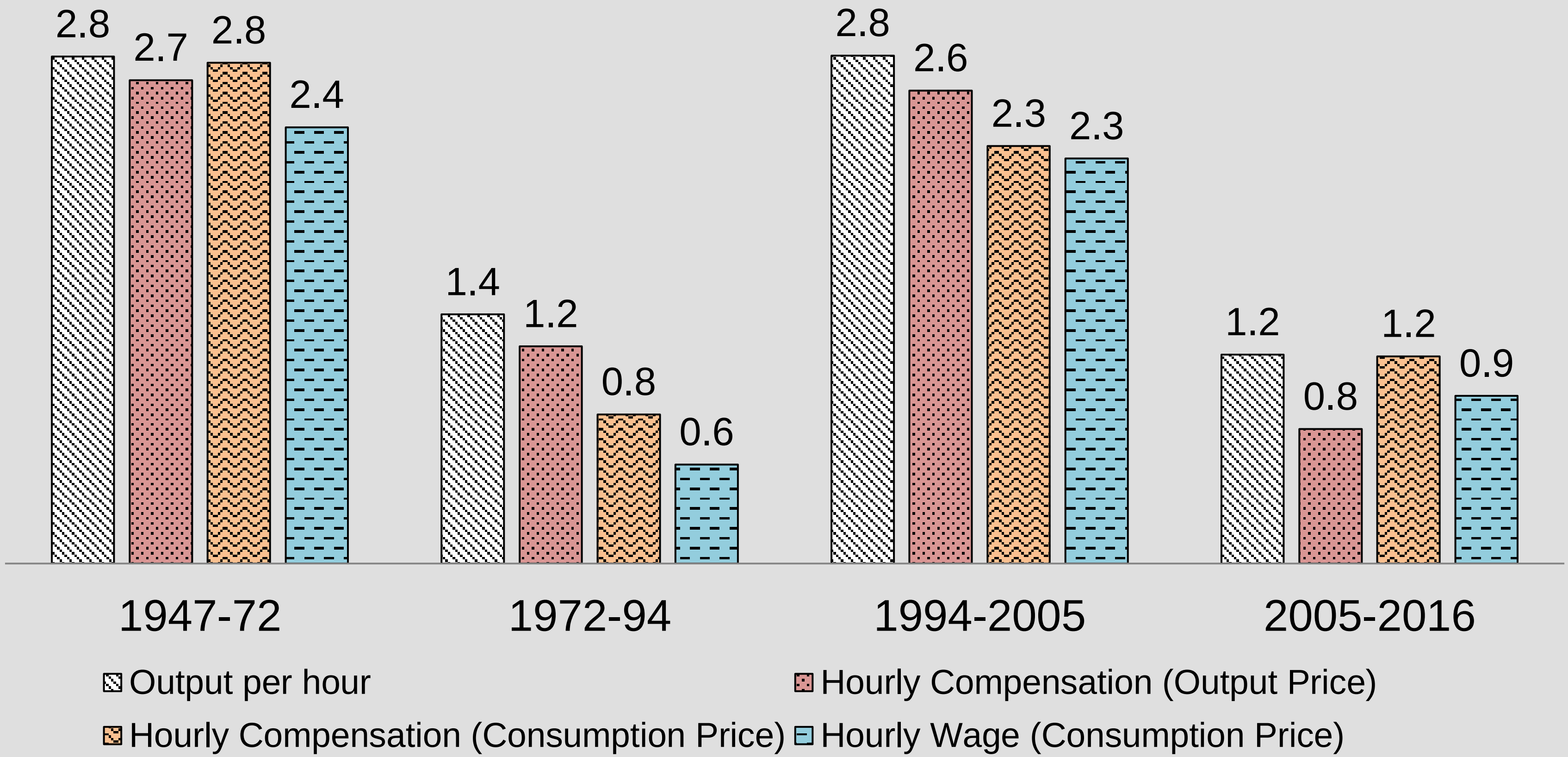
Productivity Trends, Major OECD Countries

	1970-94	1994-04	2004-16	Slowdown
Australia	1.3	2.2	1.3	-0.8
Canada	1.4	1.4	0.9	-0.5
France	3.1	1.8	0.6	-1.1
Germany	3.0	1.7	0.9	-0.9
Italy	2.7	0.8	0.0	-0.8
Japan	3.8	2.2	0.8	-1.3
United Kingdom	2.7	2.2	0.4	-1.8
United States	1.5	2.3	1.1	-1.2
Sweden	1.8	2.7	0.9	-1.8

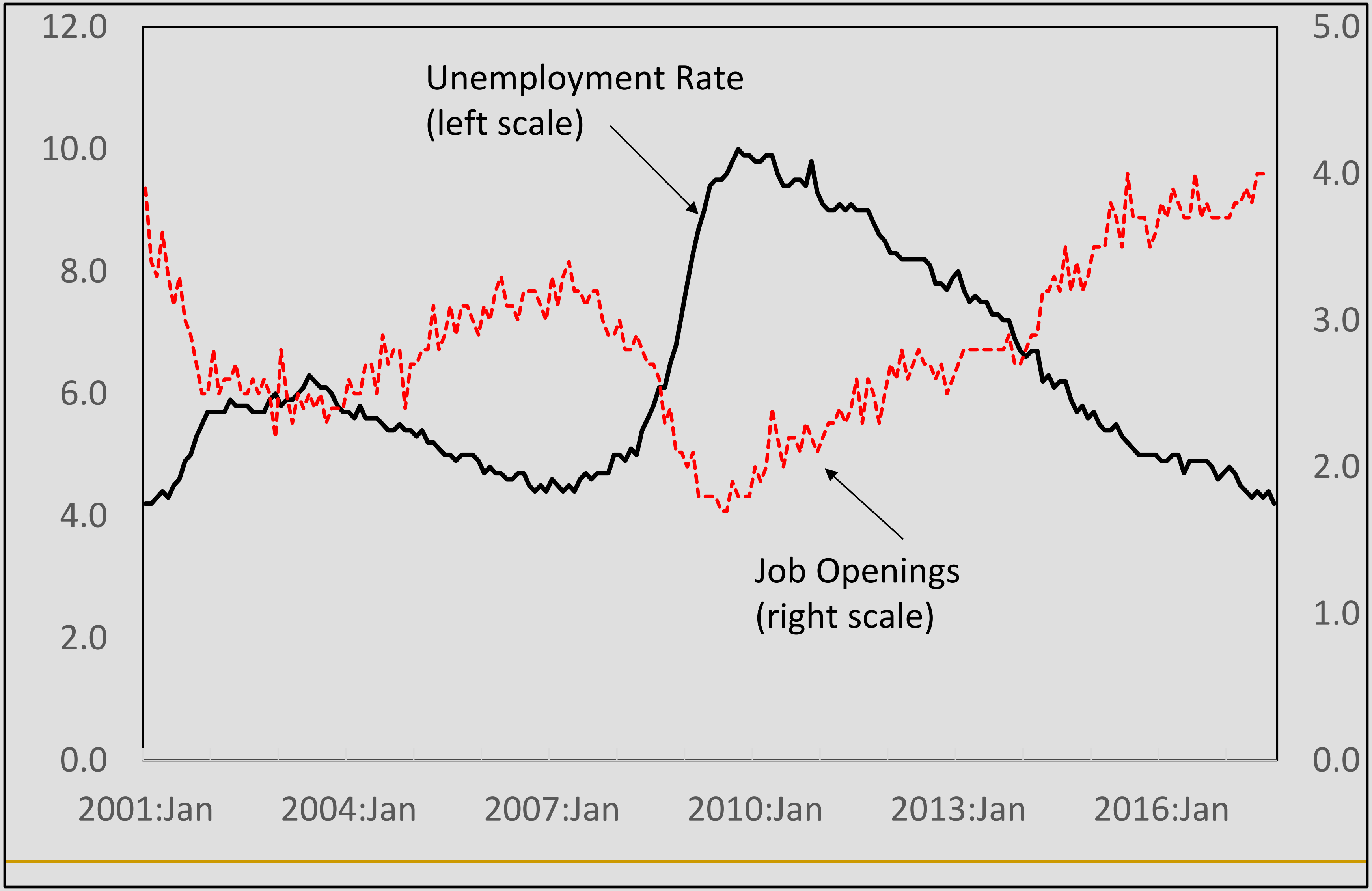
Actual and Demographically-Adjusted Labor Force Participation.



Changes in productivity and real wage, 1947-2016

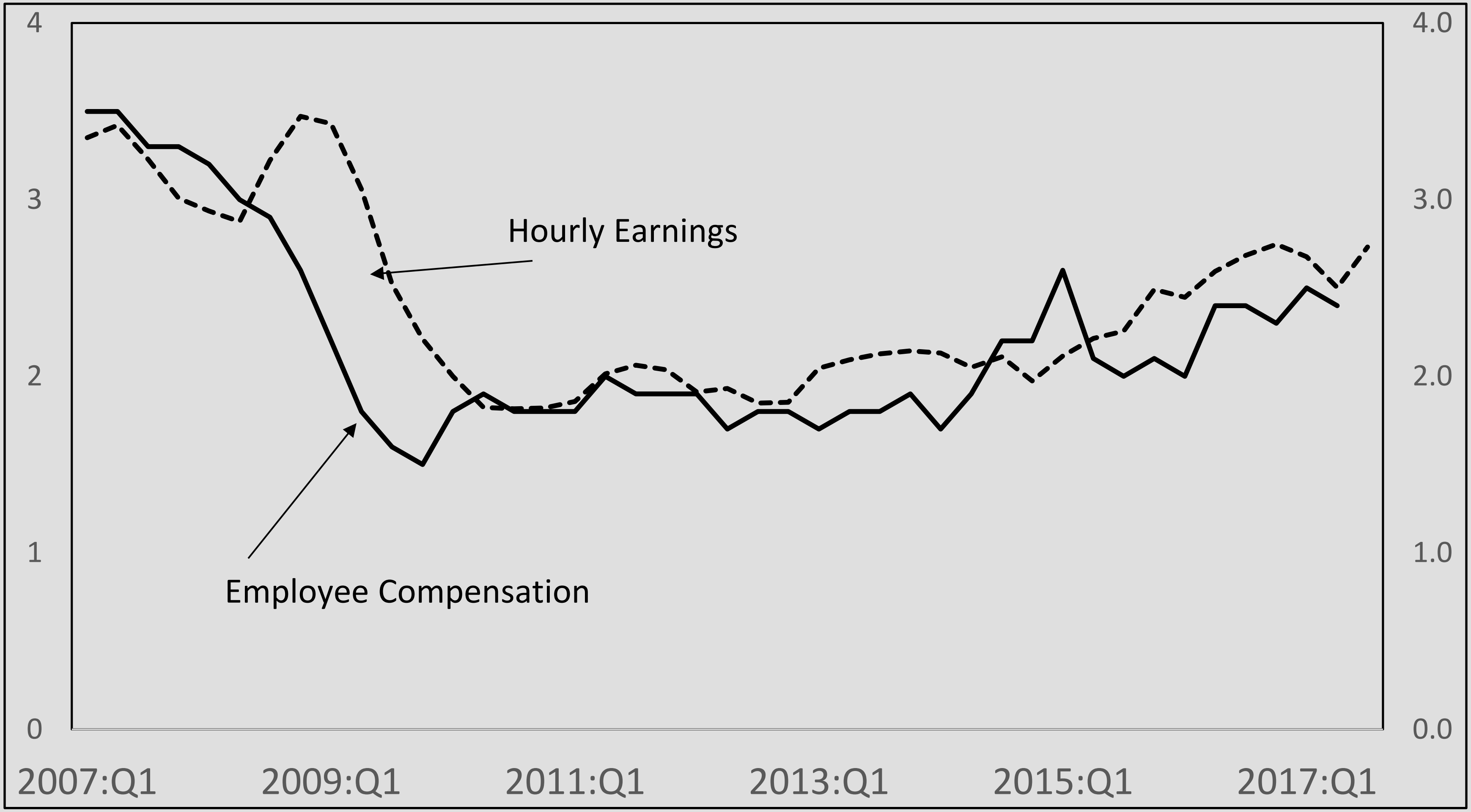


Labor Market Pressures



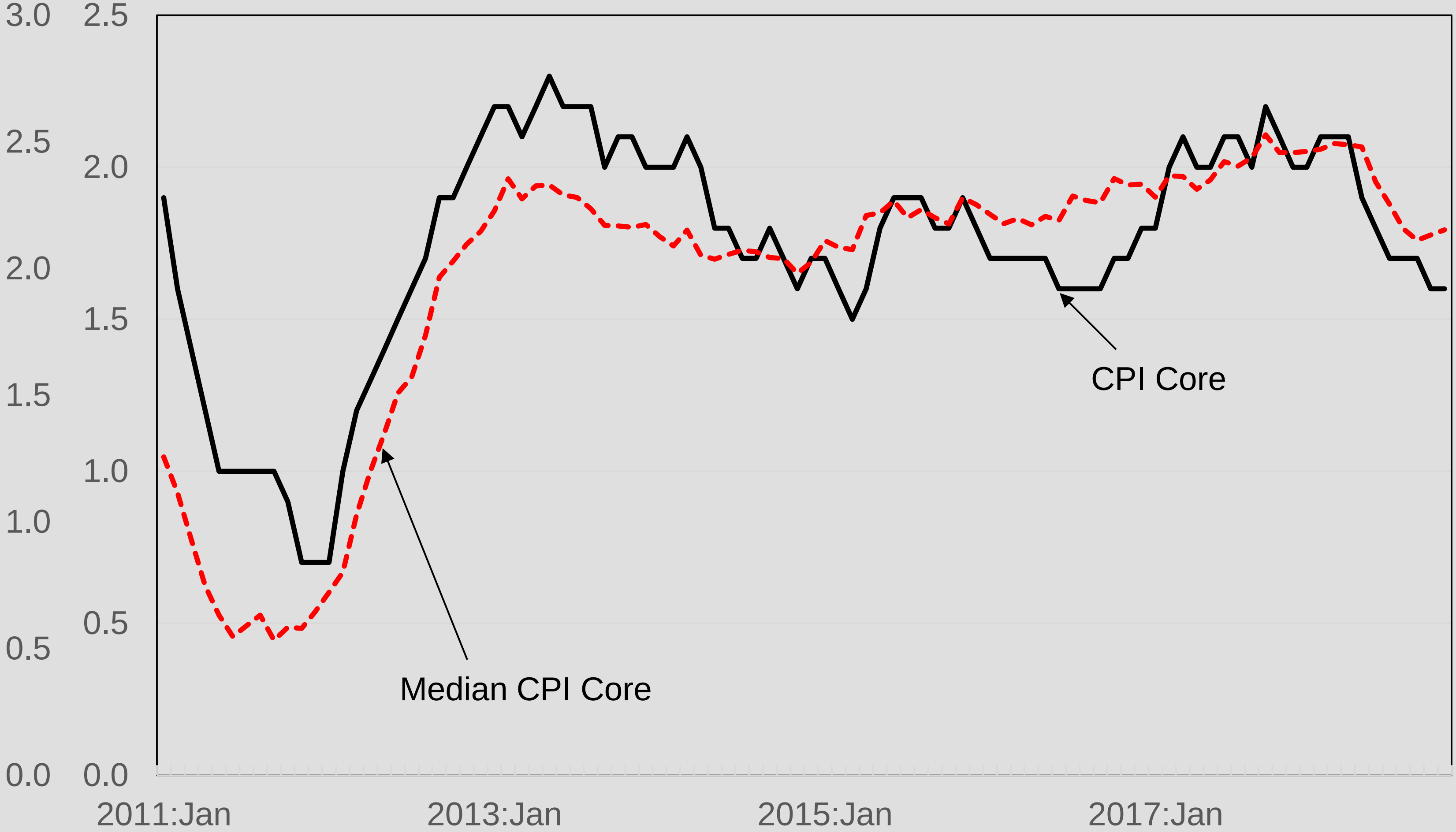
Wage Increases

annual rate



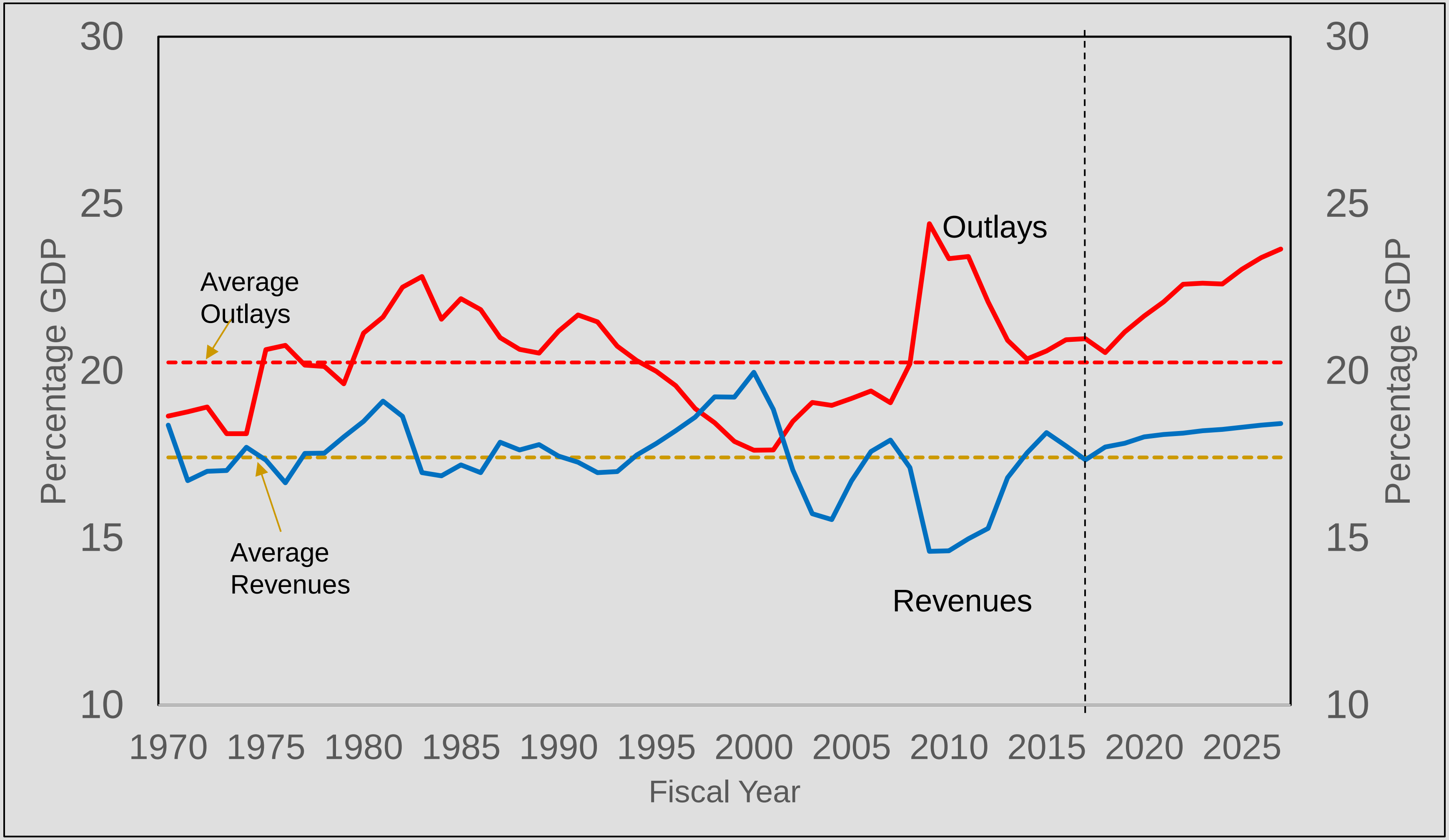
Consumer Prices

Annual Rate of Change



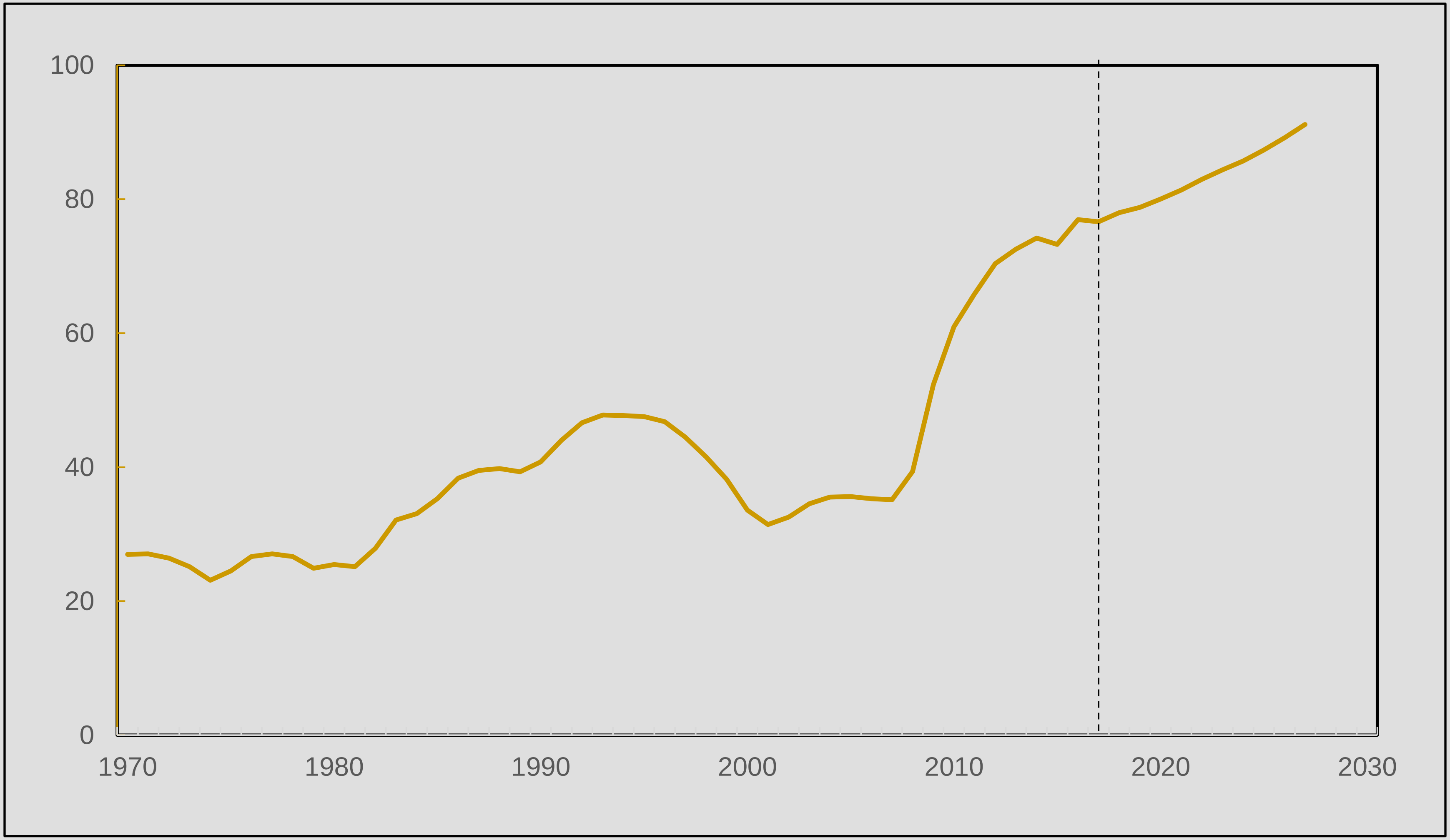
Budget Trends, 1970-2027

Percent of GDP



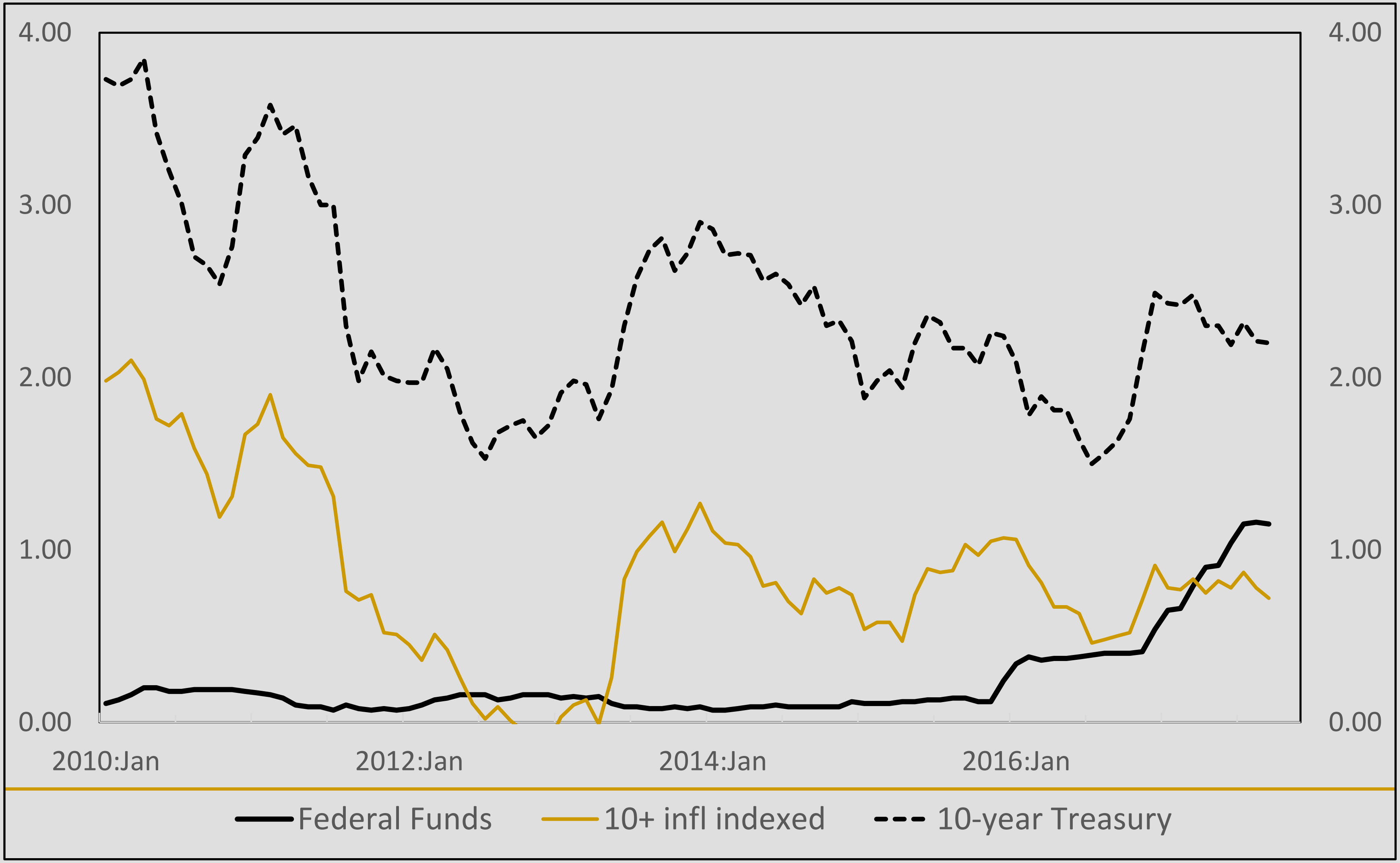
Debt Held By the Public, 1970-2027

Percent of GDP

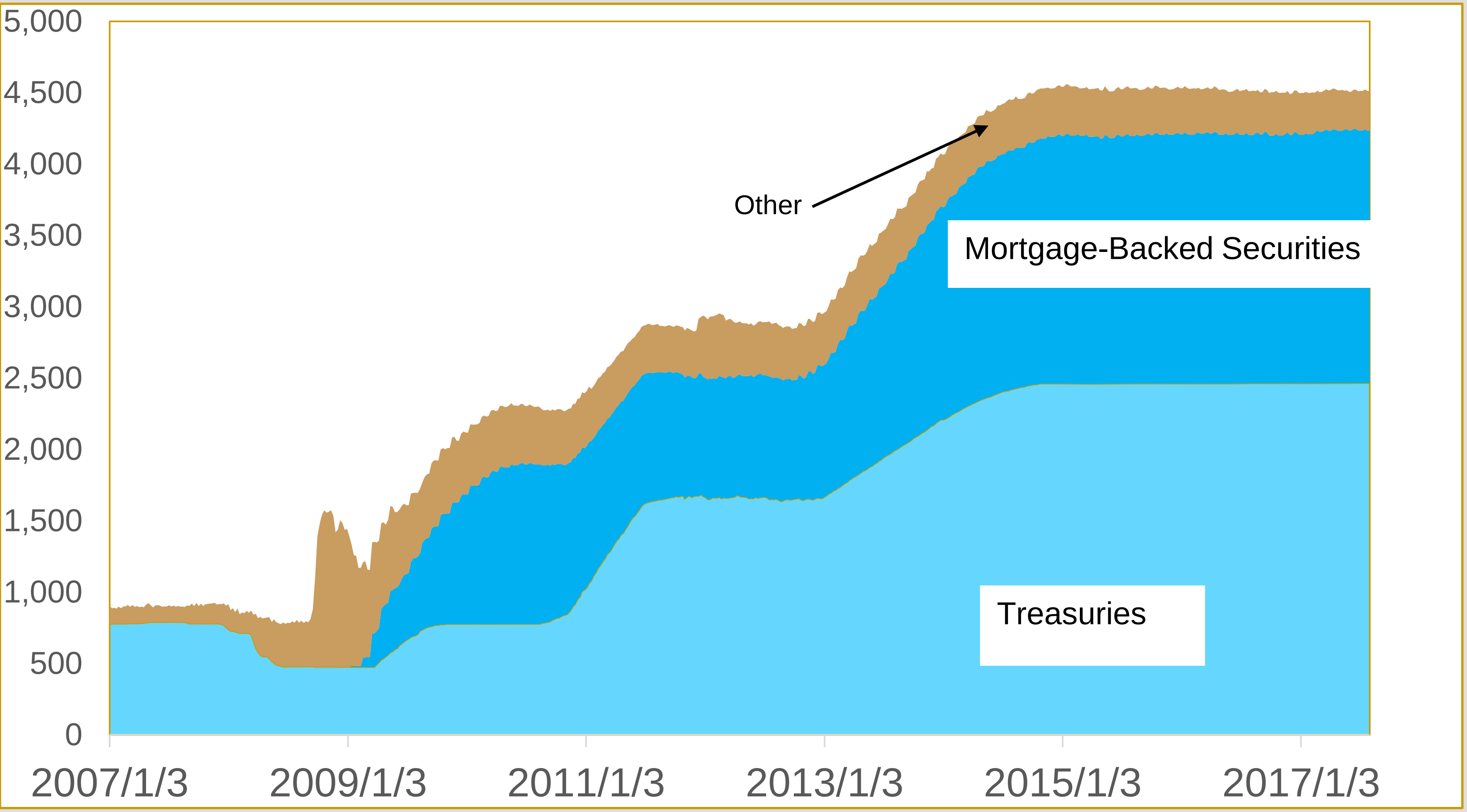


Market Interest Rates

Percentage



Federal Reserve Assets, 2007-2017



Schedule of Portfolio Caps

billions of dollars

Months	1-3	4-6	7-9	10-12	Terminal
Treasuries	6	12	18	24	30
MBSs	4	8	12	13	20

Monthly redemptions in excess of Caps will be reinvested.

Monetary Policy Concerns

- Long-term decline in nominal interest rates.
  - Future policy rates could be constrained at ZLB as much as 1/3rd of the time (Kiley&Roberts, 2017)
- Loss of CB Independence
- Policy Tools:
  - Forward guidance & quantitative easing.
  - Negative interest rates and yield curve control (limited by cash option and depth of market)
  - Higher inflation target
  - Price-level target

Monetary Policy Options (1)

- Raise current inflation rate target
  - (+)More space to lower rates in future
  - (+)Consistent with current framework
  - (+)Still incorporate unemployment considerations in determination of speed in return to target
  - (-)Cost of higher inflation-public opposition.
  - (-)Suboptimal response to transitory problem—higher long-run average inflation.
  - (-)Not calibrated to severity of ZLB event.

Monetary Policy Options (continued)

- Price-level targeting
  - Equivalent to low very-long-run average inflation rate target. (Consistent with price stability mandate)
  - (+)Bygones are not bygones
  - (+)Responsive to severity of ZLB episode
  - (-)Major shift in policy framework that may be difficult to communicate
  - (-)Need to tighten policy for temporary supply shocks with negative effects on employment and output.

Monetary Policy Options (continued)

- Temporary price-level target

  (Bernanke)

  - Limited to periods around lower bound
  - Would not require major shift in underlying policy framework
  - Would not require policy to tighten in response to supply shocks in ordinary times
  - Rule--increase in FF rate would be delayed until average inflation rate since date when FF rate first hit zero.

Fiscal Policy Concerns

- In addition to stabilization role, fiscal policy has major distributional effects within and across generations
- Fiscal rules
  - Difficult to measure fiscal stance
  - Unfunded commitments--Public pensions
  - Application of rules at subnational level
    - Enforcement through population mobility
  - Historical failures
  - Rules inhibit stabilization policy

Fiscal Policy Concerns

- Stabilization policy
  - General view that FP in recent financial crisis was too small and too quickly reversed
  - Strong shift to structural surplus in advanced economies after 2011
  - Resurgence of confidence in and need for discretionary policy
  - Variation in size of multipliers across strong versus weak economic situations
  - Interactions with existing debt levels?
  - Determinants of fiscal space?

Fiscal-Monetary Coordination

- In retrospect, the initial response to the financial crisis was quite optimal.
  - Both fiscal and monetary policy were strongly expansionary.
- But premature shift to fiscal consolidation eroded the recovery.
  - Fear that debt would not be repaid
  - References to Ricardian equivalence
- Recent shift back toward modest fiscal stimulus
- Low long-bond yields suggest primary concern is about growth not solvency.

Fiscal-Monetary Coordination

- Fiscal policy needs to do more near ZLB
- Monetary policy reforms may help, but they will have relatively small effects on overall economy.
- Primary need is for a stronger fiscal response targeted on raising inflation
- In short run there may be no fiscal-monetary conflict
  - Perception that future debt will be partially monetized has positive impact