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The FOMC: Ahead on Results, Behind on Rates

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Introduction

The monetary policy debate on QE3

- The FOMC is poised to end its controversial QE3 program this month.
- Now may be a good time to evaluate the program compared to expectations at the time it was launched.
- My assessment will suggest that the program has been more successful than the Committee anticipated, especially in terms of labor market outcomes.
- However, the Committee has not yet judged that the time is right to raise the policy rate off of the zero lower bound.

Two goals, two tools

- The Fed has two main macroeconomic goals: stable prices and maximum employment.
 - The issue of financial stability also looms large.
- The Fed also has two main tools:
 - The short-term interest rate policy, including forward guidance.
 - Quantitative easing, the purchasing of government securities and mortgage-backed securities (MBS).
- The goal variables are close to normal, but the tools are not.

The QE3 program

- The open-ended asset purchase program known as QE3 was launched in September 2012.
- At that meeting, the FOMC also made macroeconomic forecasts for 2013 and 2014.
- These included a forecast for the policy rate, with projected liftoff before the end of 2014 by six participants if macroeconomic outcomes met expectations.
- Macroeconomic outcomes have exceeded expectations, yet the Committee has not proceeded with liftoff.

Interpretations as patience

- Why hasn't the Committee moved on the policy rate?
- One interpretation is that the Committee is being very patient concerning liftoff.
- A policy rate liftoff in the first quarter of next year would exhibit considerable patience relative to the plans laid out in September 2012.

September 2012

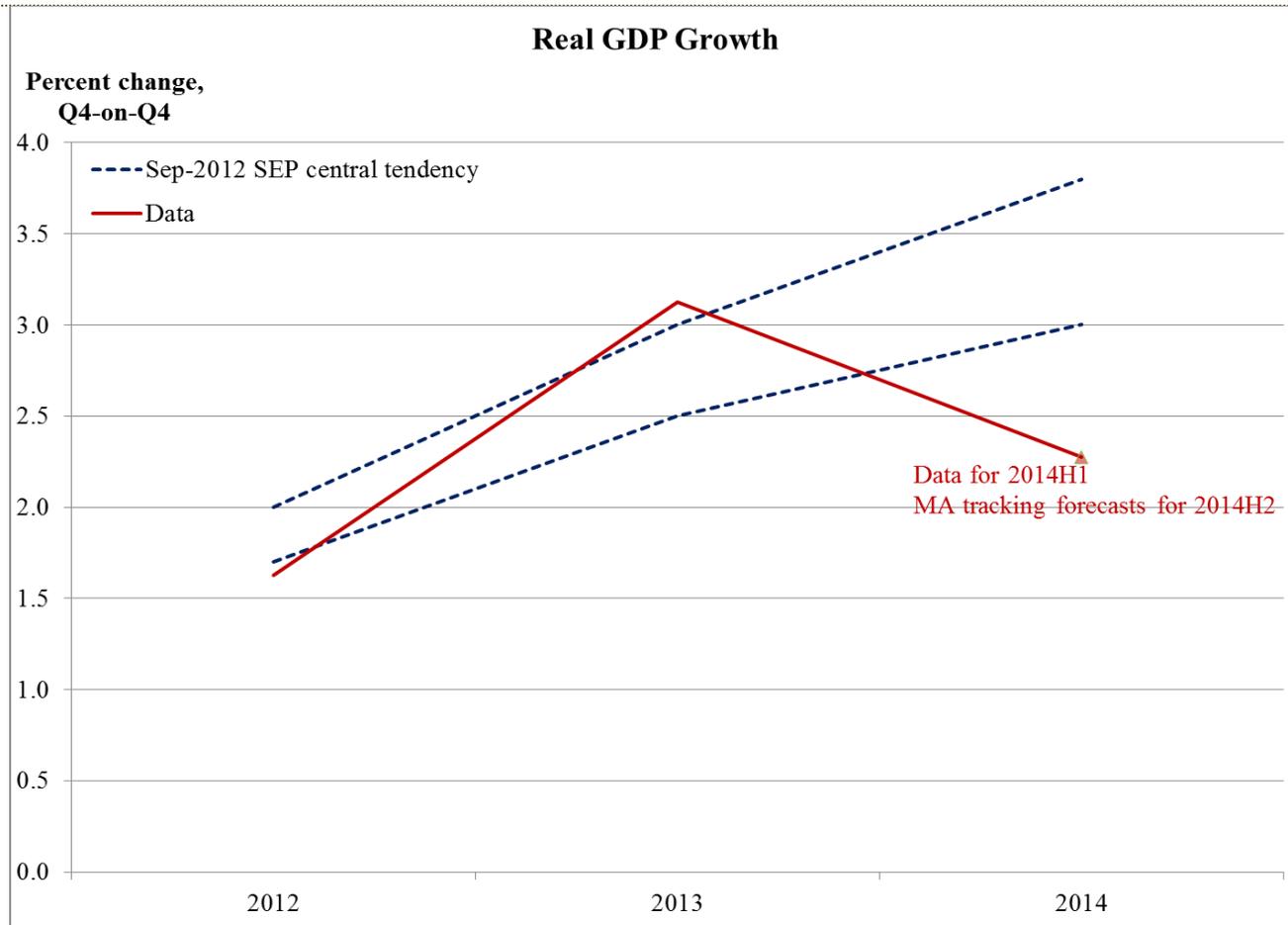
The September 2012 projections

- The Committee produced projections in September 2012 for real GDP, inflation, unemployment and the policy rate.
- For real GDP and inflation, the actual outcomes during the past two years were not too different from what was expected.
- For unemployment, however, the outcomes have been far better than expectations.
- The policy rate was projected to be higher than it is today. This projection is made under an “appropriate monetary policy” assumption.

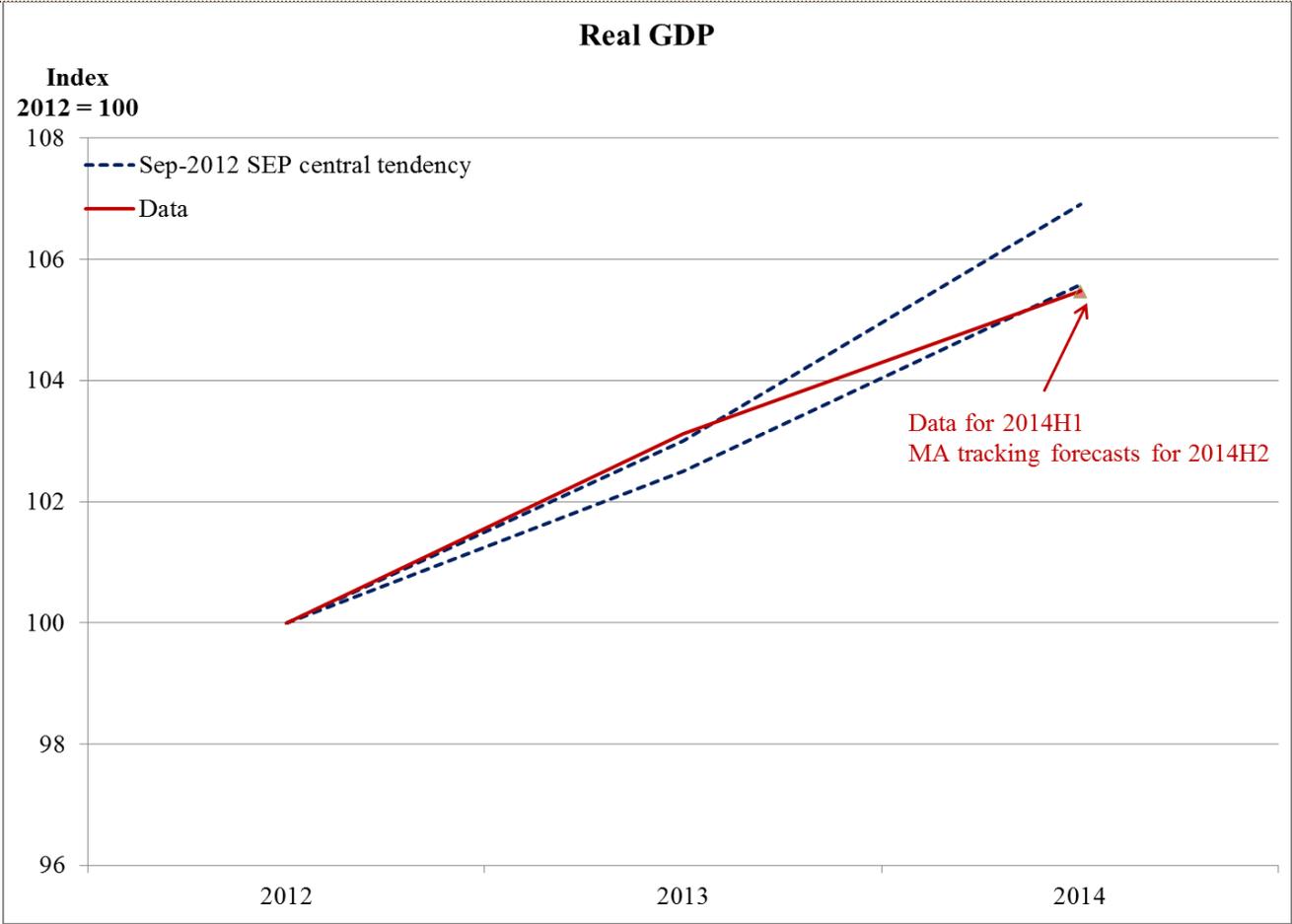
The evidence from September 2012

- Let's consider first the outlook for real GDP as of September 2012.
- The Committee predicted moderately rapid economic growth during 2013 and 2014.
- This is roughly what happened.

Real GDP projections from September 2012



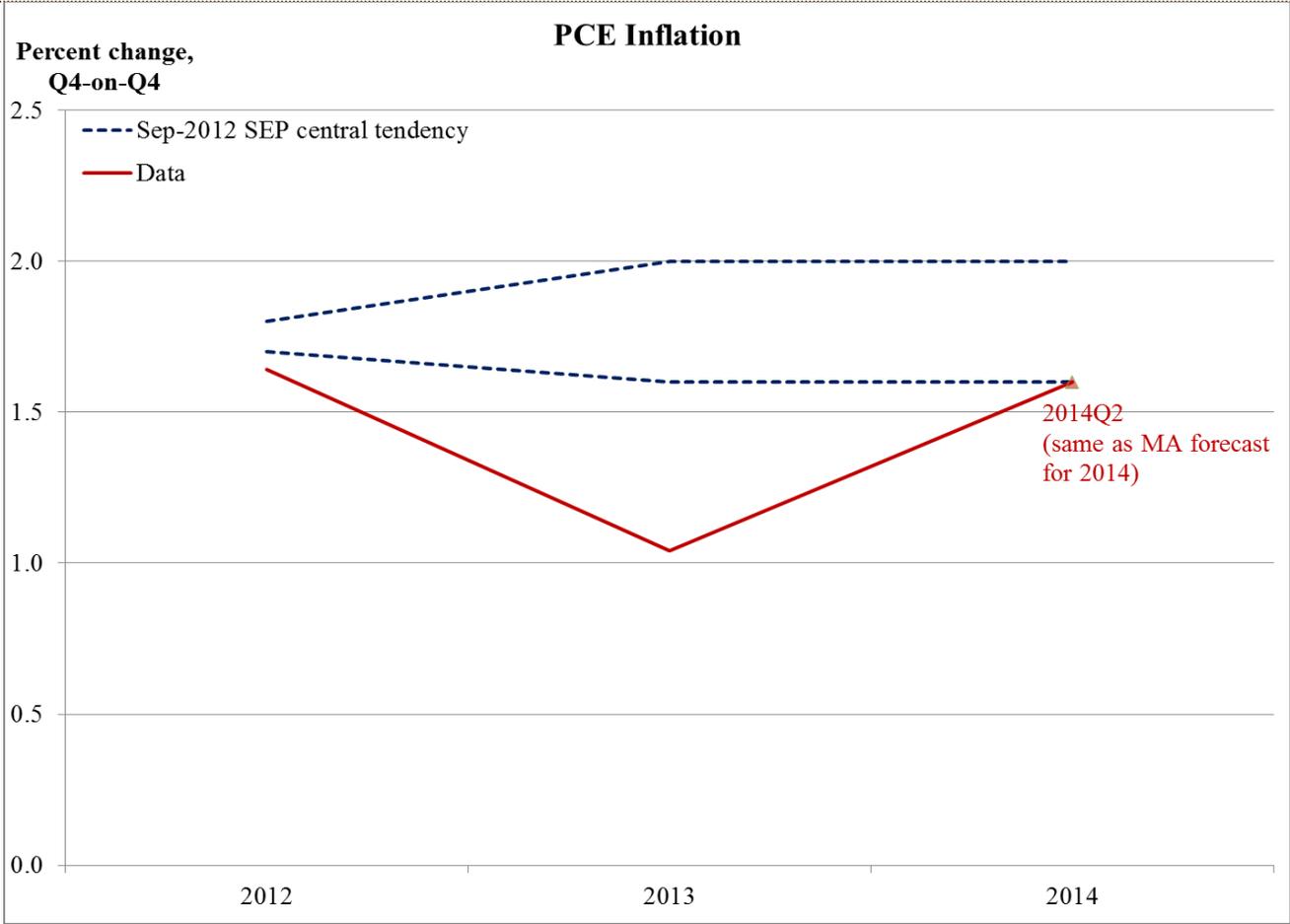
Real GDP projections from September 2012



Inflation projections from September 2012

- The Committee predicted subdued inflation at the launch of QE3 in September 2012.
- Inflation today continues to run somewhat below the Committee's target of 2 percent.

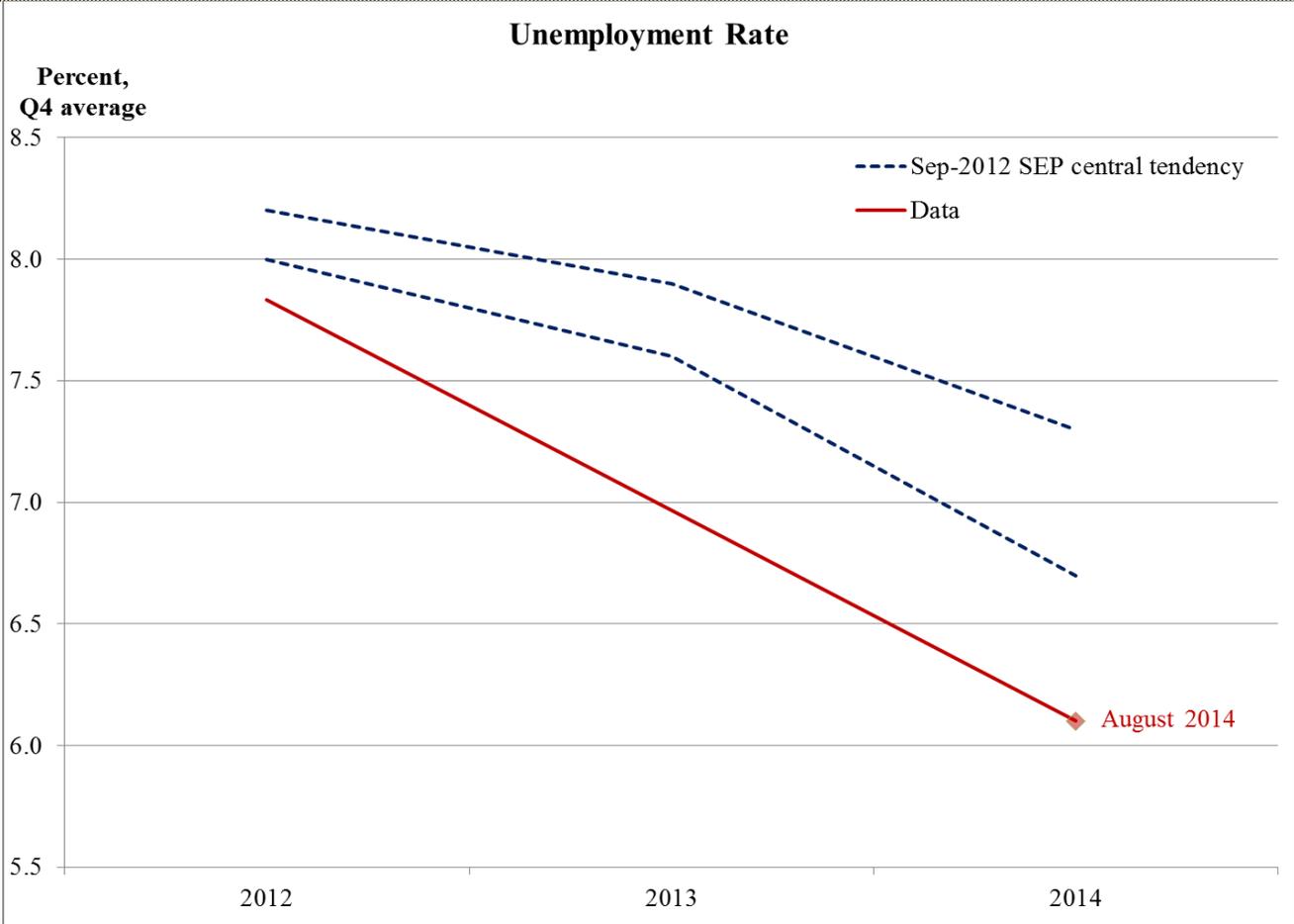
Inflation projections from September 2012



Unemployment projections from September 2012

- The Committee projected that unemployment would still be relatively high at the end of 2014.
- On this dimension, there was a substantial surprise.
- Unemployment has turned out to be much lower than the Committee projected.
- Outcomes for the labor market have been far better than expected at the launch of QE3.

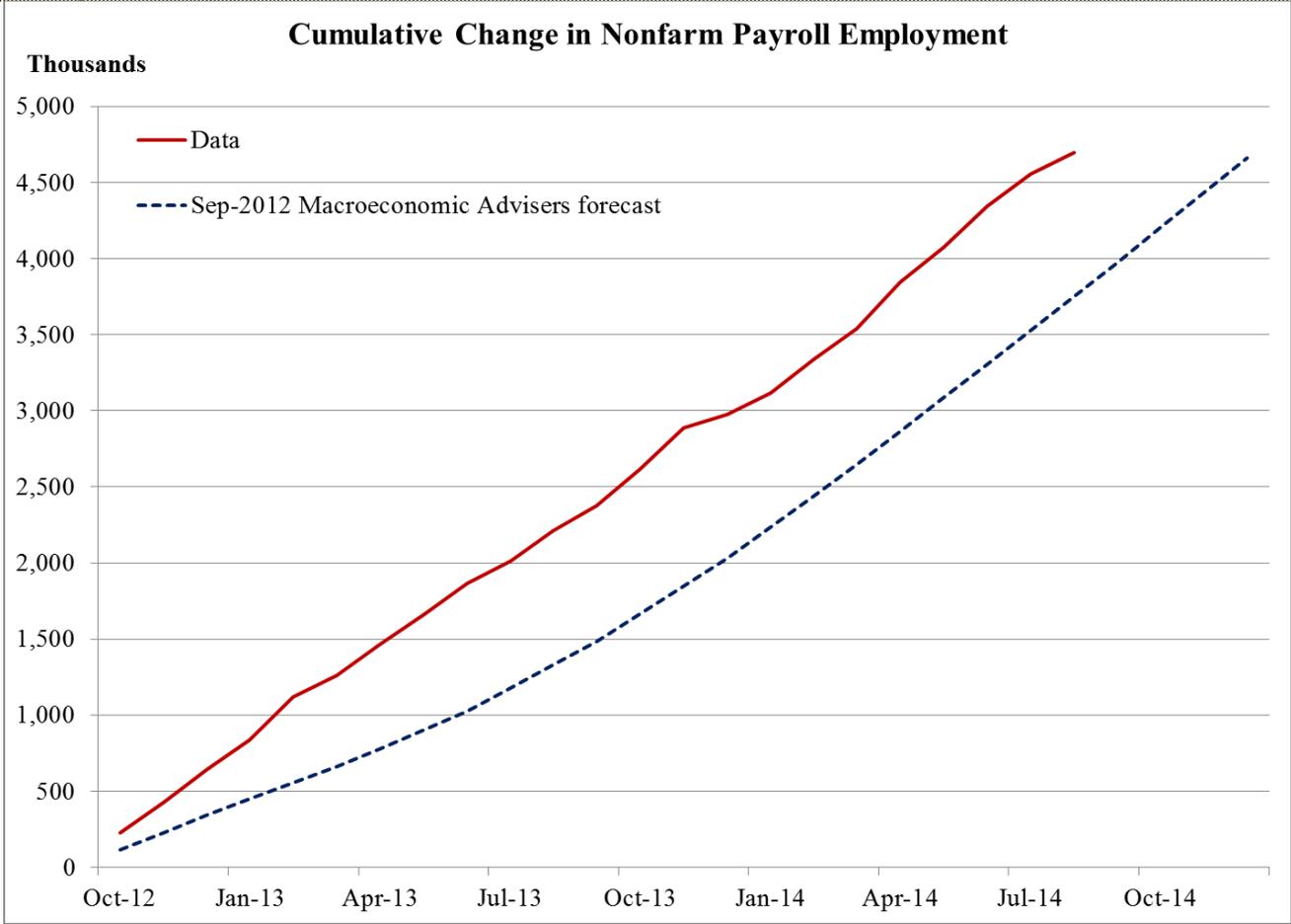
Unemployment projections from September 2012



Employment projections as of September 2012

- The Summary of Economic Projections does not include a projection for nonfarm payroll employment, a key macroeconomic labor market indicator.
- However, private sector forecasts indicate that this labor market variable has also considerably outperformed expectations as of September 2012.
- Private sector forecasts called for less employment growth than was actually observed during the past two years.

Nonfarm payroll employment projections from September 2012



Monetary Policy Expectations as of September 2012

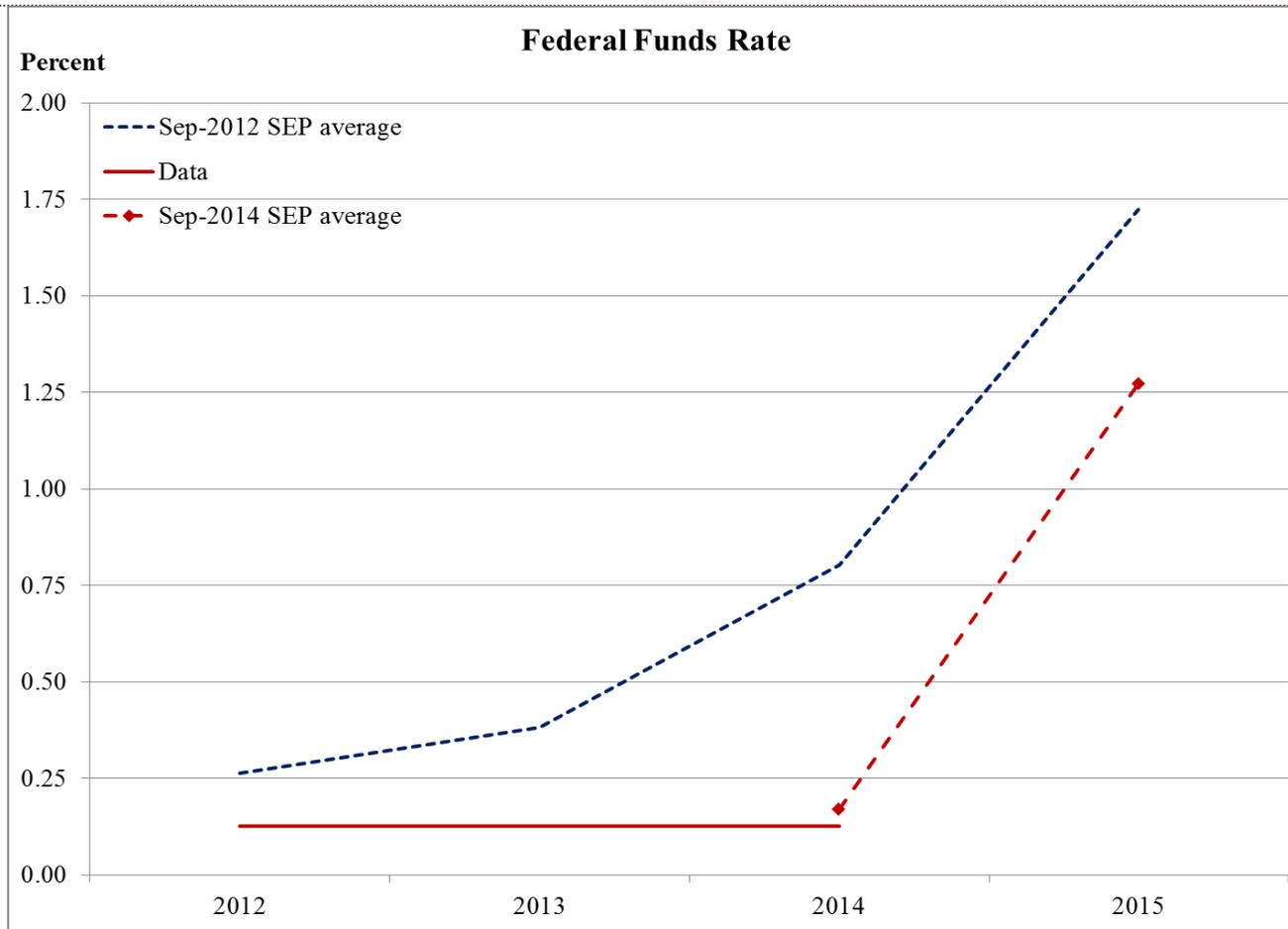
The economy outperformed

- The FOMC had a set of expectations for the economy in September 2012, and the economy outperformed those expectations.
- The FOMC also suggested a policy rate path that would be consistent with projected economic performance.
- In September 2012 six participants projected increases in the policy rate before the end of 2014. In September 2014 only one participant saw as appropriate a policy rate increase before the end of the year.

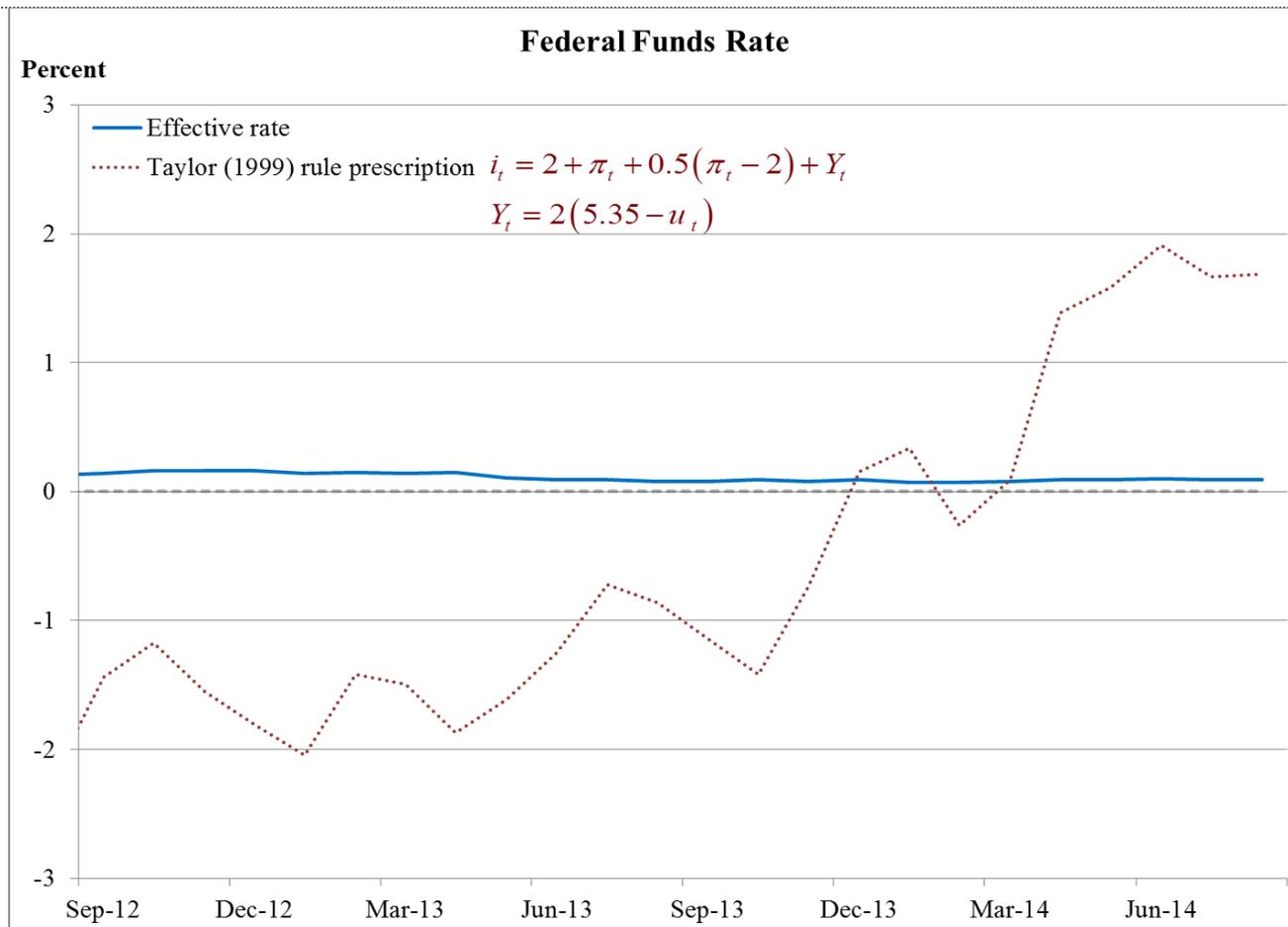
Mismatch between projections and reality

- Macroeconomic events since September 2012 suggest a higher policy rate path than the one projected at that time.
- Yet the likely policy rate path today remains below the one projected in September 2012, not above.
- I interpret this as a degree of patience on the part of the Committee with regard to policy rate liftoff.
- A liftoff date at the end of the first quarter of 2015 would already be well past what is called for by a standard monetary policy rule.

Policy rate projections from September 2012



Policy rate path suggested by the Taylor (1999) rule



Summary

Normalizing monetary policy

- How quickly should the Committee move to return monetary policy to normal given improving macroeconomic conditions?
- The Committee was surprised to the upside by the performance of the U.S. economy since September 2012.
- The policy rate normalization process remains far behind the schedule laid out at the launch of QE3.
- I interpret this as a degree of patience on the part of the Committee with respect to policy rate liftoff.



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