U.S. Monetary Policy in the Aftermath of the U.S. Presidential Election

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee.

Introduction

An electoral surprise

- The results of the U.S. election on Nov. 8 were surprising from the perspective of global financial markets.
- It is likely too soon to tell how the U.S. economy may be impacted.
- Here I will make four brief and very broad comments about the current state of monetary policy in the aftermath of the election.

Four comments

1. The level of U.S. financial market volatility has arguably not been particularly large in the immediate aftermath of the election.
2. I have not changed my near-term outlook for the U.S. economy or U.S. monetary policy as of today.
3. Single-party control of the legislative and executive branches in the U.S. means that there may be some increased scope for legislative action going forward which could have a medium-run impact on the U.S. economy.
4. Other types of policy changes may have an impact on U.S. growth prospects in the longer run.

Election Results

The election results

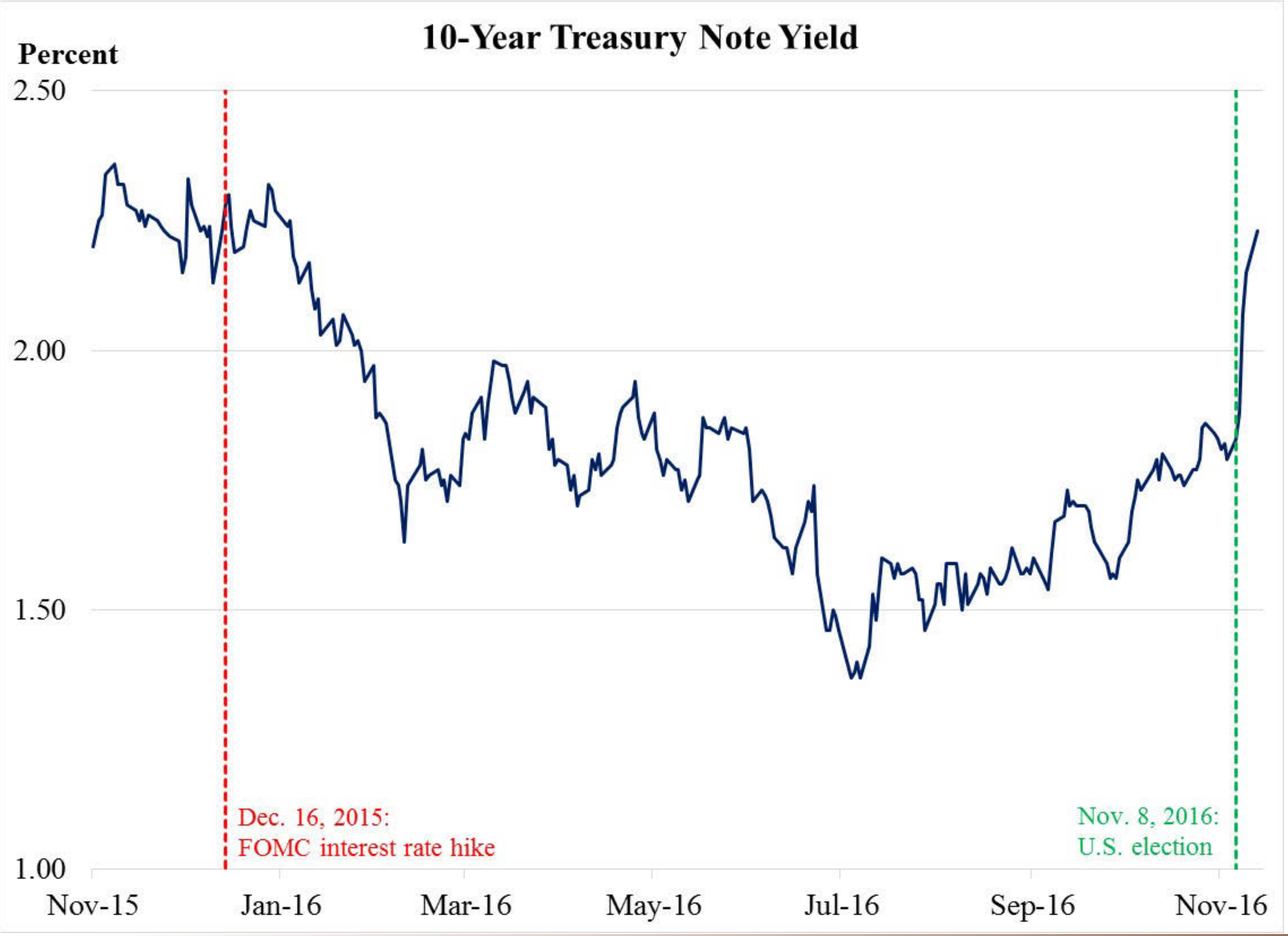
- The results of the election indicate that the Republican Party will maintain control of the House and the Senate (probably 52-48) in addition to winning the White House.
- This means that the legislative and executive branches will be in one party's control, opening a greater possibility of legislative action.
- The Republican Party's slim majority in the Senate is not filibuster-proof.
- President-elect Trump campaigned strongly in and carried a northern tier of industrial states (WI, MI, OH, PA) previously considered solidly Democrat.
- This may indicate that anti-trade sentiment was a key factor.

Post-Election Volatility Subdued

Post-election volatility subdued

- The market expectation had been for continued divided government, and the election outcome was accordingly surprising.
- However, the volatility in key U.S. macroeconomic variables has been in line with the volatility observed during the past year.
- The 10-year U.S. Treasury yield has increased but remains near its level at the time of the Fed rate increase in December 2015.
- Equities and foreign exchange rates have repriced, but are well within the experience of the past year.

Post-election volatility: long-term yields

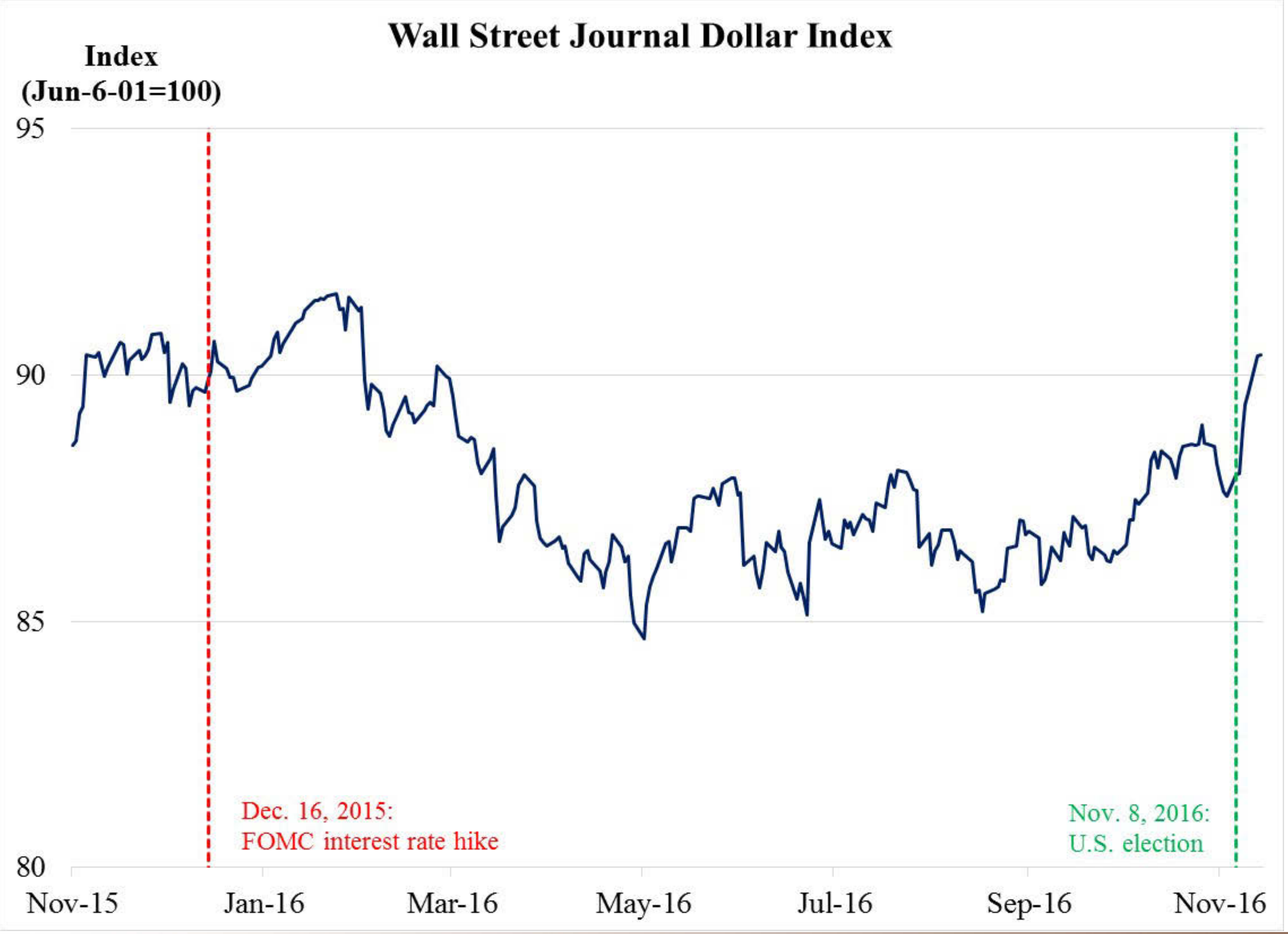


Source: Federal Reserve Board. Last observation: Nov. 14, 2016.

Post-election volatility: stock prices

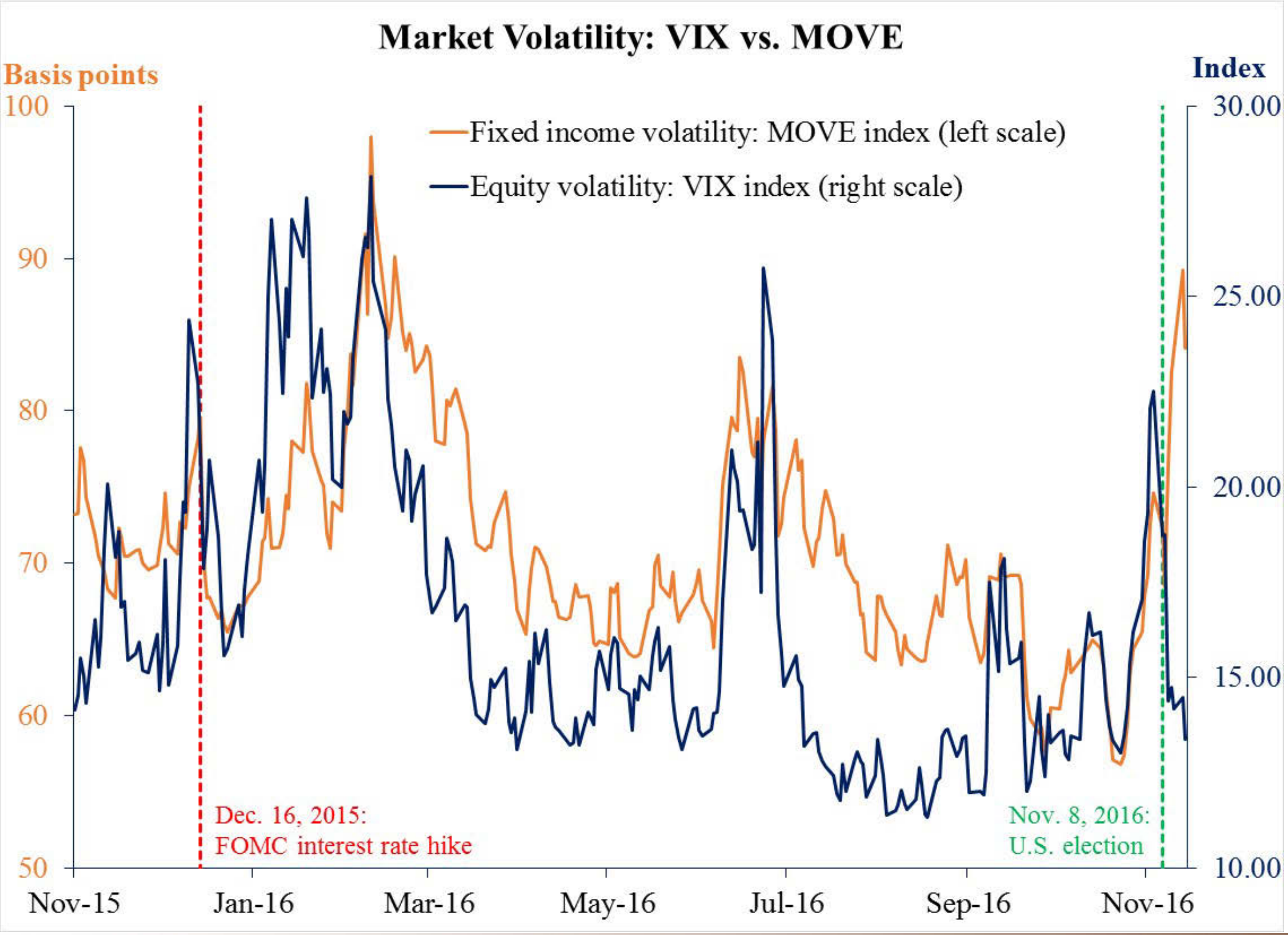
Source: Dow Jones. Last observation: Nov. 14, 2016.

Post-election volatility: U.S. dollar exchange rate



Source: Wall Street Journal. Last observation: Nov. 15, 2016.

Post-election volatility: equities vs. bonds



Source: Chicago Board Options Exchange, Wall Street Journal and Bank of America Merrill Lynch.
Last observation: Nov. 15, 2016.

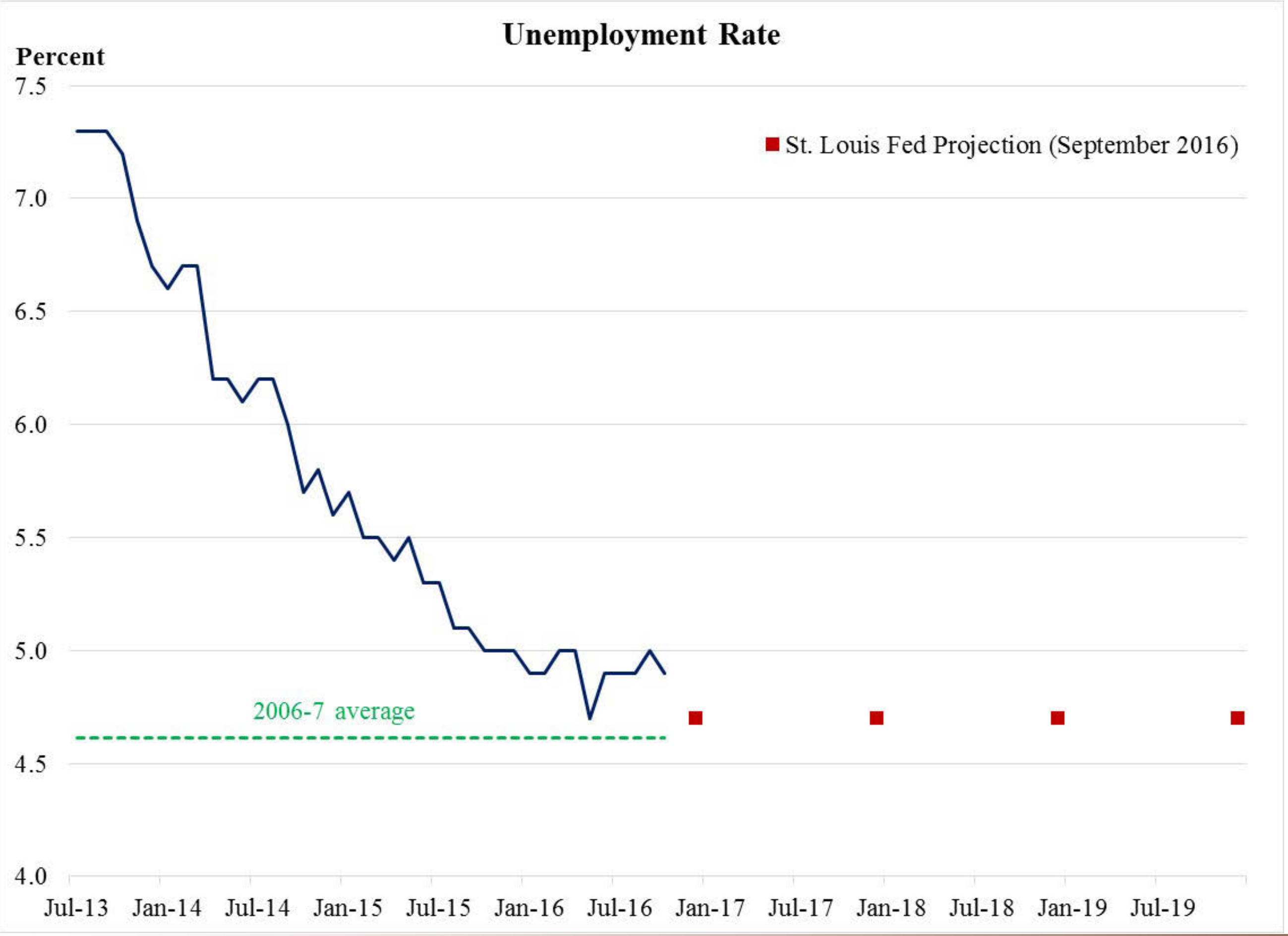
St. Louis Fed U.S. Macroeconomic Forecast Unchanged

The macroeconomic forecast

- The near-term St. Louis Fed forecast remains unchanged as of today.†
- Our outlook for monetary policy is also unchanged:
  - U.S. unemployment is effectively at the Committee's estimate of its long-run level.
  - U.S. inflation is low but close to the 2 percent target and rising.
  - Safe real rates of return are low and not expected to change.
  - A single policy rate increase, possibly in December, may be sufficient to move monetary policy to a neutral setting.

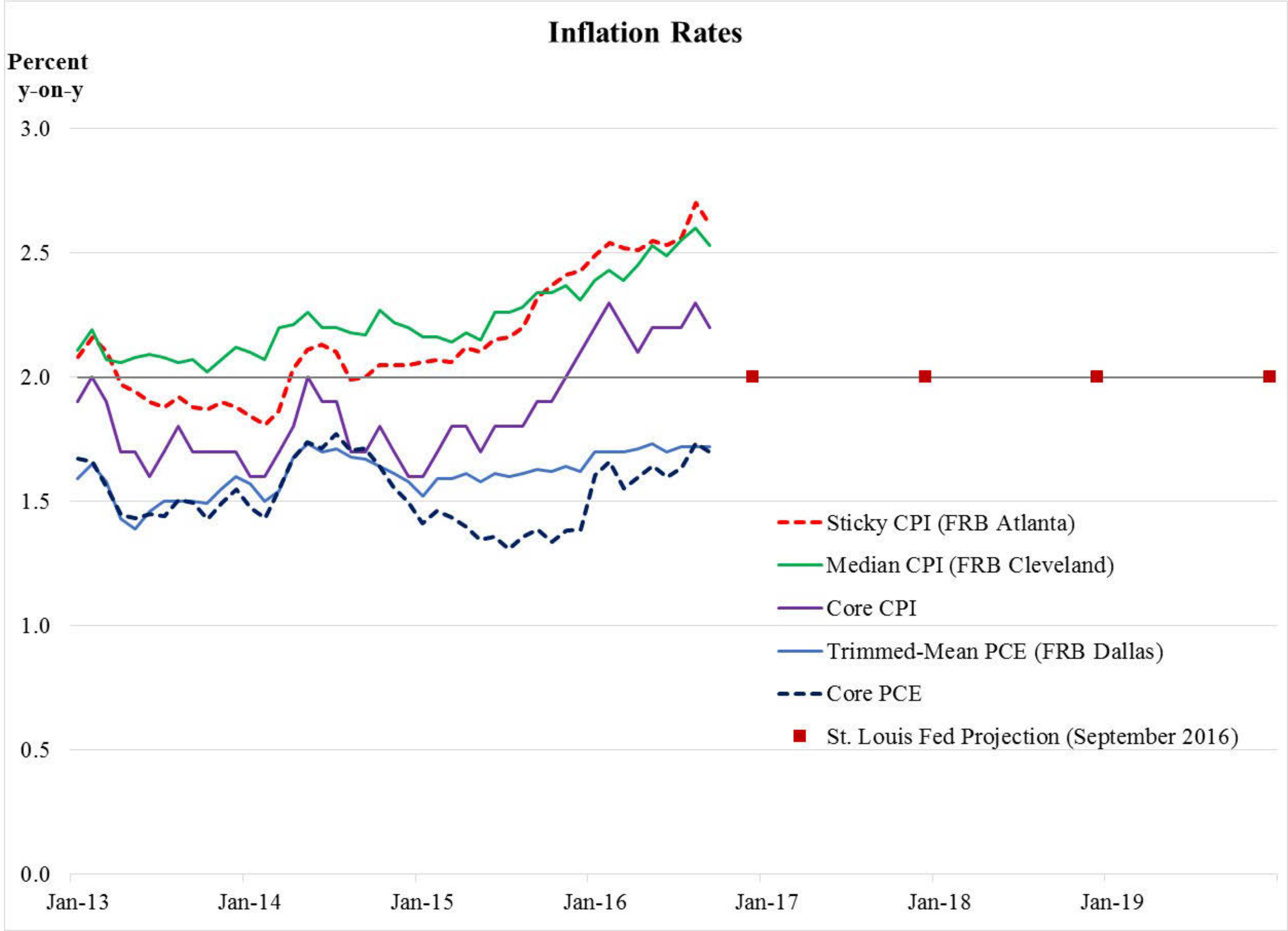
† *See "The St. Louis Fed's New Characterization of the Macroeconomic and Monetary Policy Outlook" section of the "Key Policy Papers" page on my website.*

Unemployment has declined to a low level



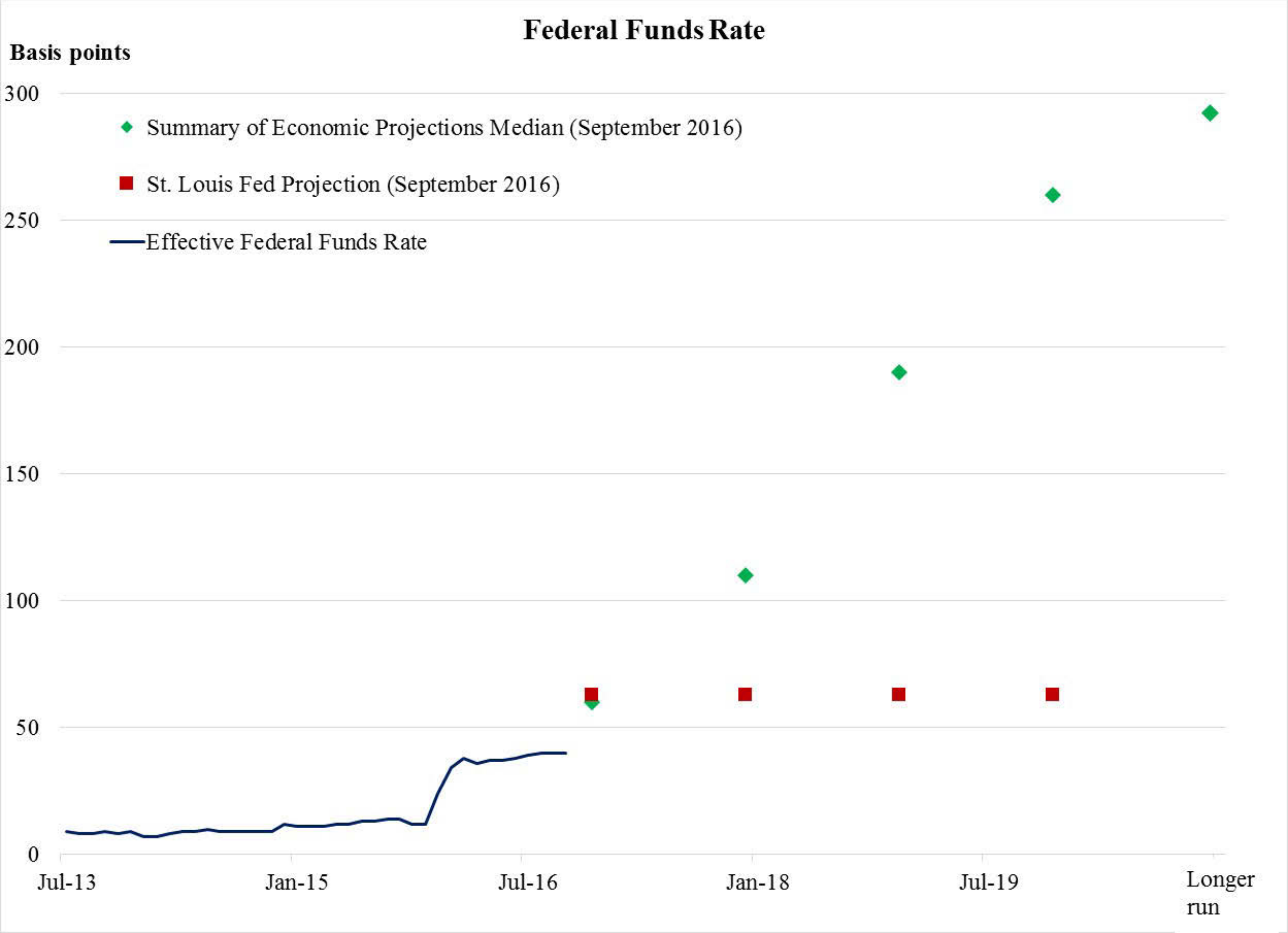
Source: Bureau of Labor Statistics and author's calculations.
Last observation: October 2016.

Smoothed measures of U.S. inflation are close to 2 percent



Source: Bureau of Labor Statistics, FRB Cleveland, FRB Atlanta, Bureau of Economic Analysis, FRB Dallas and author's calculations. Last observations: September 2016.

The policy rate path dichotomy



Source: Federal Reserve Board and author's calculations. Last observation: October 2016.

An All-Republican Lineup

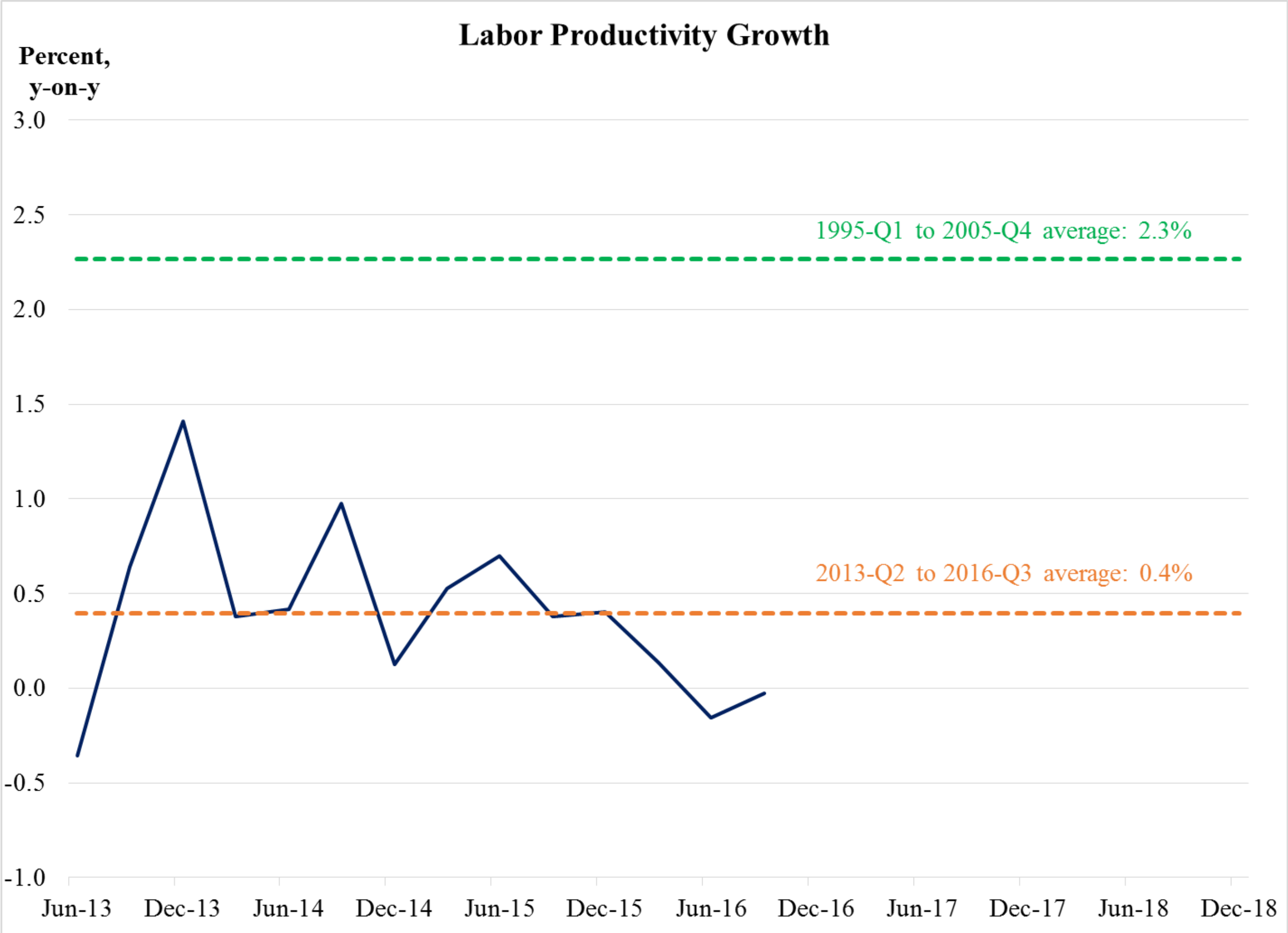
A Republican White House and Congress

- The scope for legislative action in 2017 likely increased with the Republican victory.
  - However, the party has itself been divided and holds only a slim majority in the Senate.
- Two areas may affect medium-term U.S. growth prospects, most likely in 2018, 2019 and 2020.
  - One is a fiscal package emphasizing government spending on infrastructure, possibly accompanied by tax reform.
  - Another is changes to the regulatory environment.

The possibility of a fiscal package

- The Fed takes fiscal policy into account when calibrating its monetary policy decisions.
- A key problem in the U.S. in recent years has been low productivity growth.
  - Low productivity growth has been the main factor behind the slow U.S. real GDP growth of recent years.
- A targeted fiscal infrastructure package aimed at increasing U.S. productivity growth may help to increase U.S. real GDP growth in the medium term.
- Similarly, tax reform that allows repatriation of corporate profits earned abroad may enhance investment in the U.S.

The low-productivity-growth regime



Source: Bureau of Labor Statistics, Bureau of Economic Analysis and author's calculations.
Last observation: 2016-Q3.

The swinging regulatory pendulum

- The U.S. naturally re-regulated the economy in the aftermath of the 2007-2009 recession.
- The results of the election now suggest that the period of regulatory expansion has come to an end.
- Regulation is a large area affecting many businesses.
- To the extent that there has been counterproductive regulation, its partial rollback may be beneficial for U.S. productivity and hence for economic growth.

Other Policy Changes May Have Longer-Term Effects

Longer-term policies

- Other macroeconomic issues were perhaps of more pressing concern during the recent campaign, including trade and immigration.
- Trade negotiations tend to be slow-moving relative to monetary policy.
- Trade arrangements can have important macroeconomic effects, but over the longer term.
- Similarly, immigration reform would likely have important effects on the macroeconomy, but perhaps over a longer horizon.

Conclusion

Conclusion

- The volatility of key U.S. financial indicators in the immediate aftermath of the election surprise was not particularly large in the context of the past year.
- Near term, the St. Louis Fed's macroeconomic and monetary policy outlook has not changed.
- Medium term, a targeted fiscal infrastructure package, changes in the regulatory environment, and some tax reforms could lead to faster productivity growth, more domestic investment and, therefore, faster real GDP growth.
- Longer term, changes in trade and immigration policy could have important macroeconomic impacts.

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