Central Bank and Monetary Policy Outlook

Edwin M. Truman
Nonresident Senior Fellow

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I. US monetary policy has passed its turning point, other major countries will follow

II. Definition, scope and timing of monetary policy normalization are uncertain

III. Central banking will not return to the old normal

Part I: Policy is at Turning Point

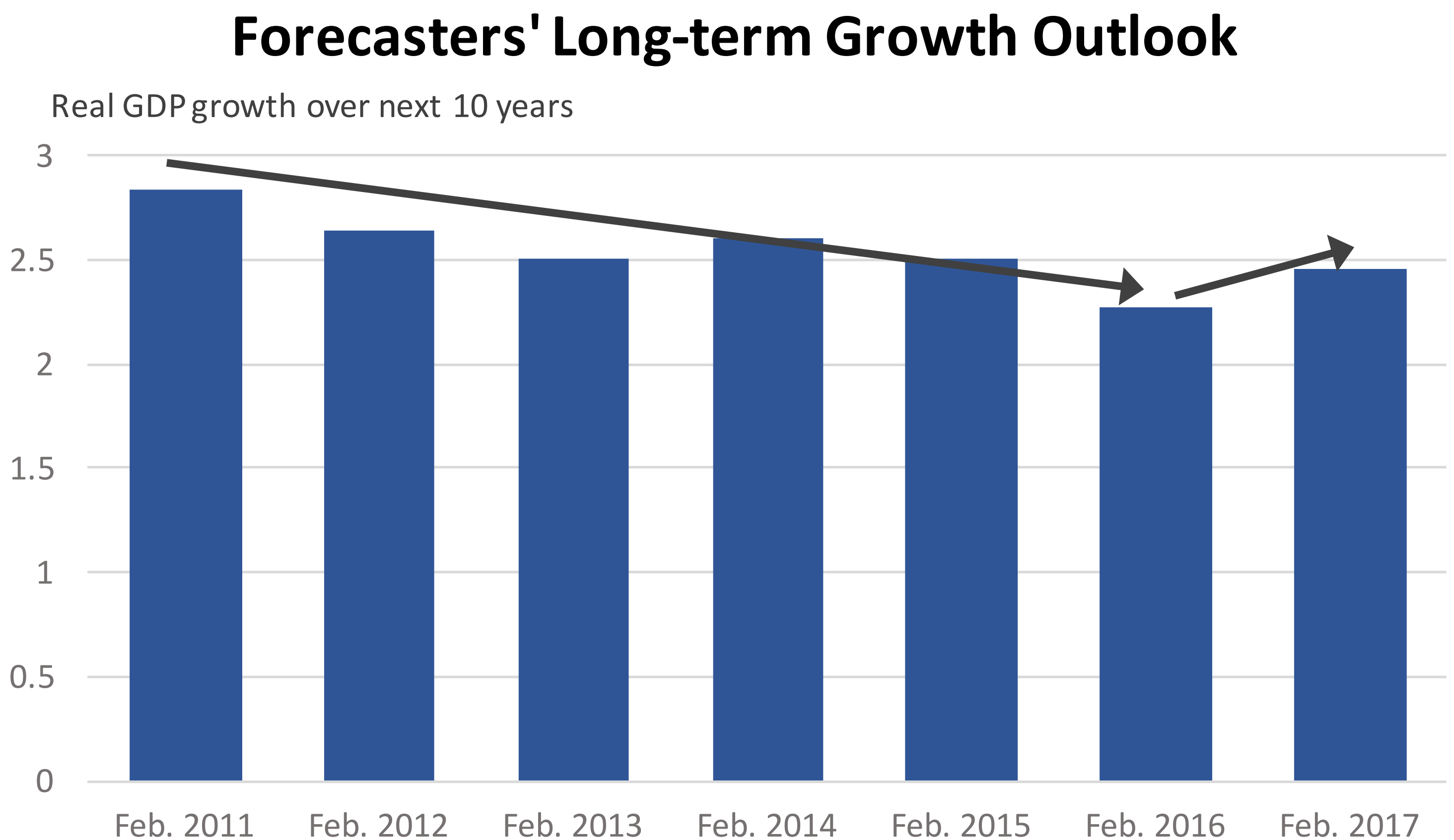
Global growth is again projected to pick up

Real GDP Growth (Y/Y)	2016	2017	2018
Global Output Growth (PPP weights)	**3.0**	**3.5**	**3.7**
US: a bump in growth	1.6	2.2	2.2
Euro Area: modest improvement	1.7	1.8	1.8
Japan: more of the same	1.0	1.3	1.0
UK: slower growth ahead	1.8	1.7	1.3
China: gradual slowdown still most likely	6.7	6.5	6.2
India: expansion on track	7.4	7.3	7.6
Russia: modest upturn	-0.5	1.2	1.3
Brazil: bottoming out at best	-3.6	0.1	1.4

Source: David J. Stockton, PIIE

This time sustained global expansion may be for real--even if modest

US Growth Will not Be this Rosy



Source. Survey of Professional Forecasters

The US Growth Challenge

Powerful supply-side factors explain why growth has been tepid relative to the 70s, 80s, 90s

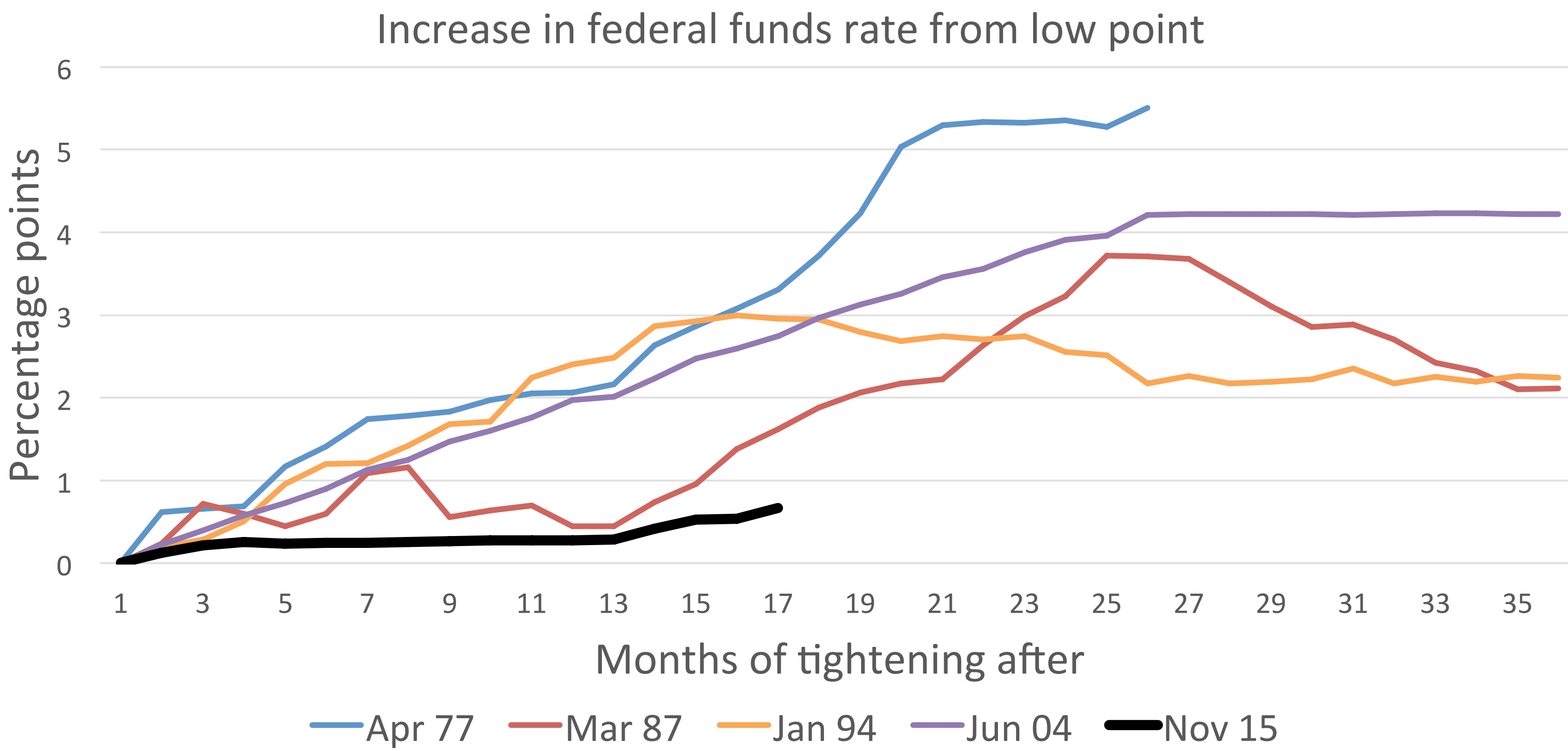
- Women are no longer surging into the workforce
- Baby boomers are starting to retire
- Slow productivity growth

A sustained higher pace of growth requires boosting the supply-side determinants of output

- Fiscal expansion and tax and financial reforms won't be enough
- Immigration policy could well be a big negative

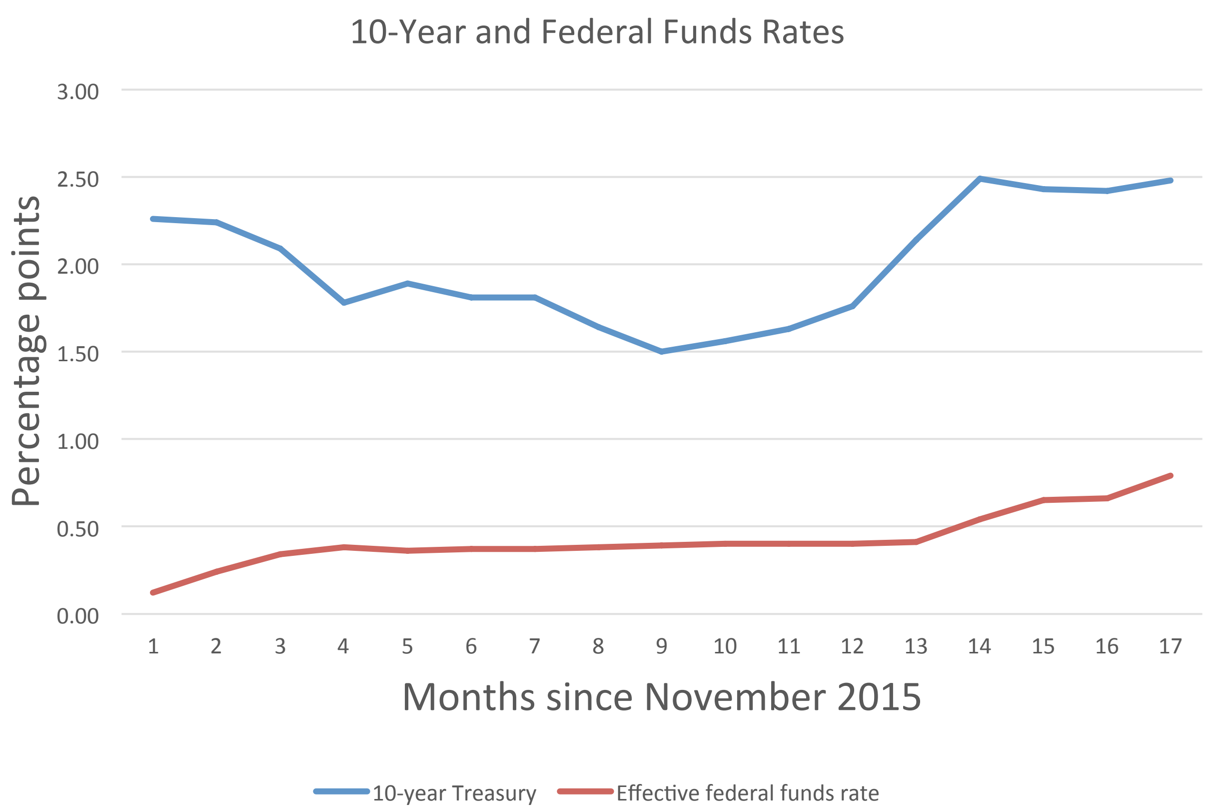
Source: Karen Dynan, PIIE

The Federal Reserve's Tightening Cycle Is Underway



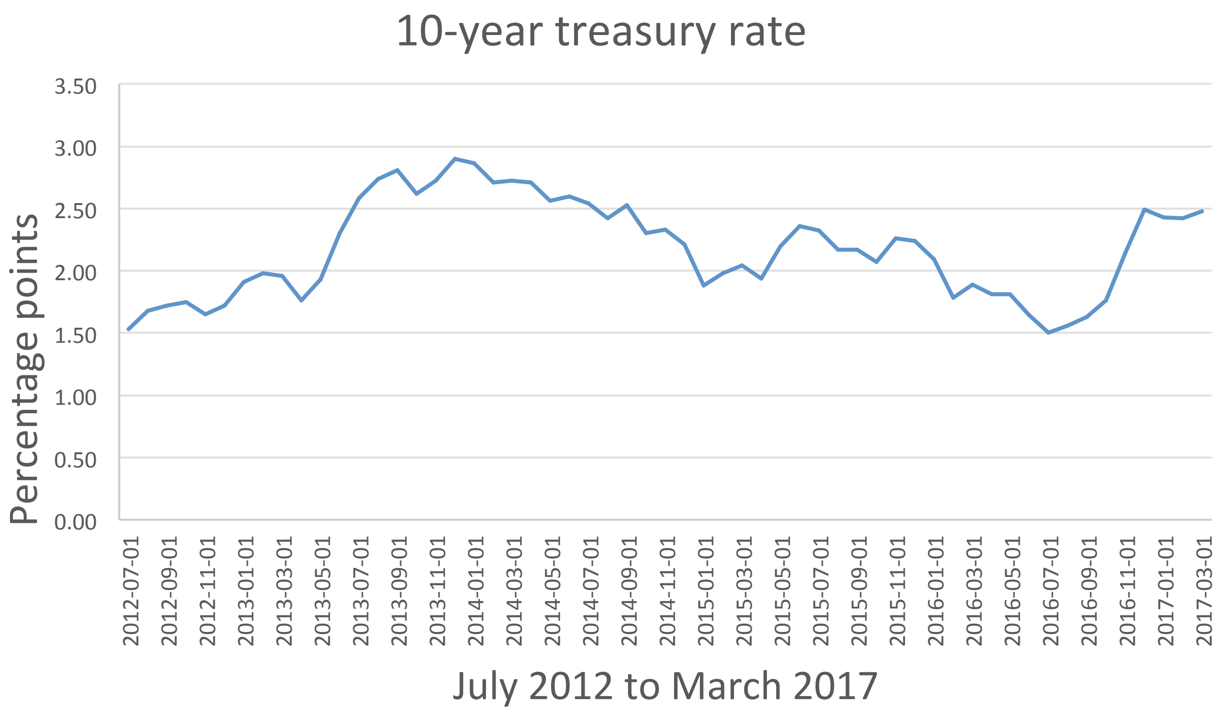
Source: Joseph Gagnon, PIIE

Long and Short Rates Are Rising



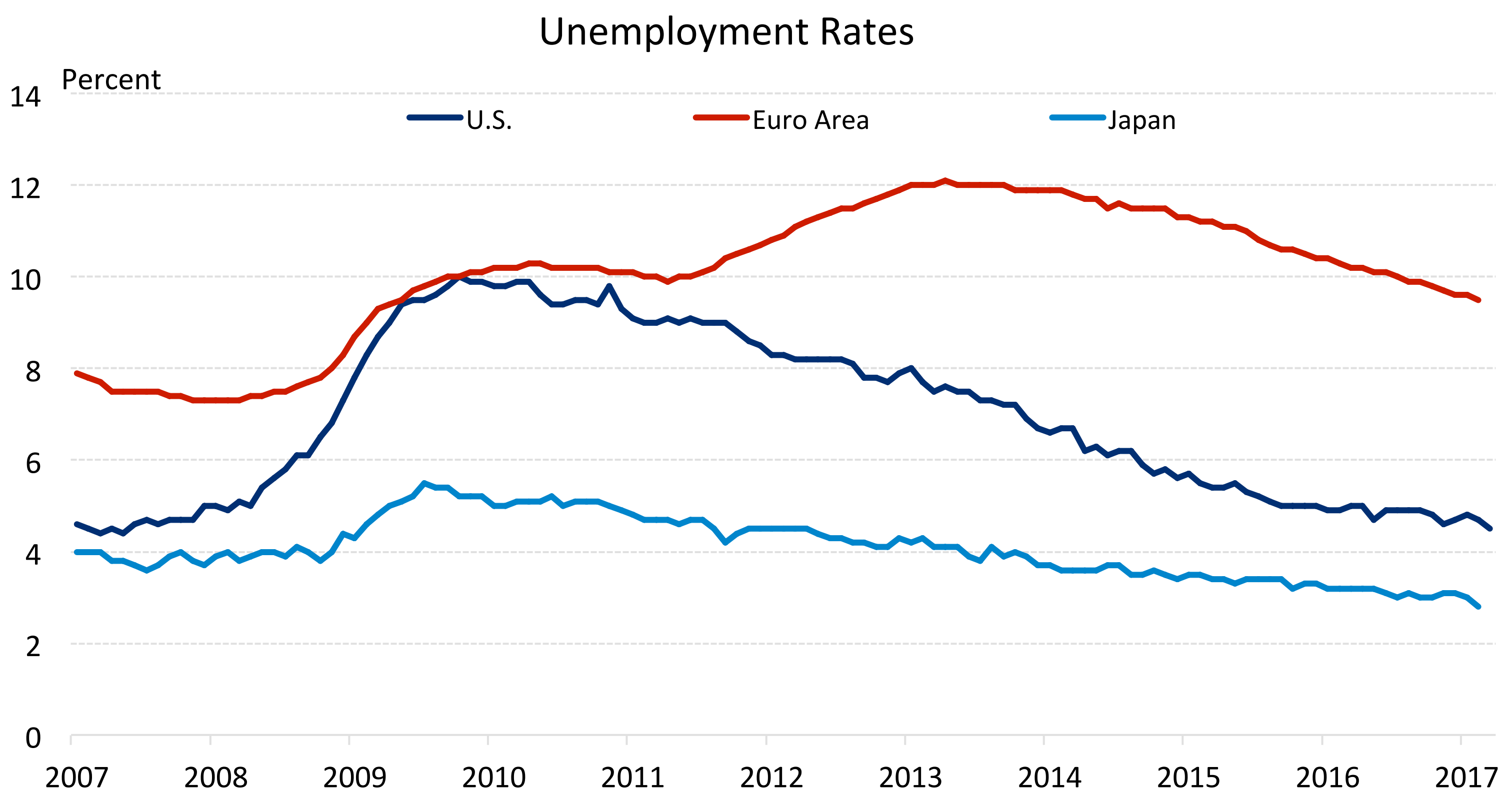
Source: FRED

After Half a Decade of Revised Expectations



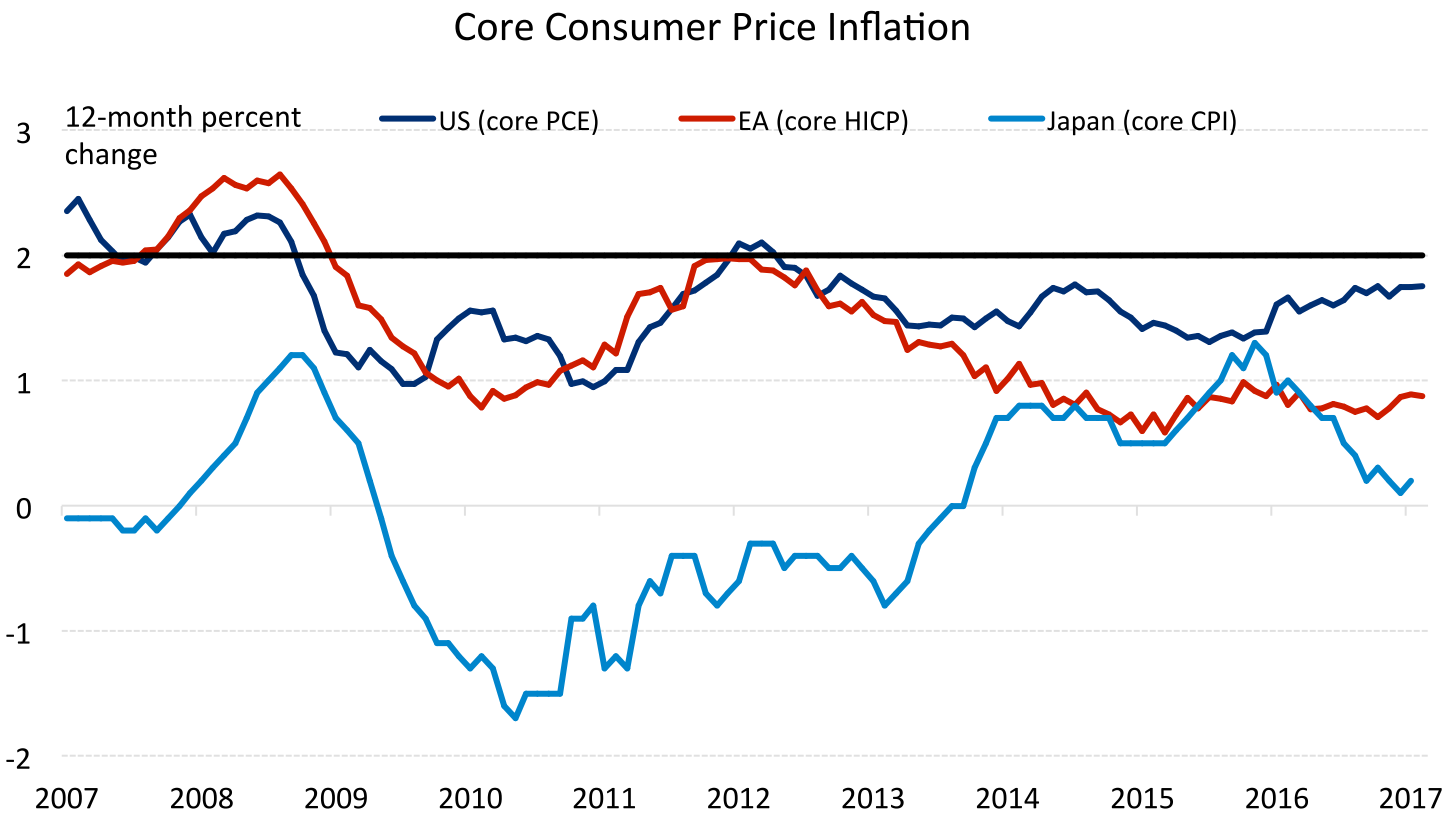
Source: FRED

Global Divergence/Convergence: Unemployment



Source: David Stockton, PIIE

Global Divergence/Convergence: Inflation



Source: David Stockton

Part II: Monetary Policy Normalization

- The United States has started monetary policy normalization
  - What is normal?
  - What will be the processes?
  - How long will it take?

We Likely Face a New Normal of Low Rates?

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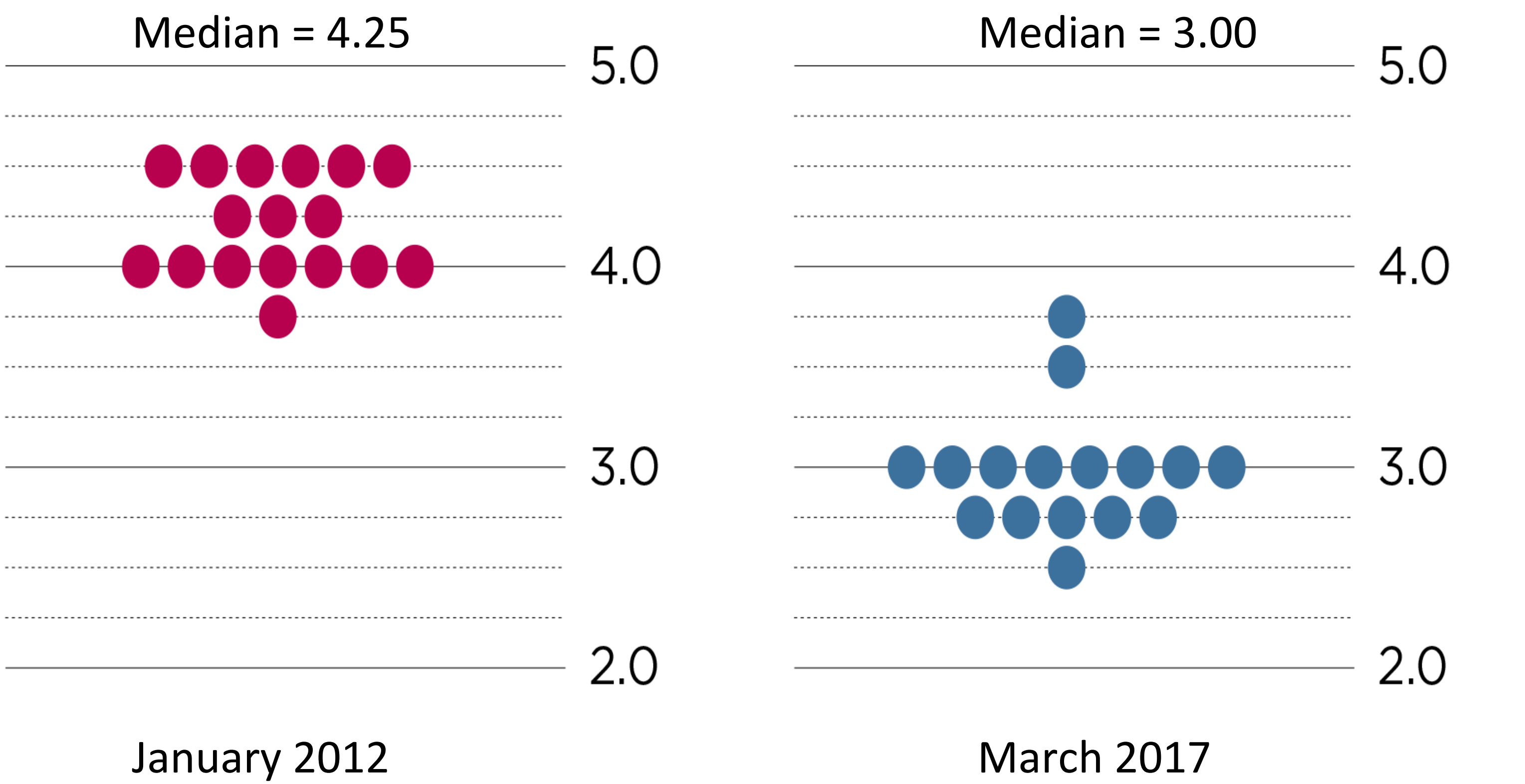
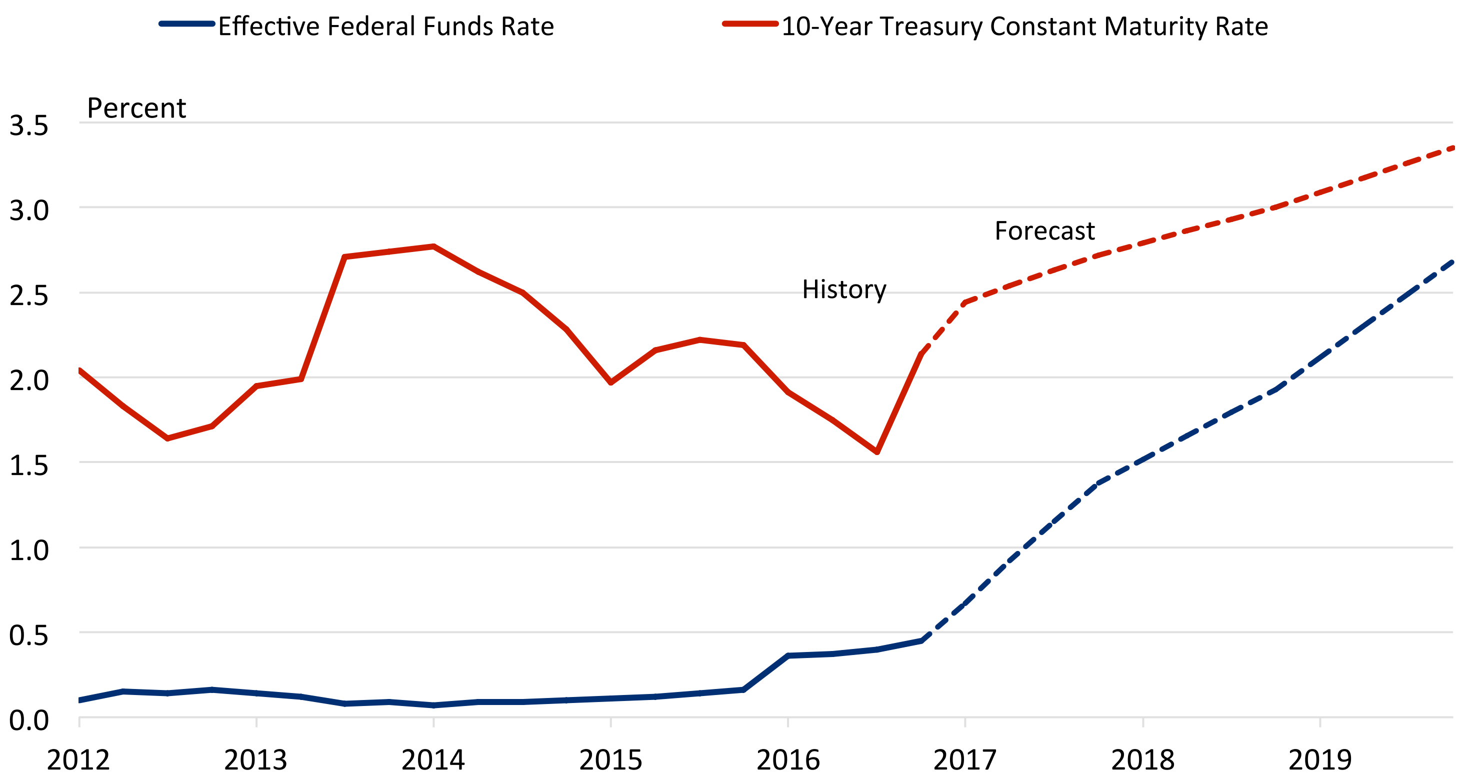
- Secular stagnation
- Low population growth
- Retirement saving
- Low productivity growth
- Global saving glut/FX policies
- Demand for safe assets

FOMC Participants "Forecasts" of Long-run Federal Funds Rate



Source: Federal Reserve Board and Joseph Gagnon, PIIE

US Monetary Policy Forecast



Source: David Stockton, PIIE

What is Normal?

If "normal" for the Federal Reserve is a funds rate at 3 percent

- The Fed may take three years to get there
- In the meantime, US monetary policy will remain accommodative
- The scope for overshooting on both inflation and employment is considerable

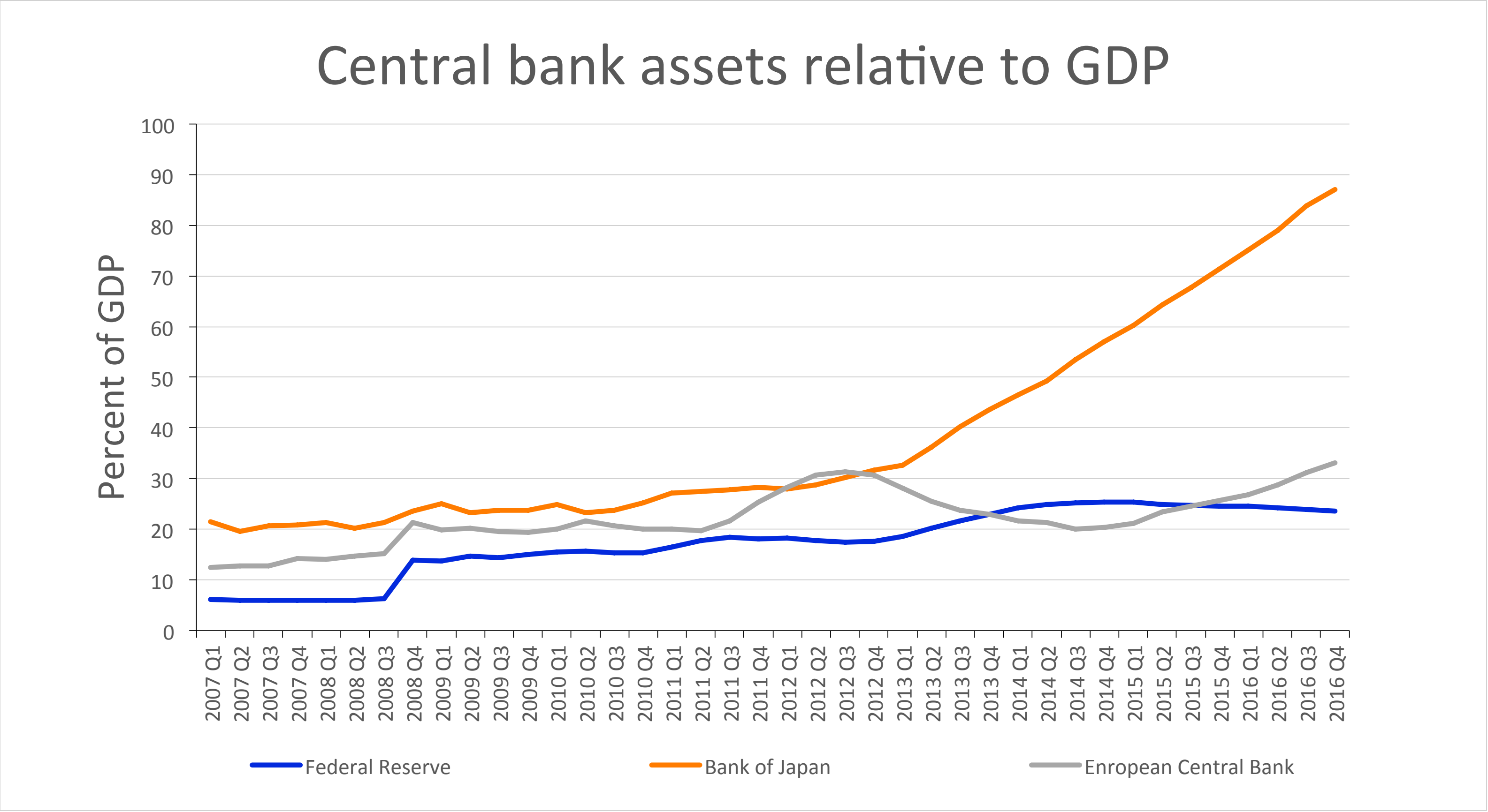
Part III: Central Banking Will NOT Return to Normal

- Central bank mandates have been expanded de facto and de jure
- Markets will expect central banks to keep their powder dry but available
- Central banks and their critics will not be able to put the genie back into the bottle

Central Banks Will Not Focus on Inflation Alone

- Central banks appropriately have regained a role in promoting financial sector stability
- Macro-prudential policies are largely untested in AEs, but are expected to play a role
- Unfortunately, some tools of crisis management have been taken away

Central Bank Balance Sheets Are Said to be Bloated



Source: FRED and author's calculations

Case for a Rapid Shrinking of Balance Sheets Is Weak

- The Federal Reserve is committed to normalizing the stance of monetary policy, starting with the funds rate
- Shrinking the Fed's balance sheet is a secondary objective
  – It already has started
  – It will and should trail the normalization of the federal funds rate
  – The case for a return to "normal" rests on considerations of market efficiency with the funds rate as the primary instrument of policy in normal times
  – The anti-inflation argument has been discredited by the events of the past decade

My Three Points

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Thank you