ECON 4325 – Friday seminar 2016

Monetary Policy meetings

(January 29 – May 6 2016)

Webpages

- http://www.Federalreserve.gov/
- http://www.bankofengland.co.uk/
- http://www.ecb.eu/
- http://www.norges-bank.no/

Current stance of monetary policy

WHAT ARE THE CURRENT STANCE OF MONETARY POLICY?

- Norges Bank:
- ECB:
- Fed:
- BoE:

- **0,5 %**
- **0,00 % (0,25 % and -0.4 %)**
- 0.25-0.5 %
- 0,5 %

Inflation targets

WHAT ARE THE DIFFERENT INFLATION TARGETS?

- Norges Bank:
- ECB:
- Fed:
- BoE:

- 2,5 %
- Close to, but below 2 %
- 2 %
- 2 %

The meetings

WE WILL FOLLOW THE NEXT MONETARY POLICY MEETINGS CLOSELY

- Norges Bank: www.norges-bank.no
  - 17/3
- ECB: www.ecb.eu
  - 21/1 10/3 21/4
- Fed: www.Federalreserve.gov
  - 16/12* 27/1 16/3* ~~27/4~~
- BoE: www.bankofengland.co.uk
  - 4/2* 17/3 ~~14/4~~

Presentations

Presentation on 8 April:

- The Fed decision from 16 March 2016 (Jørgen)

Presentations on 29 April:

- The ECB decision from 21 April 2016 (Sigri)
- The Norges Bank decision from 16 March 2016 (Morten)

Fed decision of December 2015

Vemund Vikjord and Andreas Haga Raavand

Outline

- Fed-facts
- Economic indicators pre-meeting
- Market expectations
- The December decision
  - Key points from press release
  - Feds projections
- Market reactions

Fed-facts

- 1913: the Federal Reserve Act – mandate from the Congress of promoting:
  - Maximum employment
  - Stable prices
  - Moderate long-term interest rates

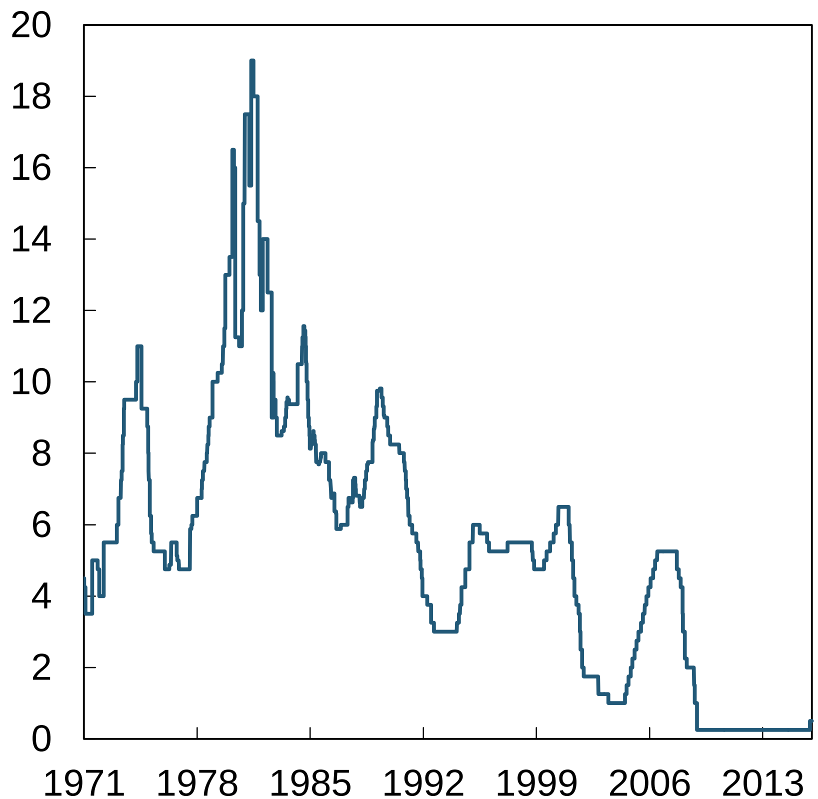
The dual mandate

- The FOMC is the monetary policymaking body of the Fed (12 members)
  - Their current judgement: a 2 percent inflation rate (yearly Δ in CPE) most consistent over the longer run with the Feds statutory mandate.
  - Recently their median estimates of the longer-run unemployment rate is just under 5 percent.

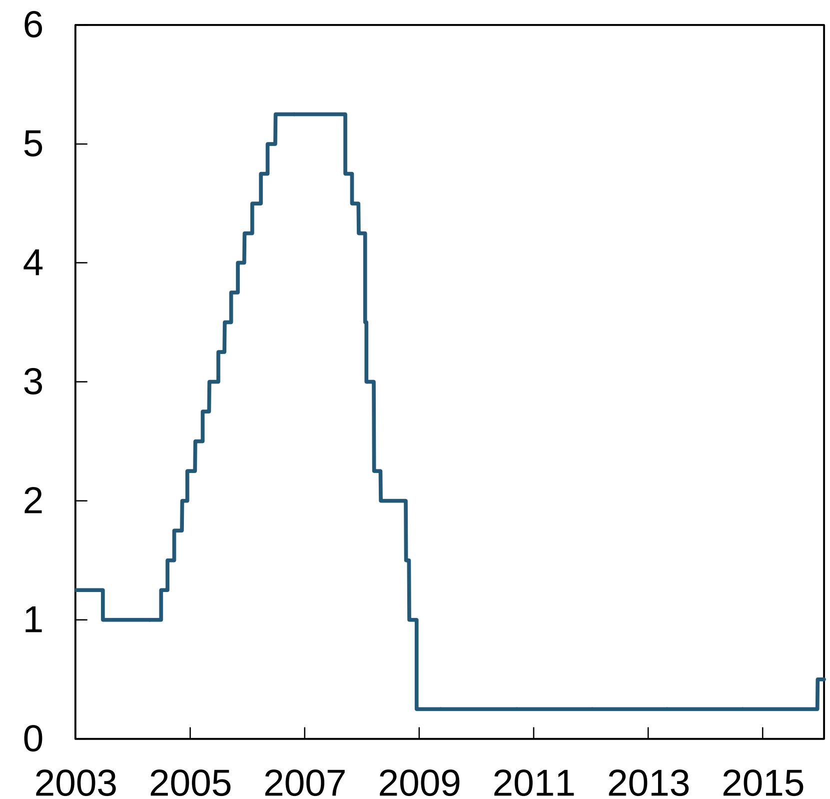
- FOMC MP tools:
  - «Usually»: adjusting short-term interest rates
  - Since 2008: attempt to influence longer-term interest rates (to improve financial conditions) by purchasing Treasury securities and securities that were issued or guaranteed by Federal agencies in a large scale

Historical US policy target rates

1971 - 2016



2003 - 2016



Source: Thomson Reuters

Fed-«FUN»-facts

- Apart from being a CB, the Fed is responsible for adressing the problem of bank panics, bank regulations and the national payment system in the US

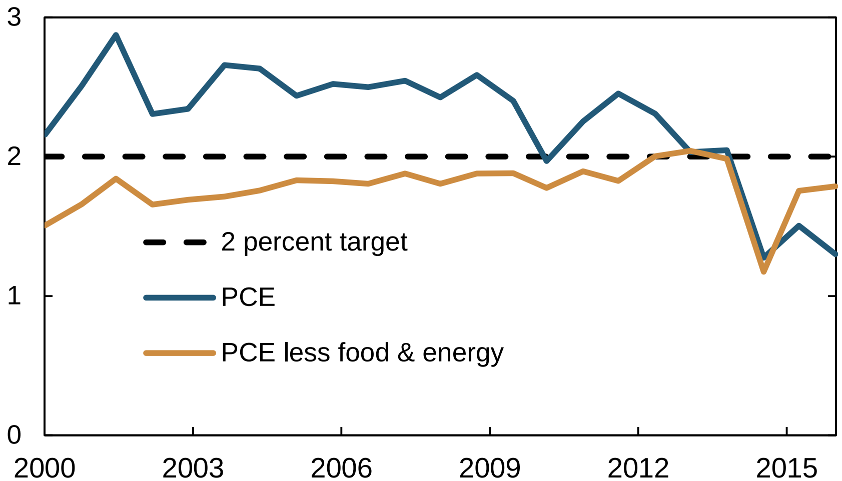
- As opposed to most other CBs, the Fed isn't responsible for producing coins and paper currency – the US Treasury actually is, but they then sell the coins and paper currency back to the Fed, which in turn is repsonsible for issuing these

- *Normally the target is a specific interest rate. But since December 2008, the Federal funds target has been a range — zero to 0.25% — because the Fed wanted to get the rate as low as possible without causing practical problems that would come with paying no interest on bank reserves.*
  The daily figure, known as the effective rate, has fluctuated from 0.07% to 0.22% since then.
  -Fed prior to December decisions

Economic indicators

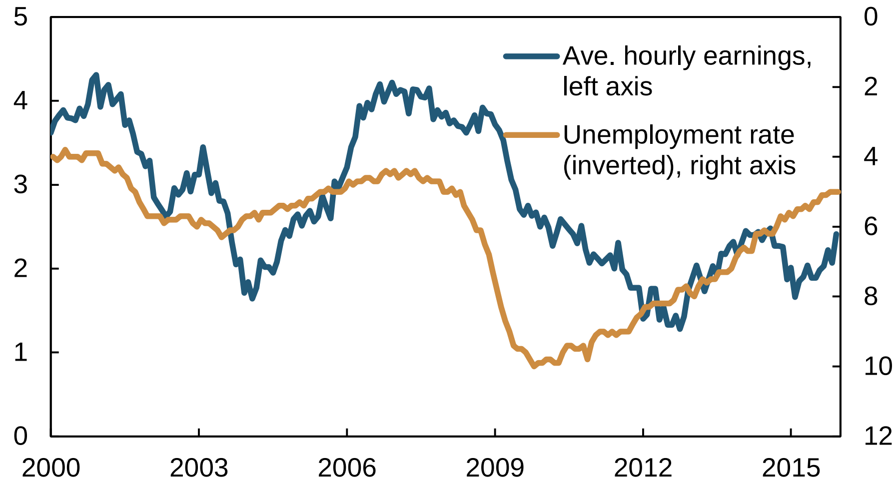
Inflation below target

12 month growth in PCE



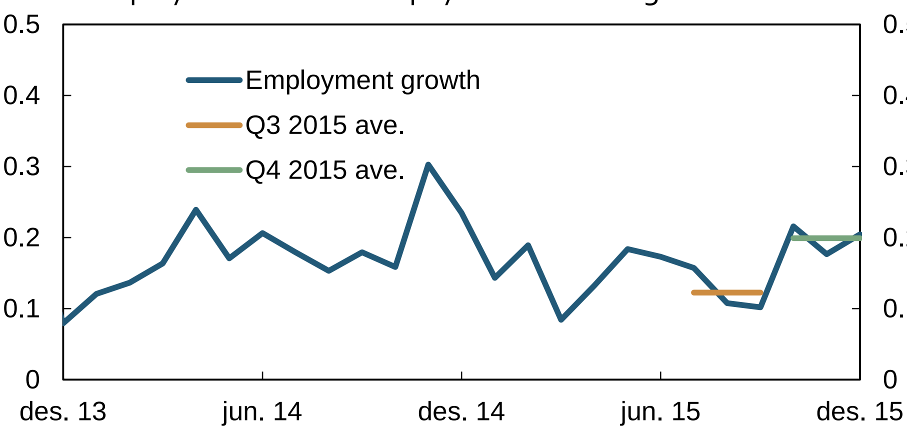
Unemployment rate falling. Salaries upwards tendency.

1 year growth in ave. hourly earnings. Unemployment in percent.



Employment on the rise

Employees on non-farm payrolls. 1 month growth



Sources: Thomson Reuters

Market expectations

November 18, 2015 7:09 pm

Fed minutes point to December rate rise

Sam Fleming in Washington and Robin Wigglesworth in New York

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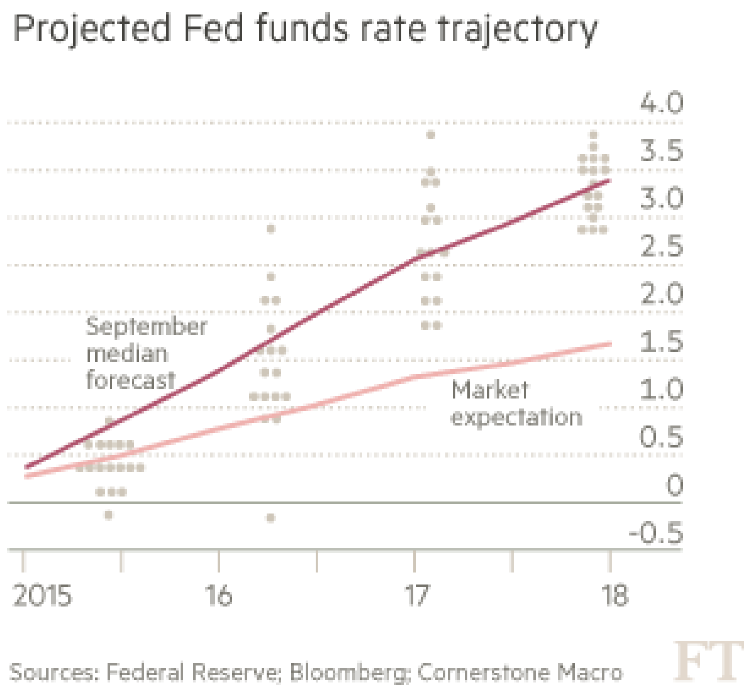
Janet Yellen

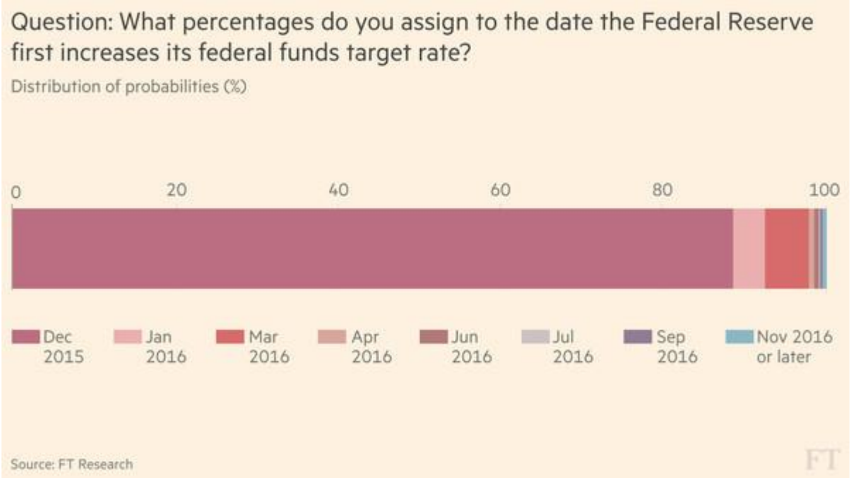
The Federal Reserve minutes from its meeting last month showed that most members thought it might be appropriate to lift rates in December provided economic data continued to improve and there were no "unanticipated shocks".

Most members of the US central bank's rate-setting body said at their October 27-28 meeting that conditions for an increase in short-term interest rates "could well be met" by the next gathering on December 16, as the central bank prepares for the possibility for the first upward move since 2006.

Expectations prior to decision

- DNB Morgenrapport 16.12.15:
  - Market has priced in an increase with a probability of at least 80 %
  - 60/64 analytics believe in an increase today





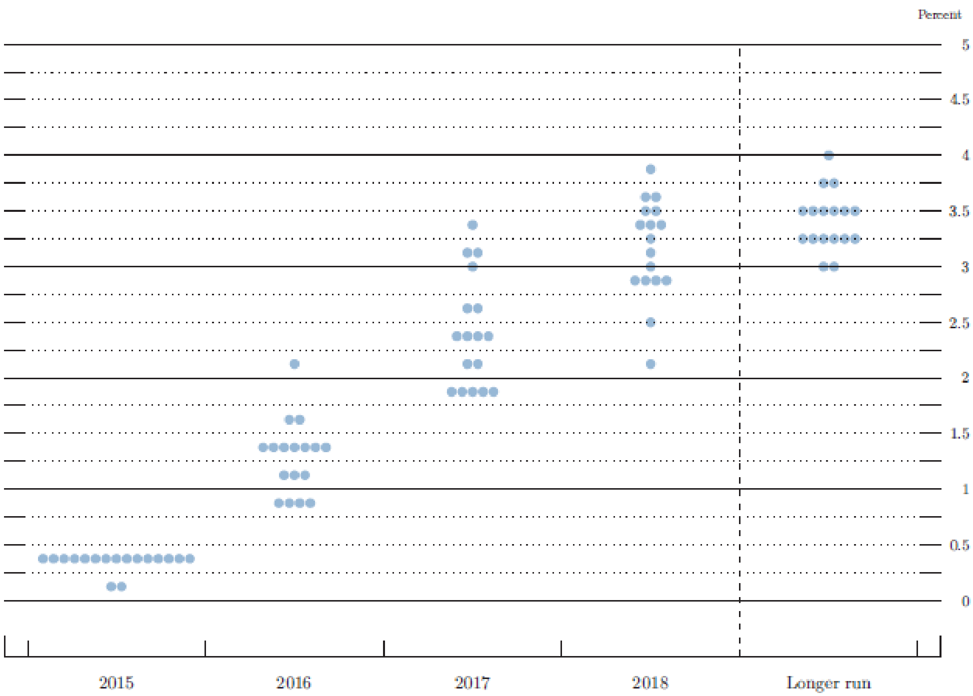
The December decision

- Interest rate raised to **0,25-0,50 percent**
- 7 years of zero lower bound
- 9 ½ years since last raise

- Emphasis on «expanding economic activity»
- Especially strengthening labor market
- Believes inflation will rise over medium run

Feds projections

- Gradual increases in the interest rate
- Monetary policy remains «accomodative»
- Inflation goal monitored closely



Market reactions

Markets | Wed Dec 16, 2015 6:22pm EST

Wall Street rallies on gradual Fed tightening, improving economy

NEW YORK | BY RODRIGO CAMPOS

"This was a Santa Claus statement," said John Augustine, chief investment officer at Huntington Wealth & Investment Management in Columbus, Ohio.

They Fed "gave savers a little bit more interest, investors a little bit more confidence in the economy, businesses a little bit more expectation of inflation," he said. "What caught our attention the most was that it was a hawkish stance and a dovish statement."

U.S. stocks rallied on Wednesday after the Federal Reserve announced it is raising its key policy rate for the first time in nearly a decade in a sign of confidence in the U.S. economy.

Markets judged the Fed's statement to be dovish, supportive of risk assets including equities. Defensive sectors of the market, recently hit in anticipation of the rate hike, were the best performers.

Campaigning in style: How Bush blew through his warchest

Planned Parenthood's accusers became the accused

Fed decision of December 2015

Vemund Vikjord and Andreas Haga Raavand

BoE Decision of February 2016

Presenter: Iman Ghayoornia

Outline

- Bank Rate Decision
- Four Key Judgements
- Projections

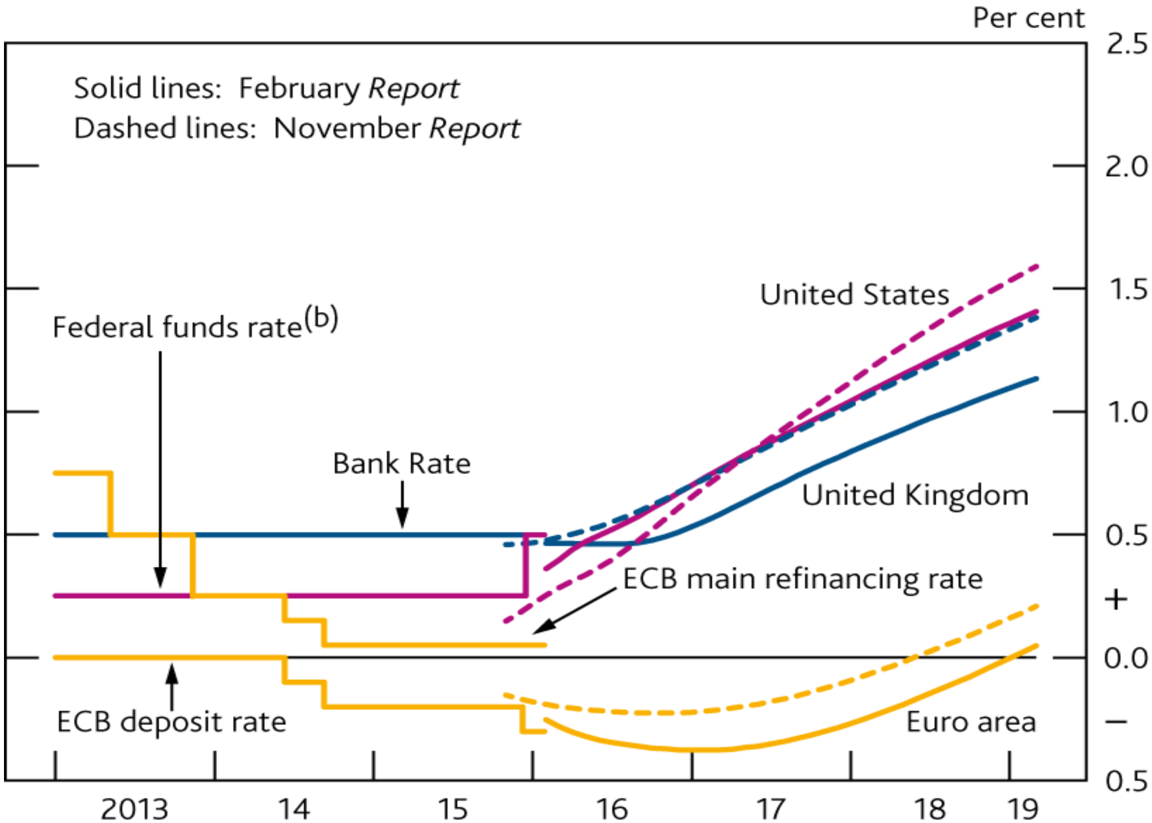
BoE Decision

- MPC decided to keep the Bank Rate unchanged at 0.5%

- Goals:
  - Price stability
  - Low inflation (2%)
  - Meet Government's objectives of growth and employment

BoE Decision

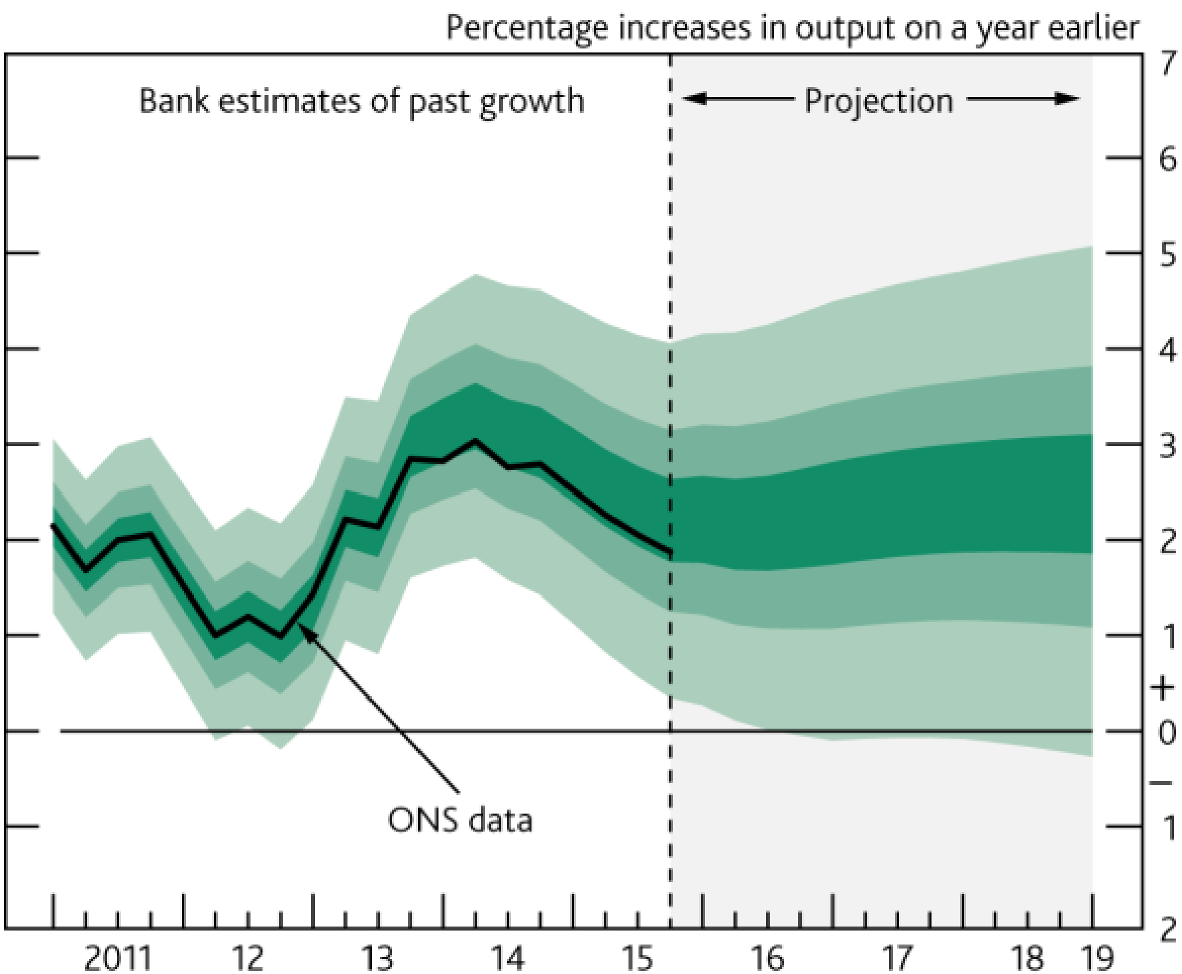
- Chart: Market-implied path for the Bank Rate



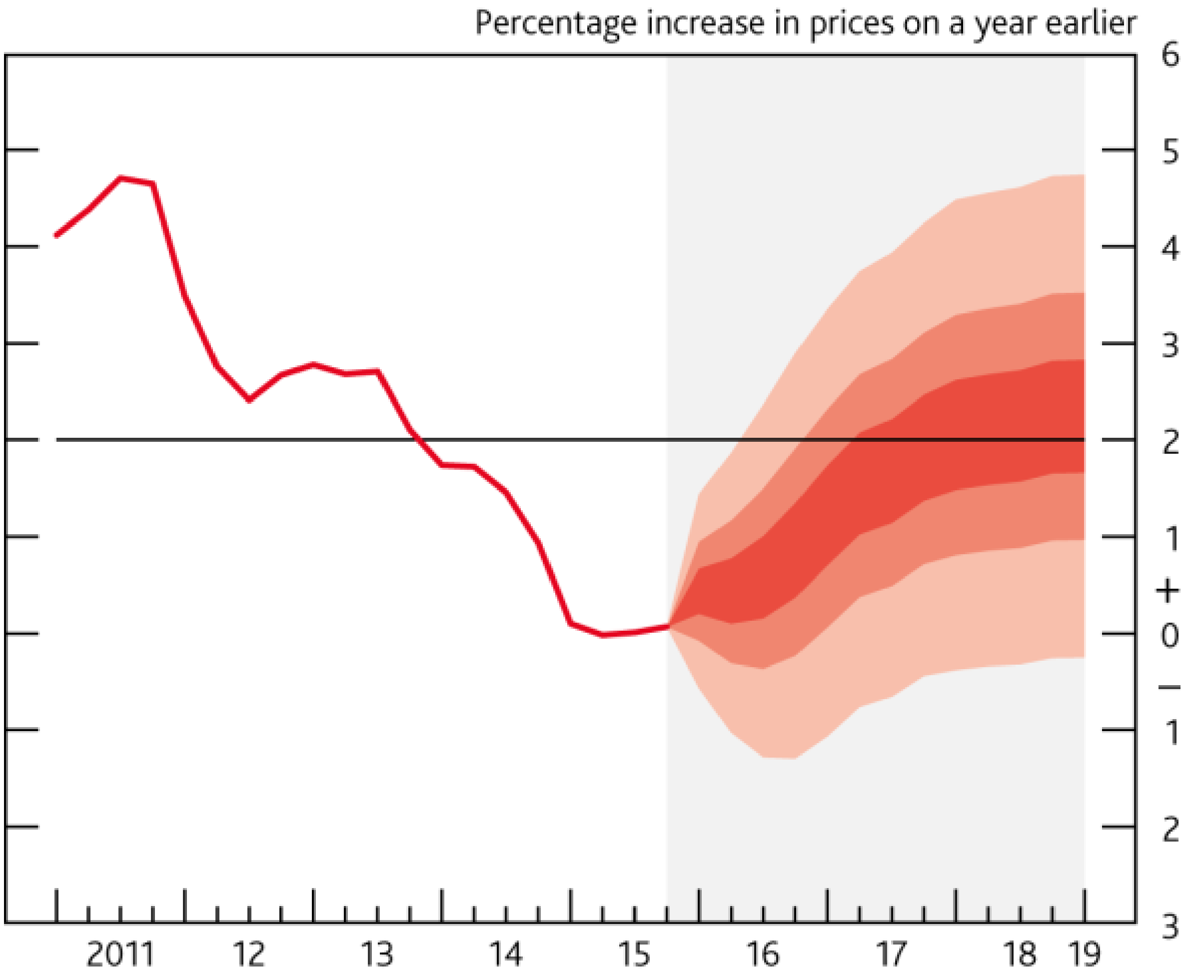
BoE Decision

- Four key judgements play an important role for this decision:
  - Slowdown in global growth
  - Resilient household and corporate spending
  - Pace in annual productivity growth
  - Domestic cost growth will pick up

Projections: GDP

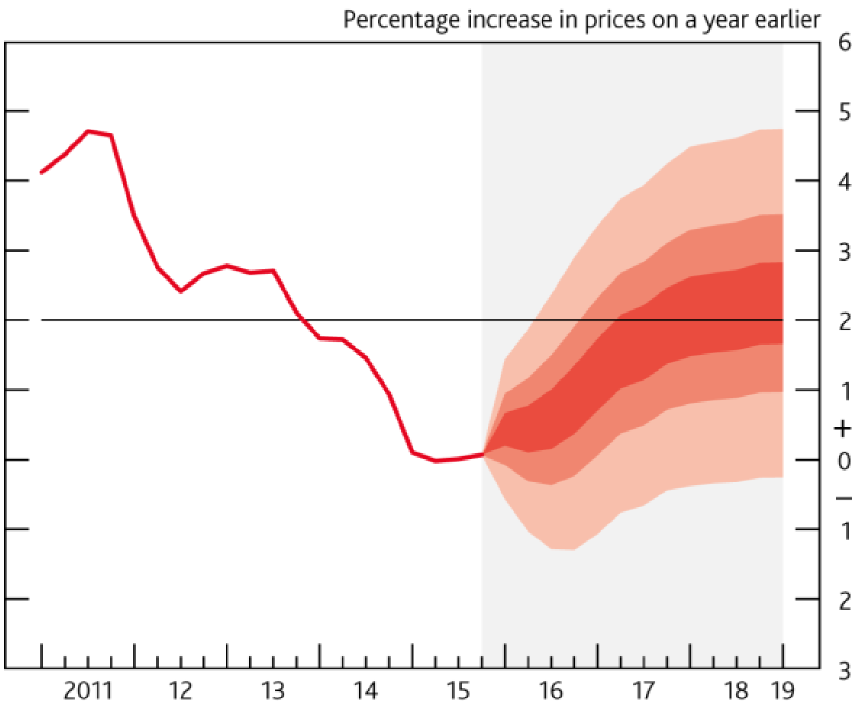


Projections: CPI Inflation

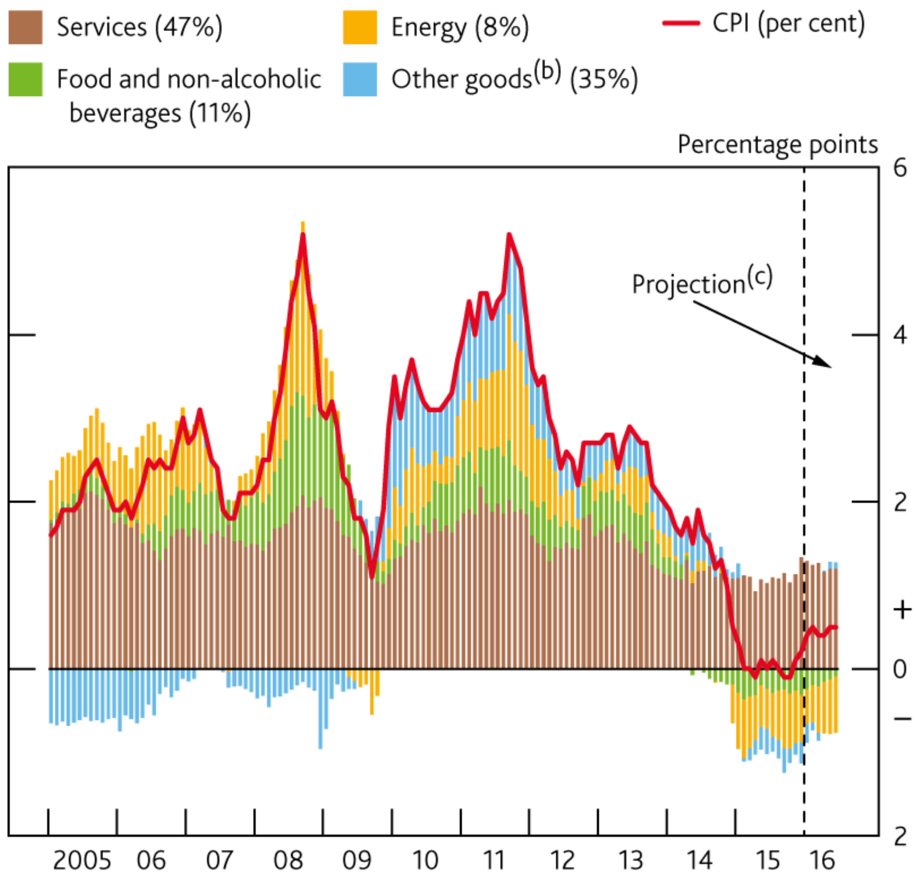


Projections: CPI Inflation

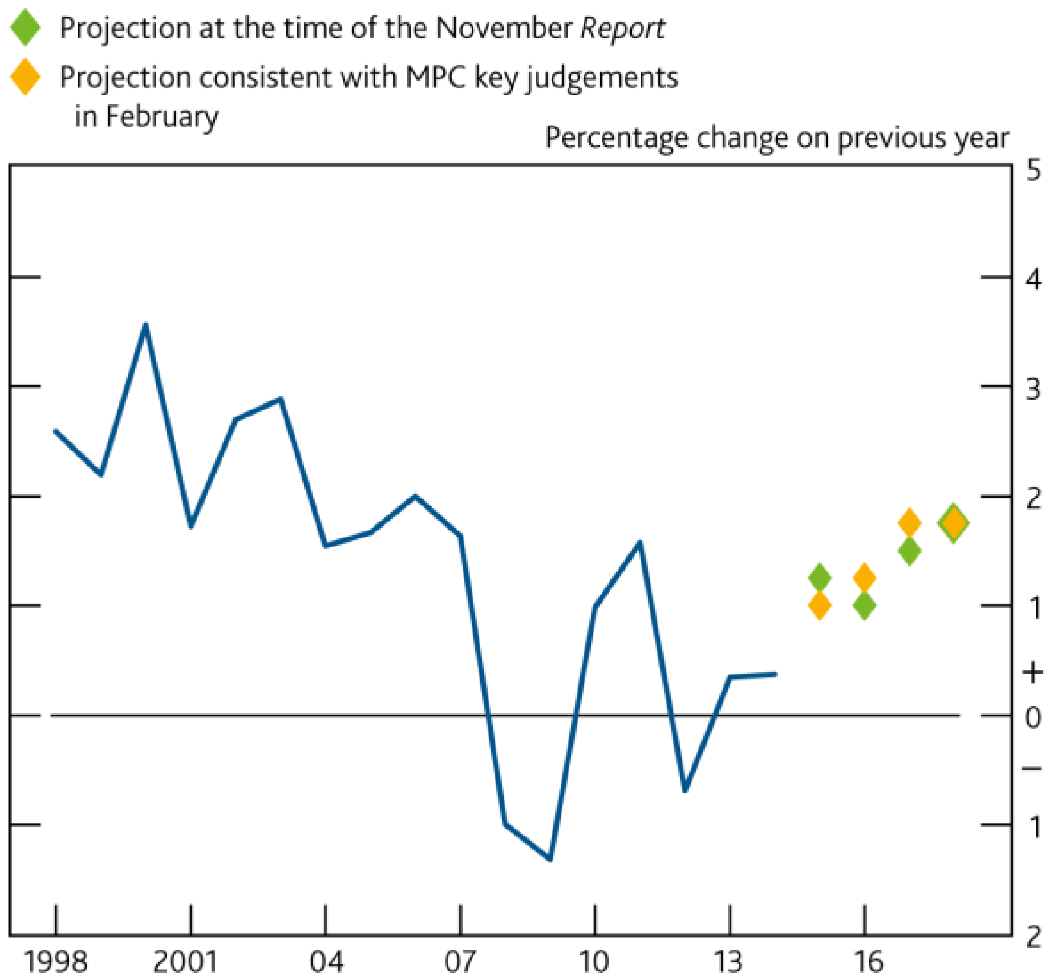
- Drag from falling commodity and energy prices
- Uncertainty concerning slack in the economy
- Robust consumer confidence and demand growth
  - MPC believes this will eliminate remaining slack



CPI Inflation: Drags

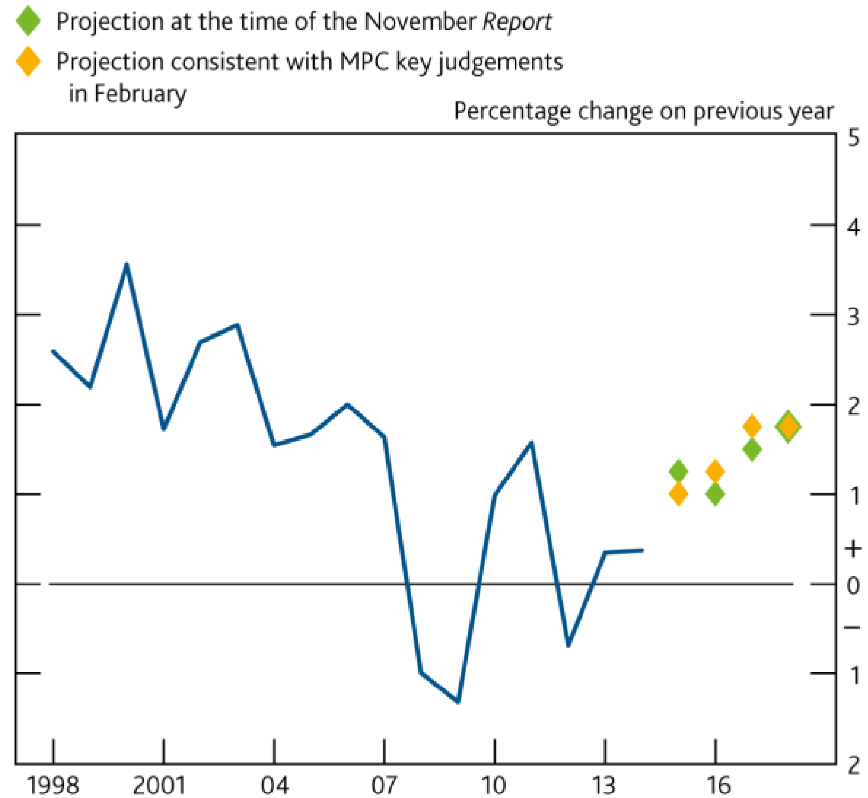


Projections: Productivity

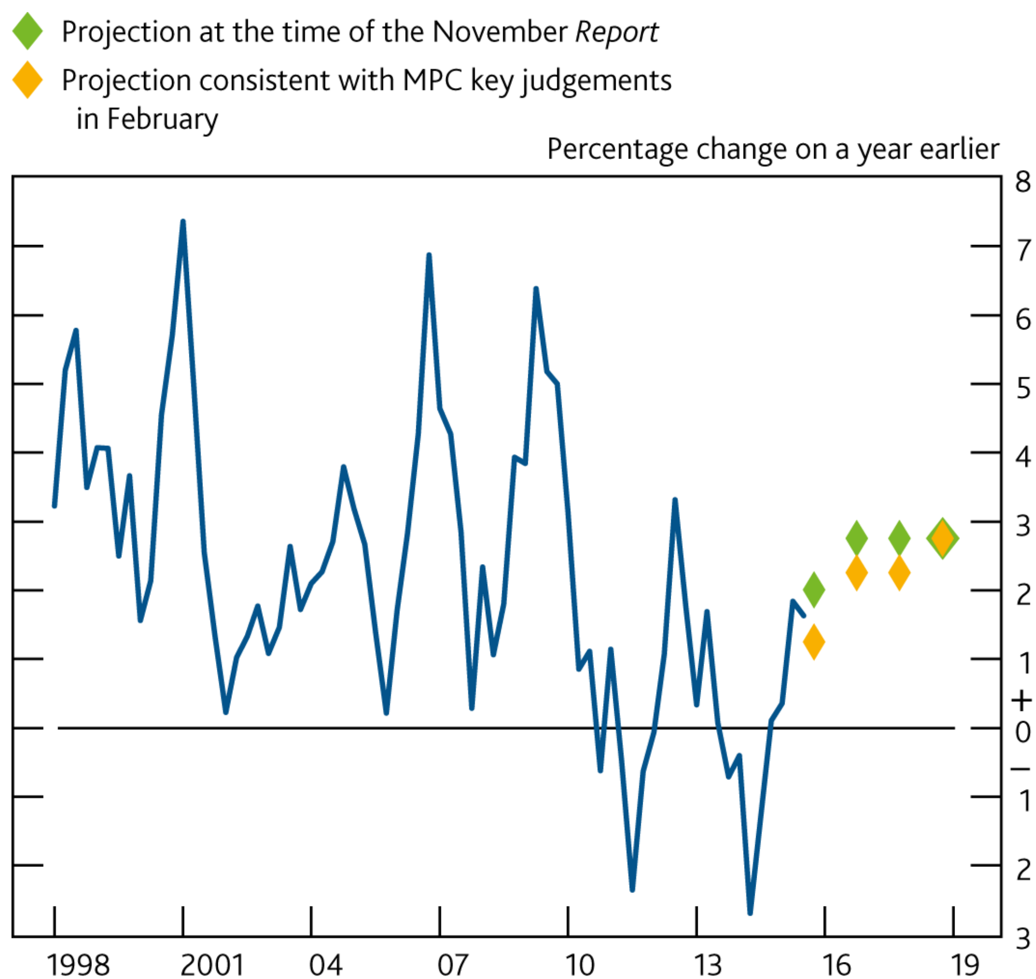


Projections: Productivity

- Annual productivity growth has slowed its pace
- Net employment growth to low-skilled jobs
- Increased job-to-job flows
  - Resources to most productive areas
  - Might explain lag in nominal wage growth



Projections: Unit Labour Costs

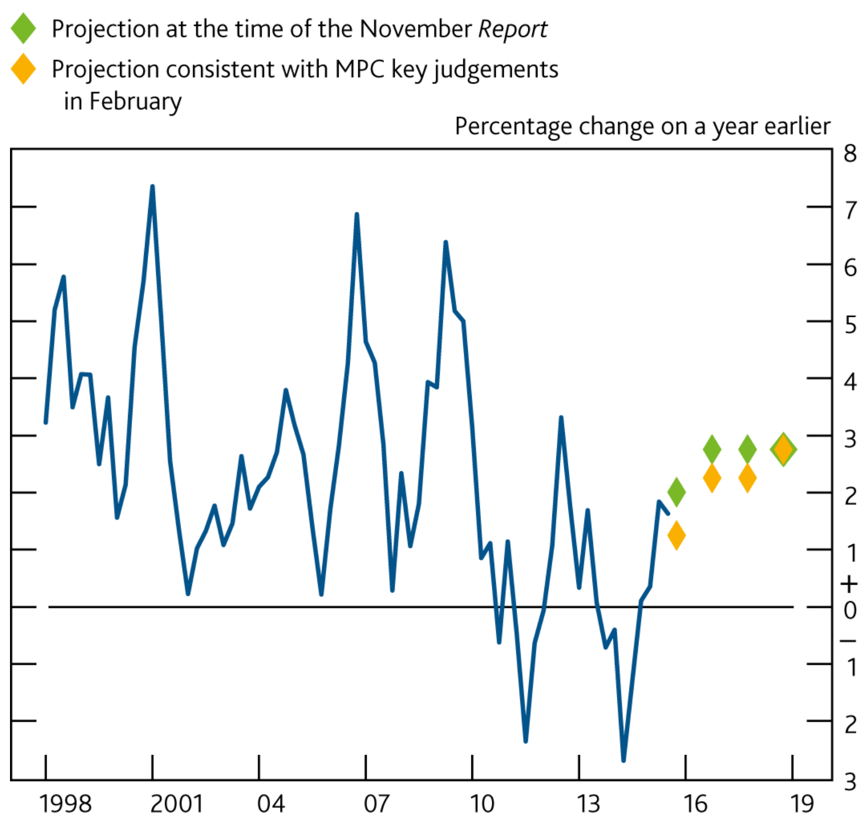


Projections: Unit Labour Costs

- Pressures in wage negotiations lacking

Possible reasons:

- Job-to-job flows
- Headline inflation used in negotiations
- Tightening in credit conditions



Conclusion

- MPC believes it best not to change the Bank Rate (0.5%) yet
  - Will observe further developments first
- MPC will pay close attention to:
  - Global economic growth
  - Labour supply and wage pressures
  - Household and corporate spending developments

BoE Decision of February 2016

Presenter: Iman Ghayoornia

ECB decision of January 2016

Caroline Espegren and Saskia ter Ellen

About the ECB

- Established in 1998
- 19 EU member states
  - which creates difficulties… (as we saw during the sovereign debt crisis)
- President: Mario Draghi since 2011
- Decision-making: Governing Council
  - Executive board (six members)
  - Governors of the national central banks

Decision-making

- Governing Council sets the key interest rate
  - Executive board (six members)
  - Governors of the national central banks
- 3 key interest rates
  - Interest rate on main refinancing operations (0,05)
  - Interest rate on the deposit facility (-0,30)
  - Interest rate on the marginal lending facility (0,30)

ECB's objective 1/2

- Maintain price stability within the Euro area
  - Inflation target: (close to but below) 2 percent
  - Horizon: medium term, 2-3 years

- Inflation measured by the HICP
  - A Laspeyres-type price index
  - Includes food and energy (headline, not core)

ECB's objective 2/2

- ECB has missed its inflation target for 4 years
  - Has the target lost its credibility?
  - Can Super Mario fix it?

ECB – conventional and unconventional monetary policy

- **Conventional**: lowering rates increases economic activity and inflation, increasing rates dampens this.
- **(Un)conventional**: lowering rates below the Zero Lower Bound (ZLB).
- **Unconventional**: asset purchase programs – Quantitative Easing (QE).
- As the ECB is already **below the ZLB**, they have to resort to unconventional MP.

QE combined with negative interest rates – more effective?

- QE: CB buys assets (mostly European government bonds) from banks.
  - Banks can either stall the money from those purchases at the CB or do something with it.
  - When deposit rate < 0, banks are incentivized to put the money to use (i.e. either invest it in riskier assets, lend it to households/businesses, invest outside Europe).
- QE depresses exchange rate – stimulates inflation.

- Criticism QE: asset price bubbles, deflated rates do not reflect riskiness of assets, search for yield, risk on balance sheet CB and banks, …

The Decision: no change

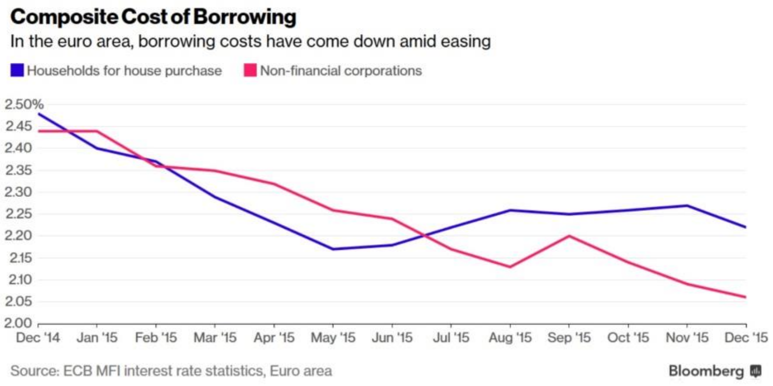
- "we decided to keep the key ECB interest rates **unchanged** and we expect them to remain at **present or lower levels** for an extended period of time."
- "non-standard monetary policy measures: the **asset purchases** are proceeding smoothly and continue to have a **favourable impact on the cost and availability of credit** for firms and households."

But: prospects for March..

- "**downside risks** have increased again amid heightened uncertainty about emerging market economies' growth prospects, **volatility** in financial and commodity markets, and **geopolitical risks**."
- "**euro area inflation dynamics** also continue to be weaker than expected."
- "necessary to **review and possibly reconsider** our monetary policy stance at our next meeting in early March."

Background

- GDP growth picking up.
- Inflation low, from 0.1% to 0.2% (*oil).
- Further improvements in demand for bank loans.
  - But will even lower rates really increase lending?



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ECB communication

- Is the ECB good at communicating future actions (forward guidance)?
- October meeting: no action but indications for action in December.
  - Markets still disappointed in December (1/3 of Bloomberg respondents expected -20 bps or more).
- Q about ECBs credibility this meeting.
  - Draghi's response: economic circumstances changed, so reviewing is needed.

Fed decision of January 2016

Eirik Lading

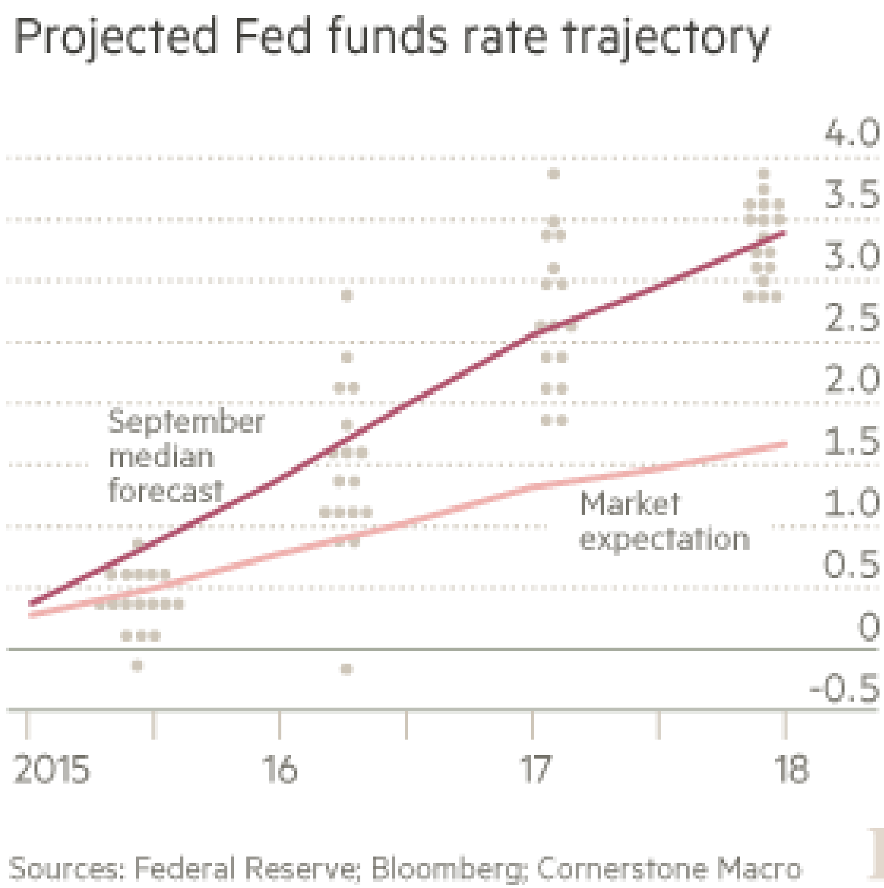
Decision

- Federal Open Market Committee maintain the target for the federal funds rate at 0.25%-0.5%
- No press conference or projections
- Reaffirmation of "Longer-Run Goals and Policy Strategy"
- "… the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run." – FOMC Statement, December & January
- US is going to the downturn of the business cycle as currently showing in growth, investment and expectations at a faster pace than in December

Overall economy

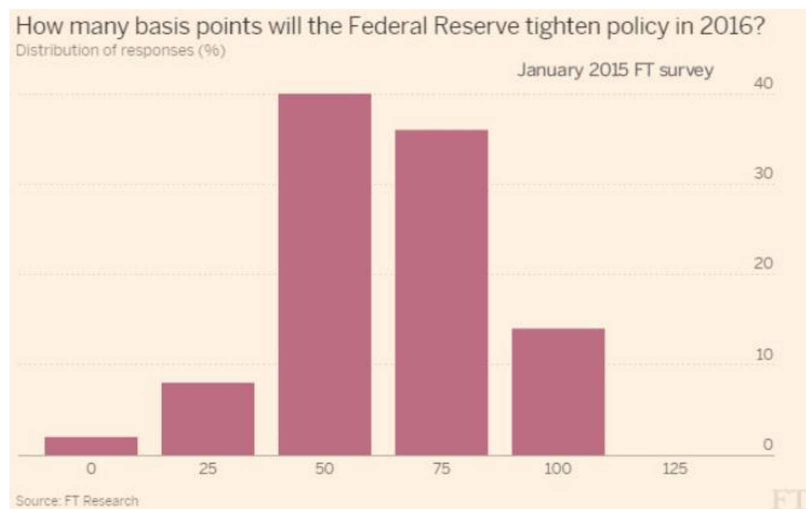
- FOMC Press Release, January:
  - "growth slowed last year "
  - Fixed and inventory investment slowing

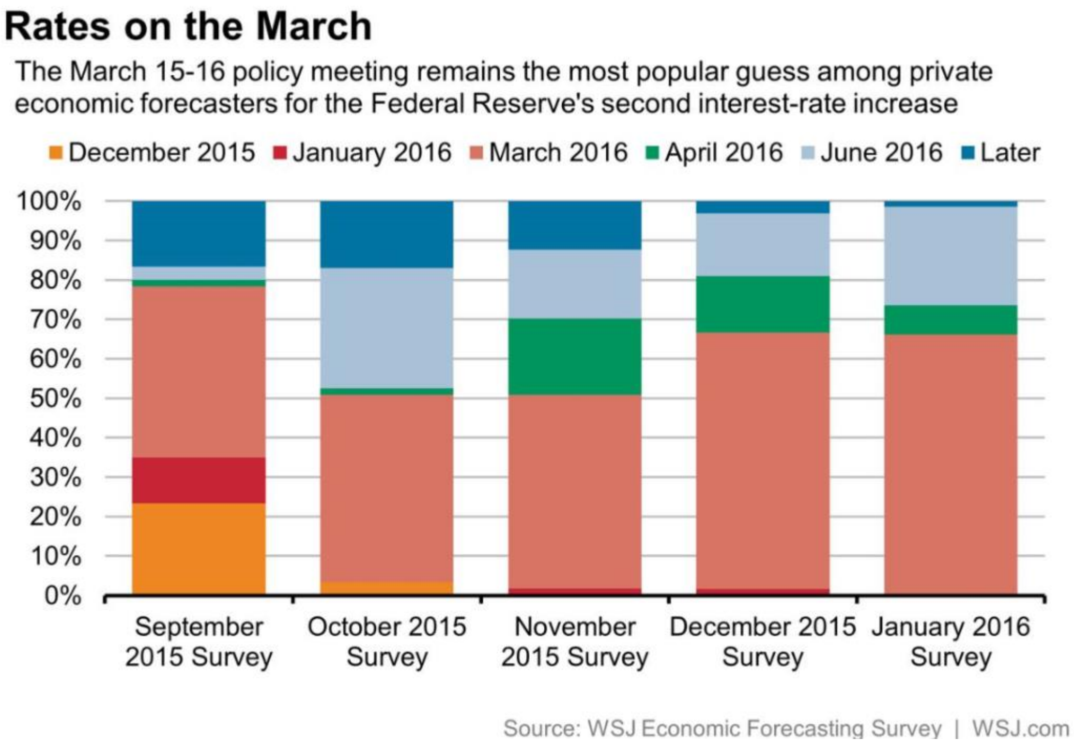
Maybe the markets were right



Expectations

- "Economists surveyed by the FT emphasised that while the odds of a recession had climbed, a large majority still expected the US to escape one. " – Financial Times 2016-01-26

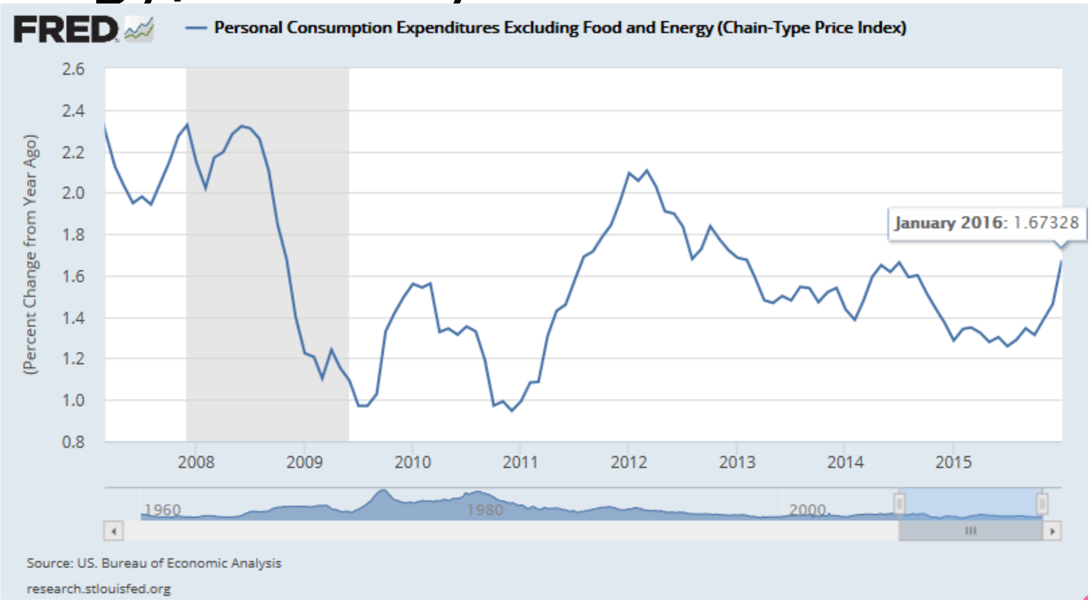




Rates on the March
The March 15-16 policy meeting remains the most popular guess among private economic forecasters for the Federal Reserve's second interest-rate increase
December 2015
January 2016
March 2016
April 2016
June 2016
Later
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
September 2015 Survey
October 2015 Survey
November 2015 Survey
December 2015 Survey
January 2016 Survey
Source: WSJ Economic Forecasting Survey | WSJ.com

Inflation – dual mandate I

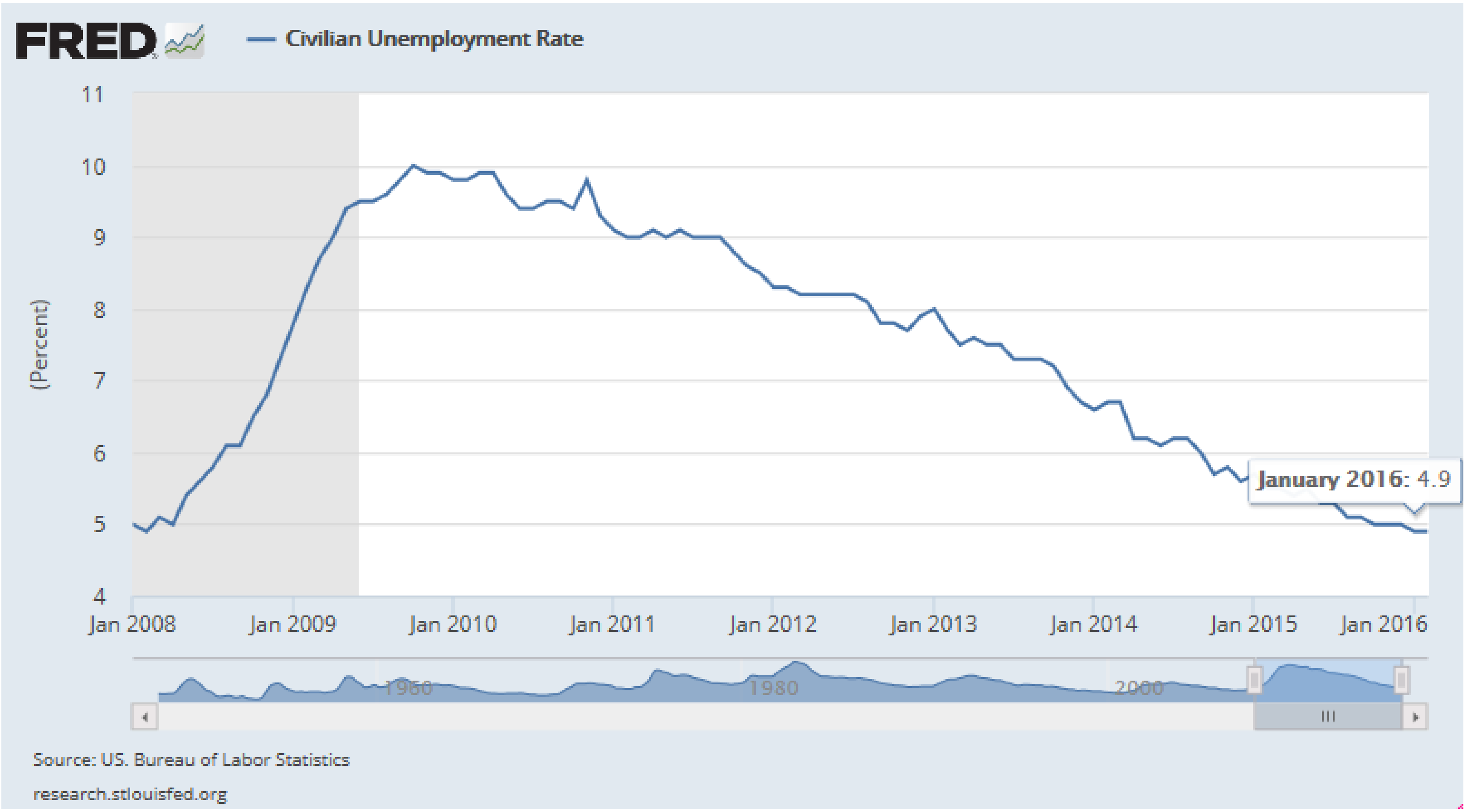
- "The Committee would be concerned if inflation were running persistently above or below this objective. " – Longer-Run Goals and Policy Strategy, January 2016
- 2% target



Inflation – dual mandate I

- "Market-based measures of inflation compensation **remain low**; some survey-based measures of longer-term inflation expectations **have edged down**. " – FOMC Statement, December
- " Market-based measures of inflation compensation **declined further**; survey-based measures of longer-term inflation expectations **are little changed**... " – January

Unemployment – Dual mandate II



Unemployment – Dual mandate II

- "labor market conditions improved further" – FOMC, January
- No explicit target
- FOMC Summary of Economic Projections, 2015, longer-run normal rate of unemployment :
  - Range: 4.7 - 5.8
  - Median: 4.9 – on target

Fed decision of January 2016

Eirik Lading

ECB decision of March 2016

Kristin Celius

Decisions I

- Cut the three key interest rates
  - Interest rate on main refinancing operations down by 0.05%, to 0.00%
  - Interest rate on marginal lending facility down by 0.05% to 0.25%
  - Interest rate on deposit facility down by 0.10% to -0.40%

Decisions II – APP

- Asset purchase programme (QE)
- Monthly purchase expanded from 60 to 80 billion euros
- Now including bonds issued by non-bank corporations in the euro area
- Will run until March 2017, or beyond if necessary

Decisions III – TLTRO II

- Four new targeted longer-term refinancing operations to reinforce the ECB's accommodative monetary policy stance and to foster new lending.
- Operations starting in June 2016, then one each quarter until March 2017
- Four-years maturity on each operation, repayment possible after two years
- Fixed interest rate at the rate of main refinancing operations at the time of take-up

Doing whatever it takes?

- "Let me say that rates will stay low, very low, for a long period of time, and well past the horizon of our purchases. From today's perspective, and taking into account the support of our measures to growth and inflation, we don't anticipate that it will be necessary to reduce rates further."
- "While very low or even negative inflation rates are unavoidable over the next few months, as a result of movements in oil prices, it is crucial to avoid second-round effects by securing the return of inflation to levels below, but close to, 2% without undue delay."

From underdeliver to overdeliver?

- The measures presented was more expansionary than expected
- Projections for GDP growth and inflation revised slightly down since December
  - Inflation in February: -0,2%, expected to remain negative in the months to follow
  - HICP projections: 0.1% in 2016, 1.3% in 2017, 1.6% in 2018
  - GDP growth: 1.4% in 2016, 1.7% in 2017, 1.8% in 2018

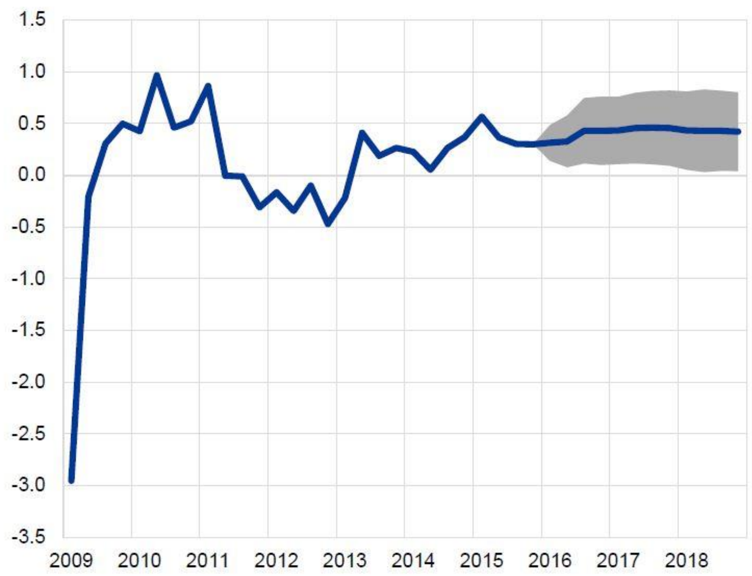
Projections

Macroeconomic projections[1]

(quarterly data)

Euro area real GDP[2]

(quarter-on-quarter percentage changes)



Euro area HICP

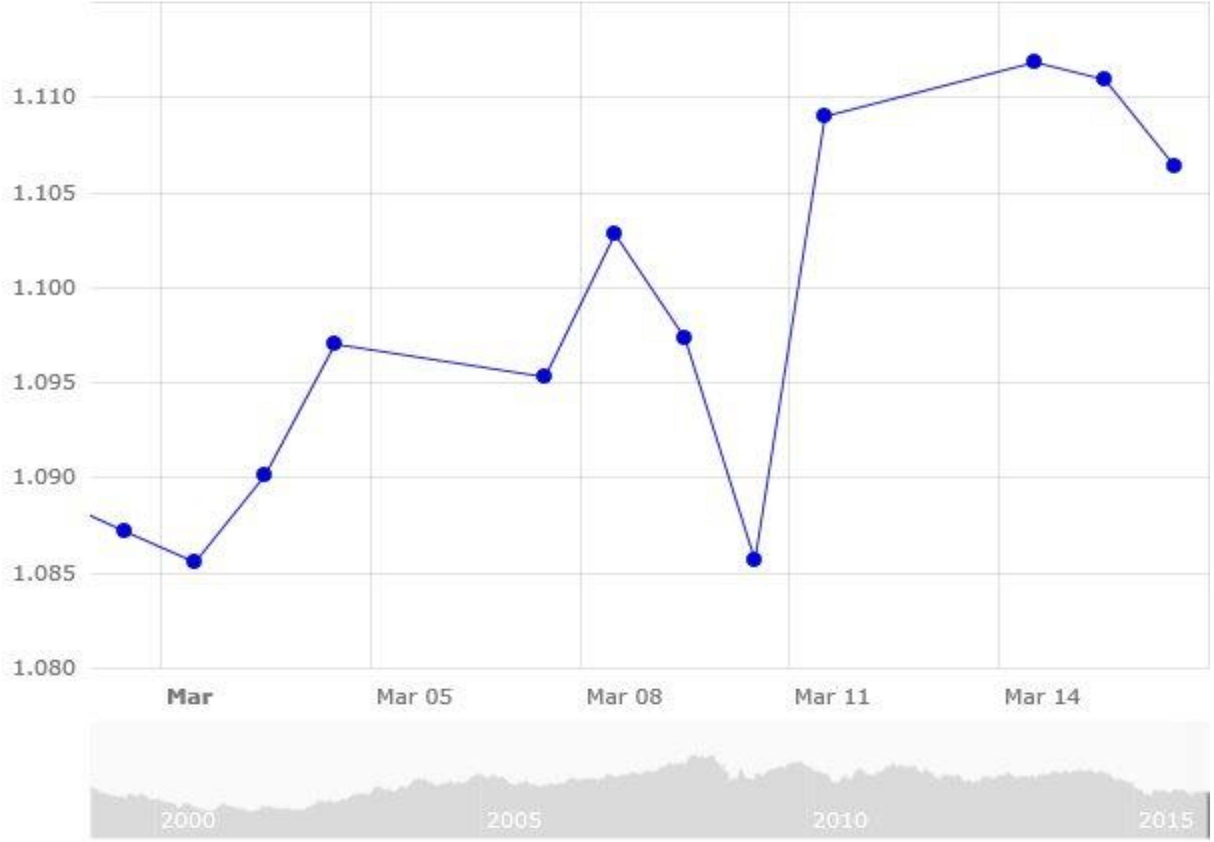
(year-on-year percentage changes)

1) The ranges shown around the central projections are based on the differences between actual outcomes and previous projections carried out over a number of years. The width of the ranges is twice the average absolute value of these differences. The method used for calculating the ranges, involving a correction for exceptional events, is documented in *New procedure for constructing Eurosystem and ECB staff projection ranges*, ECB, December 2009, available on the ECB's website.
2) Working day-adjusted data.

- Rejects that ECB is participating in a currency war
- Don’t believe that the negative interest rates will hurt the profitability of the banking sector
  - But adds that they might put more emphasis on non-conventional instruments rather than interest rates

The euro

- Big swings in the euro after the meeting



- “The euro has been extremely volatile since Draghi spoke, and bounced back as quickly as it fell after he also hinted that rates may now be at their bottom. It’s going to be a very bumpy ride for the euro into the end of the week.” - The Guardian 10.03.2016

Jørgen Larsen

FED: FOMC Press Release 16th March

Main message from FOMC

- The state of the economy is just like in December…
- … except it’s worse.
- But try to forget that.

Key figures

- The Federal Funds Rate (the styringsrenten equivalent) is kept at the [1/4 , ½] % interval
- Medium run outlook:
  - Growth rate: 2 % (slight decrease)
  - Core inflation: 1,6 % (unchanged)
  - Labour market: considerable improvement
- Long run outlook: negligible changes

The Labour Market

- Negligible change in unemployment (4,7 %)
- Increase in work force (230k per month)
- Labour market improvements surprised the FOMC
- FOMC believe $\tilde{u}_t \to 0$
- However, involuntarily part time employment still high

PCI Inflation

- Energy and food non-adjusted vs. core inflation: some difference
- Core is picking up
- Wage growth has yet to pick up pace
- FOMC believes in reaching target rate within 3 years

Growth outlook

- Economy is picking up…
- … but expected pace is slightly slower
  - Higher consumption
  - Lower investments
  - →Impact of low oil prices is ambiguous
- Global economic conditions pose considerable risks
  - International growth is "softer" than expected
  - 2015Q4 growth in Japan was negative
  - Emerging markets aren't delivering

- However: Baseline outlook is unchanged

$$E_{2016}(\tilde{y}_{2018}) = 0, \qquad y^{ss} = 3\ \% \approx \ln\left(\frac{Y_t}{Y_{t-1}}\right)$$

The Federal Funds Rate and Policy

- Expected rate through 2016: 0,9 %

$$i_t - E_t(\pi_{t+1}) < {r_t}^n$$

- Expected FFR-path has moved down
- "Accommodative policy": outlook is not bad, but vulnerable to further shocks
- FOMC remains conservative
  - "Cautiously removing accommodative policy"
  - QE: The never ending story
  - Wants verification of labour market strengthening before $di_t > 0$
- Yellen might fear for the FED's public confidence
  - Underscores commitment to the target rate
  - Underscores FED policy isn't crippled by intertwined financial markets
  - Somewhat downplays the fact that the FED has continuously downgraded their assessments
  - Underscores that policy rate forecasts are not FOMC promises

Main message from FOMC

- Nothing has really changed.
- You can still trust the FED