ECON 4325 – Wednesday seminar 2016

The presentation package is complete

Monetary Policy meetings

(January 27 – May 4 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:	2,5 %
ECB:	Close to, but below 2 %
Fed:	2 %
BoE:	2 %

The meetings

WE WILL FOLLOW THE NEXT MONETARY POLICY MEETINGS CLOSELY

- Norges Bank: www.norges-bank.no
- ECB: www.ecb.eu
- Fed: www.Federalreserve.gov
- BoE: www.bankofengland.co.uk

- 17/3
- 21/1 10/3 21/4
- 16/12* 27/1 16/3* ~~27/4~~
- 4/2* ~~17/3 14/4~~

FED Monetary Policy Decision 15/16 December 2015

About the Federal Open Market Committee (FOMC)

- Determines the federal funds rate

- Twelve members:
  - Seven governors of the Federal Reserve Board and five Federal Reserve Bank presidents

- Chair of the Board of Governors is Janet L. Yellen

- Holds eight scheduled meetings per year

Objectives for monetary policy

- **Primary objectives**
  - Maximum employment
  - Stable prices – long run inflation goal of 2 % (PCE)
  - Moderate long-term interest rates

- *«If the objectives are not complementary, it follows a balanced approach promoting them»*

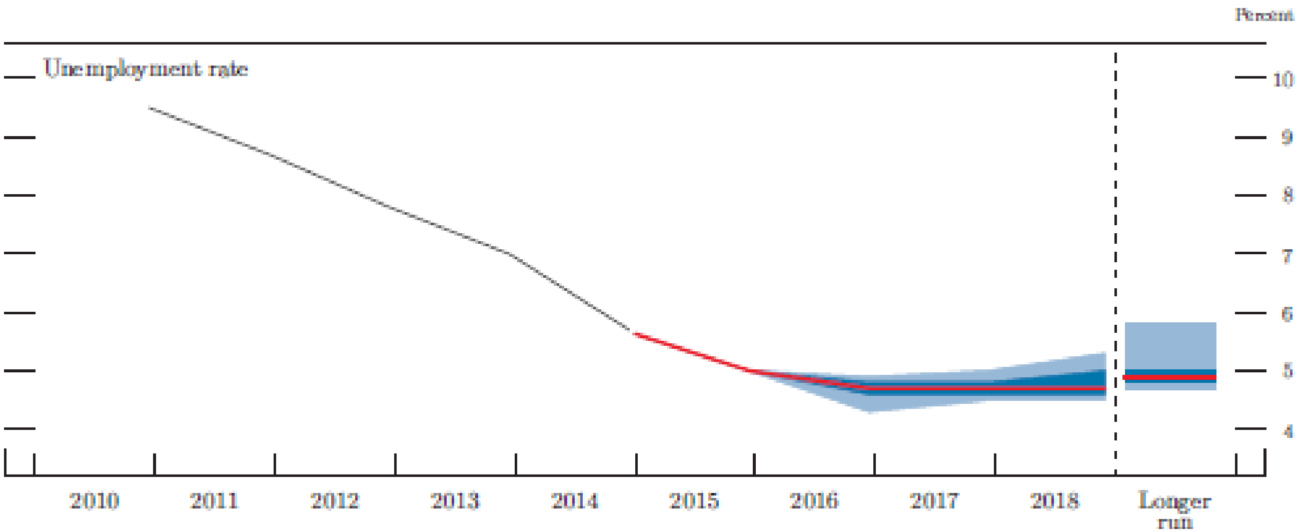
FOMC's decision 15/16 December

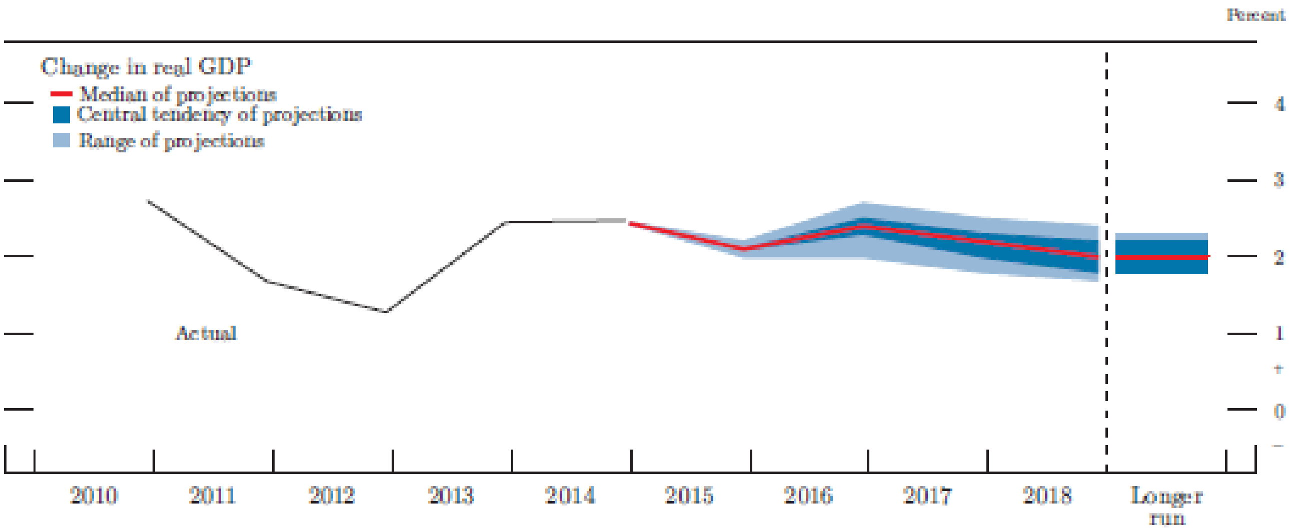
- Target range increased with 0,25 basis points
  - From 0%-0,25% to 0,25%-0,5%
  - First increase in 9,5 years

- Stated explicitly that the pace of rate hikes is likely to be **gradual**

- Further increases depend upon whether inflation picks up

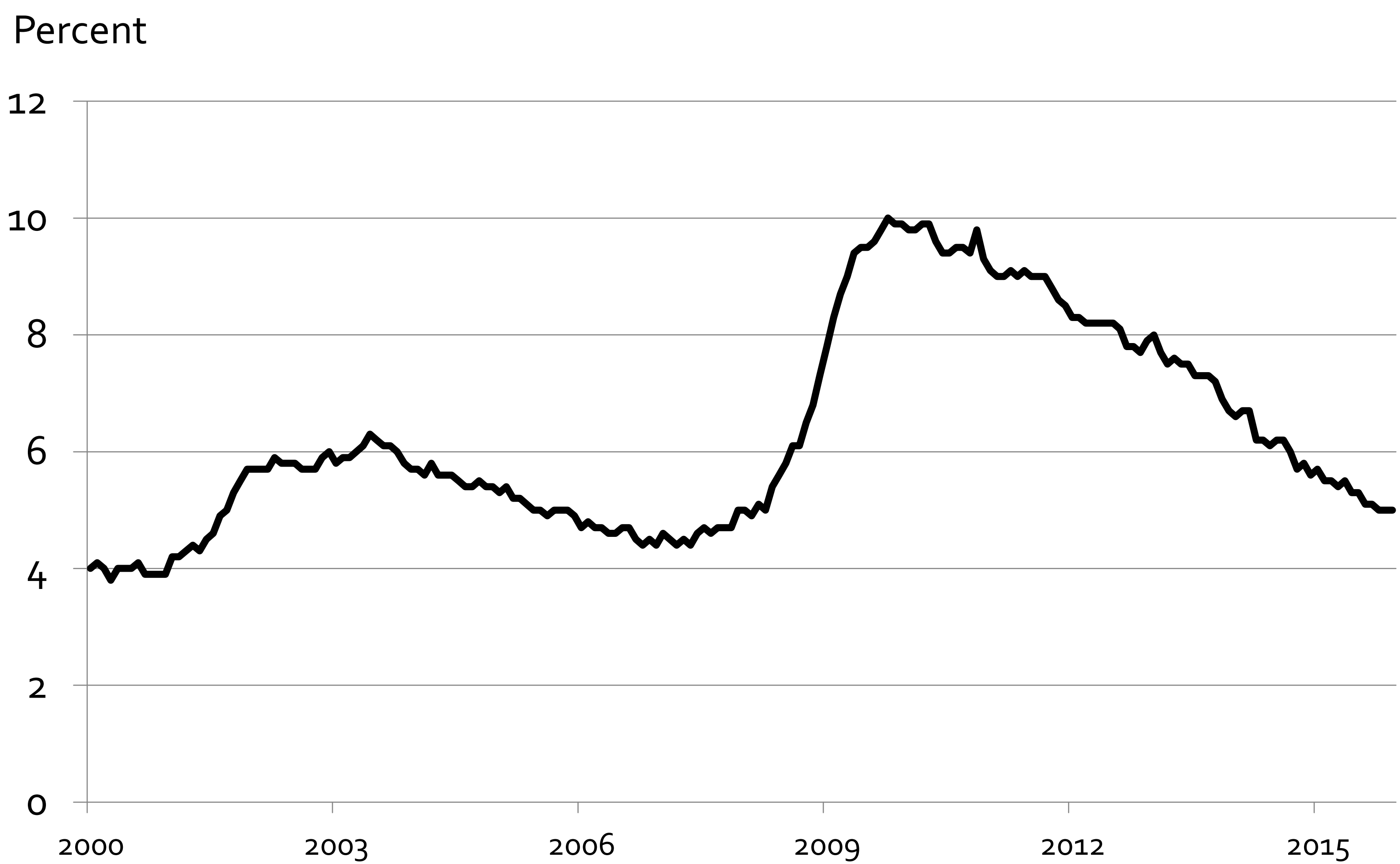
Background: Unemployment low, GDP-growth solid





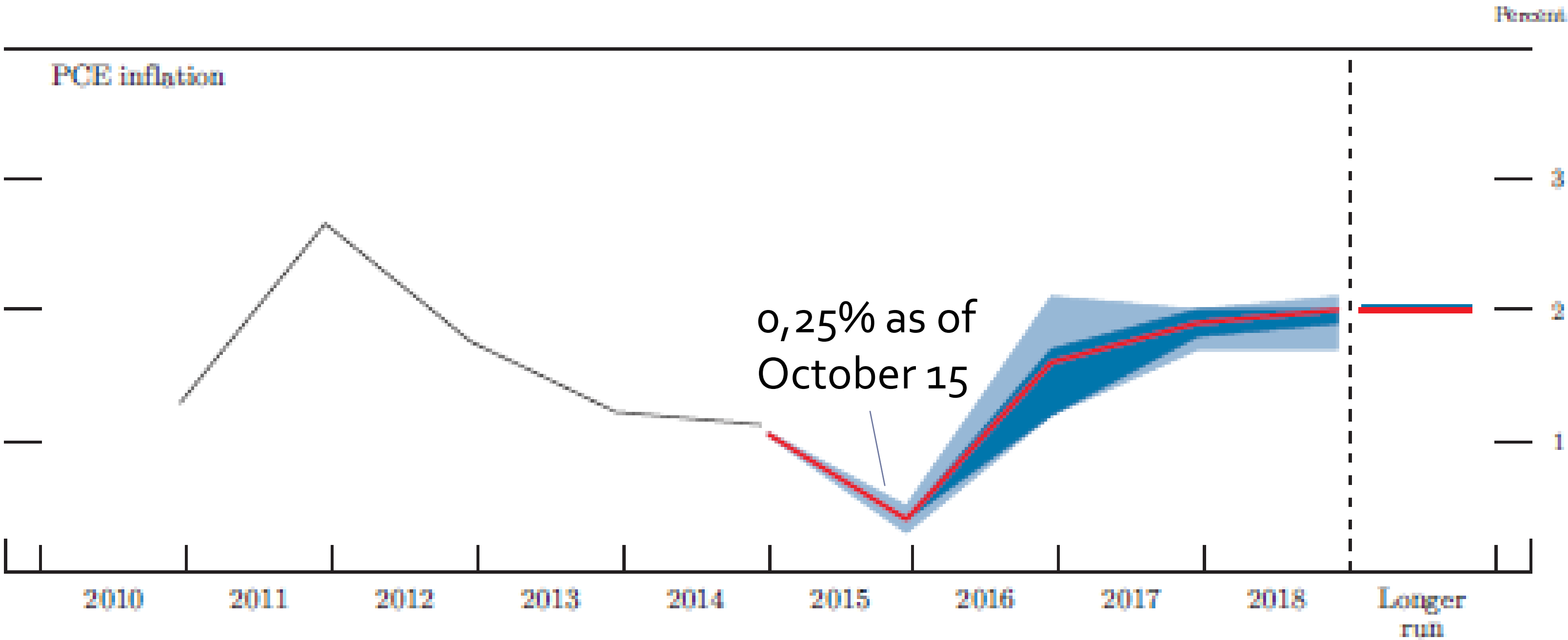
Source: FED

Background: Unemployment back to pre-crisis level



Source: Datastream

Background:
But inflation is well below the target

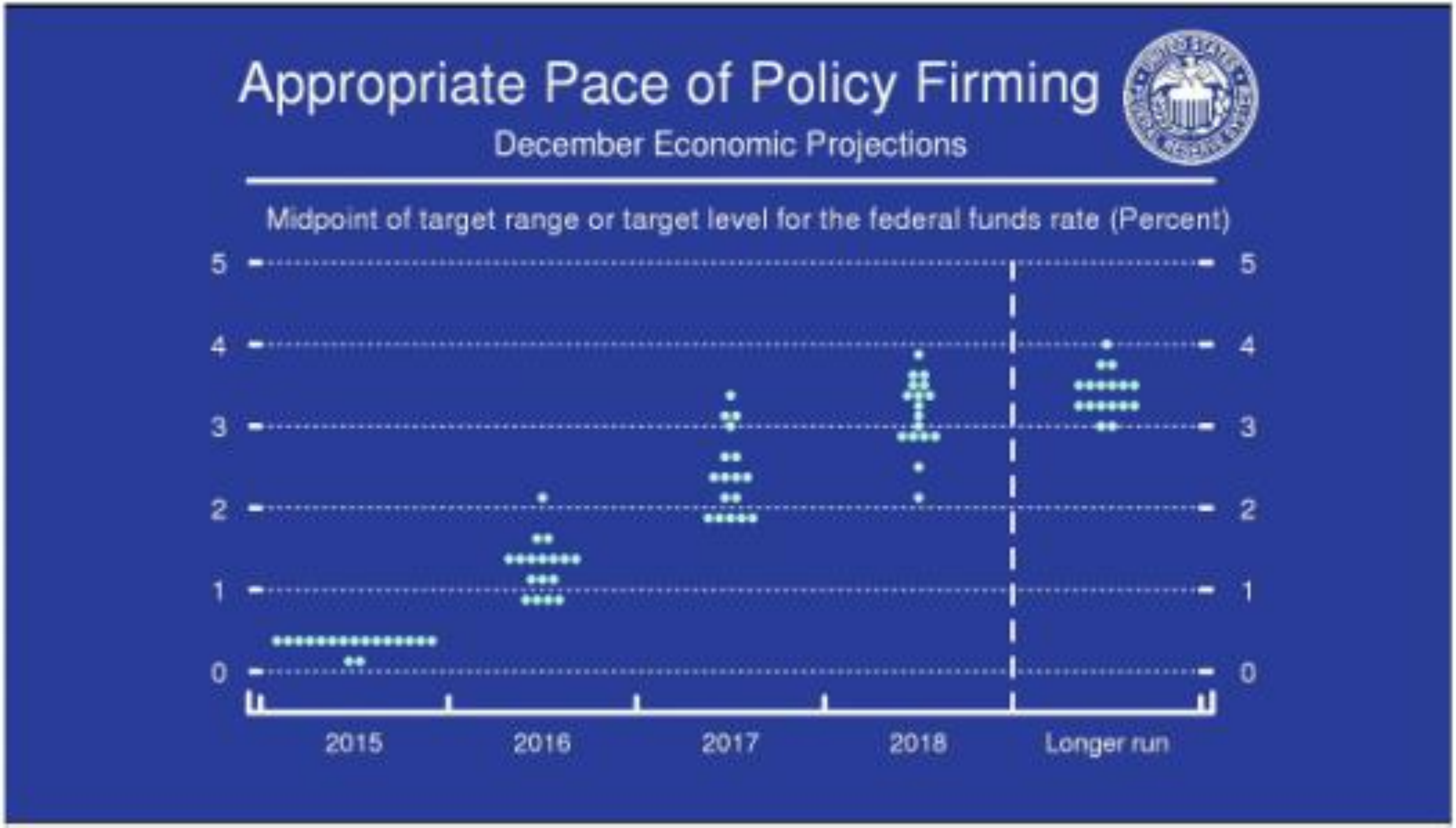


Source: FED

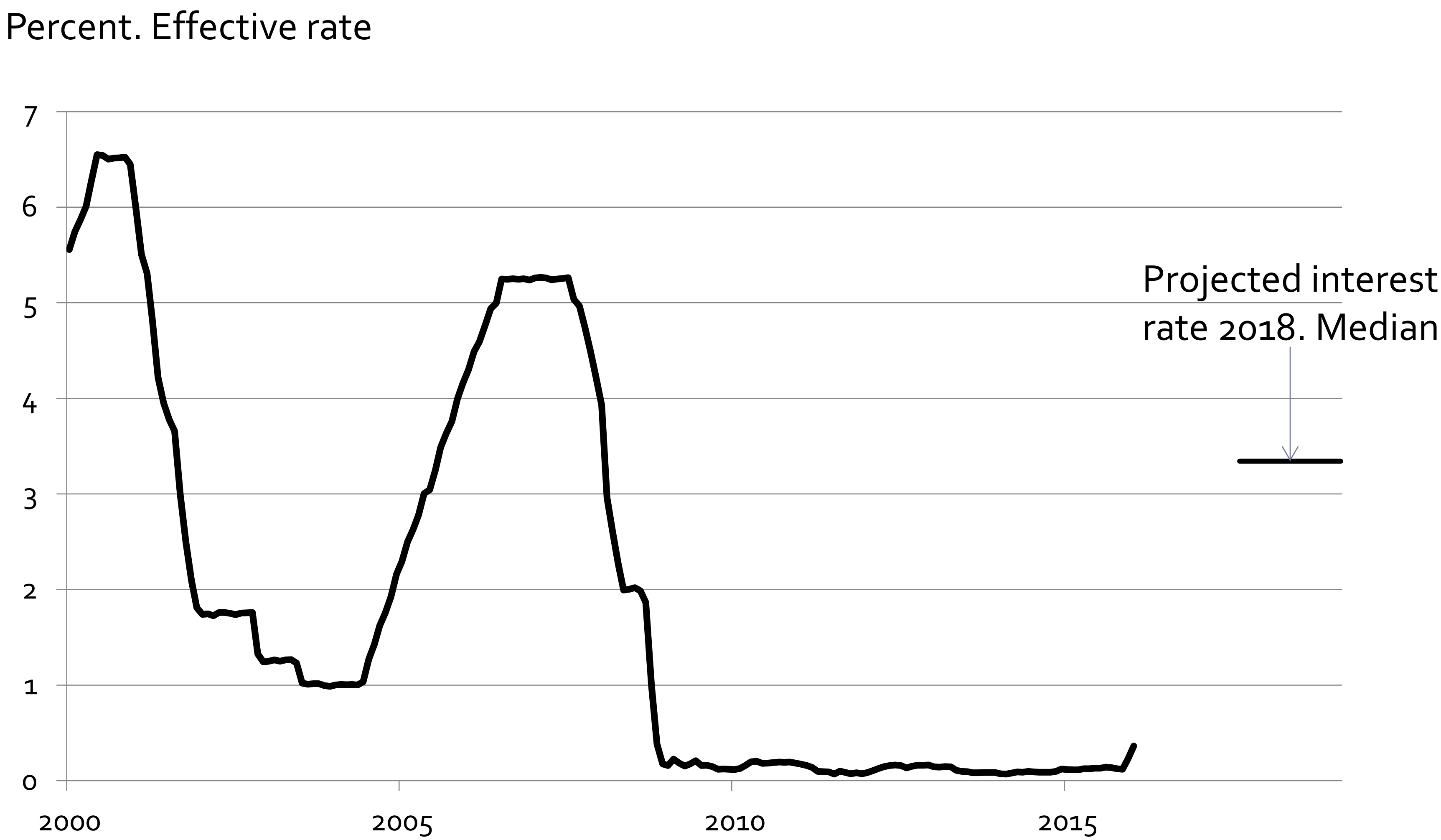
Why was the rate increased despite that the inflation is well below the target?

- Low inflation mainly due to temporary factors:
  - Sharp decline in energy prices
  - Appreciation of the dollar
- Expect solid economic growth and further improvements in the labor market
- Monetary policy operates with lags

Projections for the interest rate the next years



Effective interest rate since 2000



ECB's monetary policy decision January 21st

ECB's decition from January 21st

- Interest rate unchanged at 0,05 percent
- Some hints about upcoming stimulus…

Photo: Reuters

About ECB

- Currency for 19 member states
- Decision-makers: The Governing council
- President: Mario Draghi

Objective

- Maintain price stability (HICP inflation) close to, but below 2 percent.

«Without prejudice to the objective of price stability, it shall support the general economic policies in the Union with a view to contributing the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union"

Situation in the Eurozone

- Inflation lower than expected (0,2 percent n december)
- Fall in oil prices
- Lower food and services price inflation

- Indications on real GDP growth
- Renewed fall in oil prices
- Refugee crisis
- Some dampening effects

Draghi's hints

- «[…] necessary to to review and possibly reconsider our monetary policy stance at our next meeting in early March […]»
- «Expect the rates to remain at present or lower levels for an extented period of time»
- Next meeting: March 10th

BoE Monetary Policy Decision 4 February 2016

Objectives for the BoE

- Primary objectives:
  - Maintain public confidence in bank notes.
    - eg. provide high quality bank notes.
  - Protecting the value of money
    - Deliver low and stable prices (inflation target)
  - Maintaining financial stability
    - eg. trust in financial institutions

The Bank of England's Monetary Policy Committee (MPC)

- Decides the level of interest rates.
- Nine members
  - Five from the BoE.
  - Four external members.
- Meets over three days each month
  - 1st day: discuss their views on the latest economic data.
  - 2nd day: debate what their response should be.
  - 3rd day: the Governor presents the policy he believes will get a majority among the members.

MPC's decision February 2016

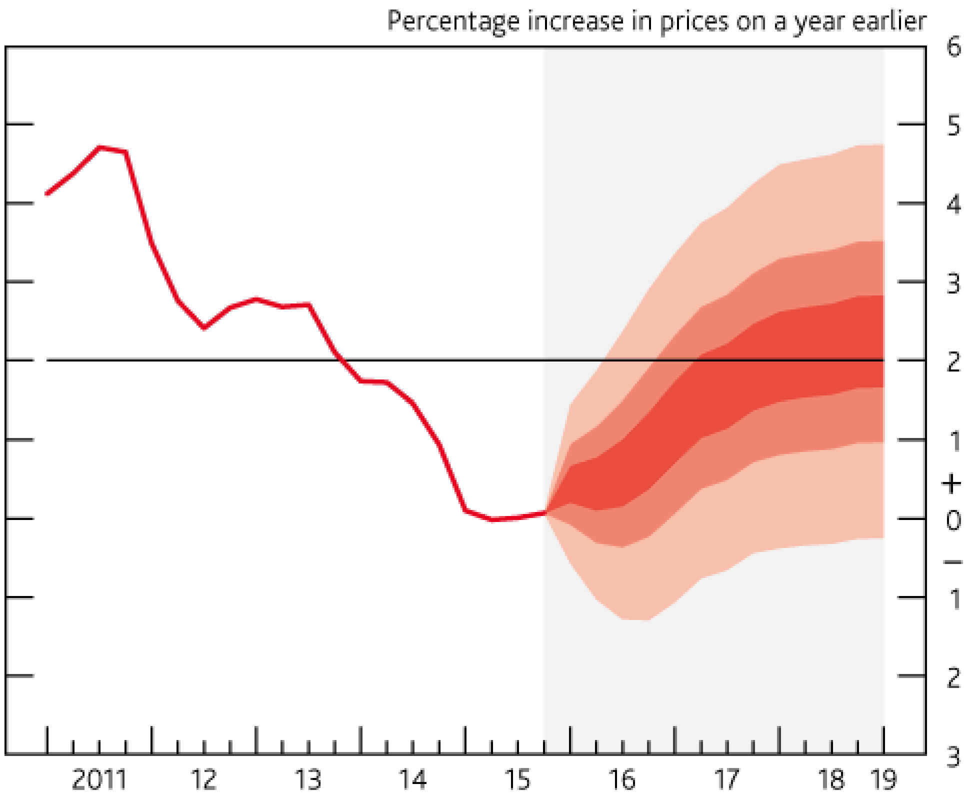
- Bank Rate maintained at 0,5 %.
  - Unanimous vote

- When rate begins to rise: will do so more gradually and to a lower level than in earlier cycles.

- The actual path over the next few years will depend on economic circumstances.

Background: Inflation low, but expected to rise

- Twelve-month CPI inflation at 0.2 %.
- CPI excluding food, tobacco, beverage and energy at 1,2-1,4 %.
- Expected to return to target in around two years.



Source: BoE

Background: Global growth weaker

- Emerging economies have continued to slow.

- US has grown less than expected.

Table 1.C Global growth remained muted in 2015 Q3

GDP in selected countries and regions[a]

Percentage changes on a quarter earlier, annualised

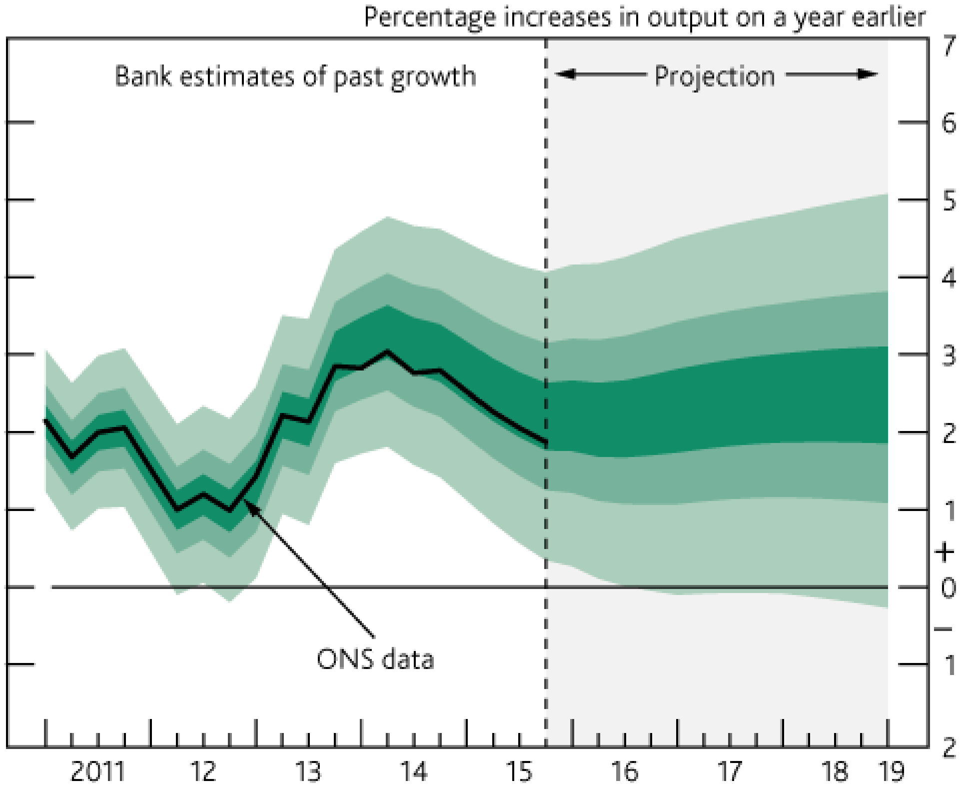
	Averages			2015		
	1998–2007	2012–13	2014	H1	Q3	Q4
United Kingdom	2.9	1.9	2.8	1.8	1.8	2.0
Euro area (39%)	2.3	-0.2	0.9	1.9	1.2	n.a.
United States (16%)	3.0	1.9	2.5	2.3	2.0	0.7
China (4%)[b]	10.0	7.7	7.3	7.0	6.9	6.8
Japan (2%)	1.1	1.1	-0.8	2.0	1.0	n.a.
India (2%)[b]	n.a.	n.a.	7.1	7.3	7.4	n.a.
Russia (1%)[c]	7.8	1.6	-0.7	-4.9	-2.3	n.a.
Brazil (1%)	3.1	2.5	-0.7	-5.6	-6.7	n.a.
UK-weighted world GDP[d]	3.0	1.6	2.1	2.2	2.1	n.a.

Sources: IMF *WEO Update* January 2016, OECD, Thomson Reuters Datastream and Bank calculations.

(a) Real GDP measures. Figures in parentheses are shares in UK goods and services exports in 2014.
(b) Data are four-quarter growth. The earliest observation for India is 2012 Q1.
(c) The earliest observation for Russia is 2003 Q2.
(d) See footnotes (a) and (b) to Chart 1.11.

Background:
GDP growth on average

- Expected to grow at average rates.
- Consumer confidence robust.
- Although capital spending in oil/gas is expected to decline.



Projections for the interest rate the next years

Table 5.A Conditioning path for Bank Rate implied by forward market interest rates[a]

Per cent

	2016				2017				2018				2019
	Q1[b]	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
February	0.5	0.5	0.5	0.5	0.6	0.6	0.7	0.8	0.9	0.9	1.0	1.1	1.1
November	0.5	0.5	0.6	0.6	0.7	0.8	0.9	1.0	1.1	1.1	1.2	1.3	

(a) The data are fifteen working day averages of one-day forward rates to 27 January 2016 and 28 October 2015 respectively. The curve is based on overnight index swap rates.
(b) February figure for 2016 Q1 is an average of realised spot rates to 27 January 2016, and forward rates thereafter.

Fun facts

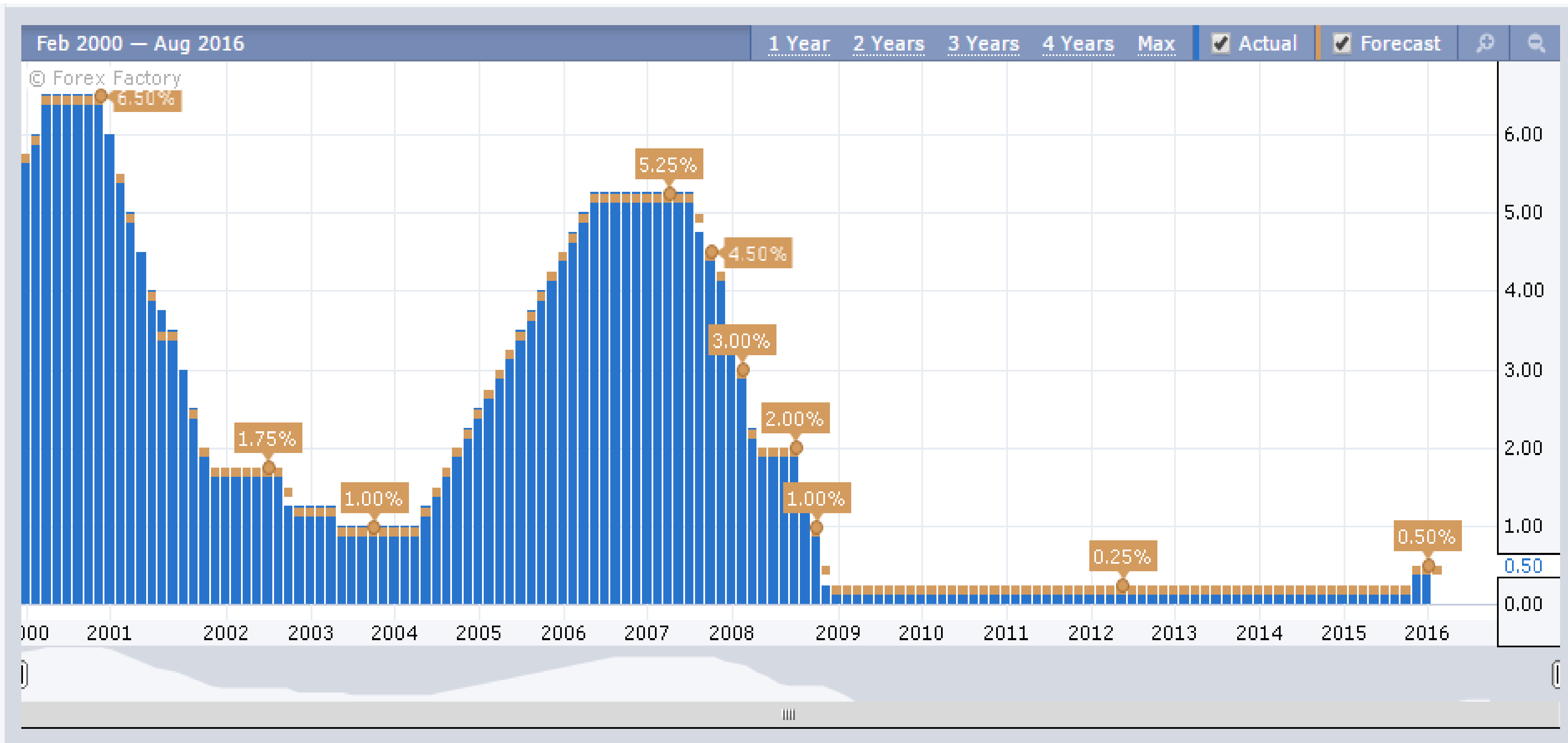
- In extreme circumstances the government has power to give instructions to the Bank on interest rates for a limited period.

- If CPI inflation misses the target by more than 1 percentage point, the Governor must write an open letter to the Chancellor explaining why, and explain what the Bank proposes to do to get inflation back on target.

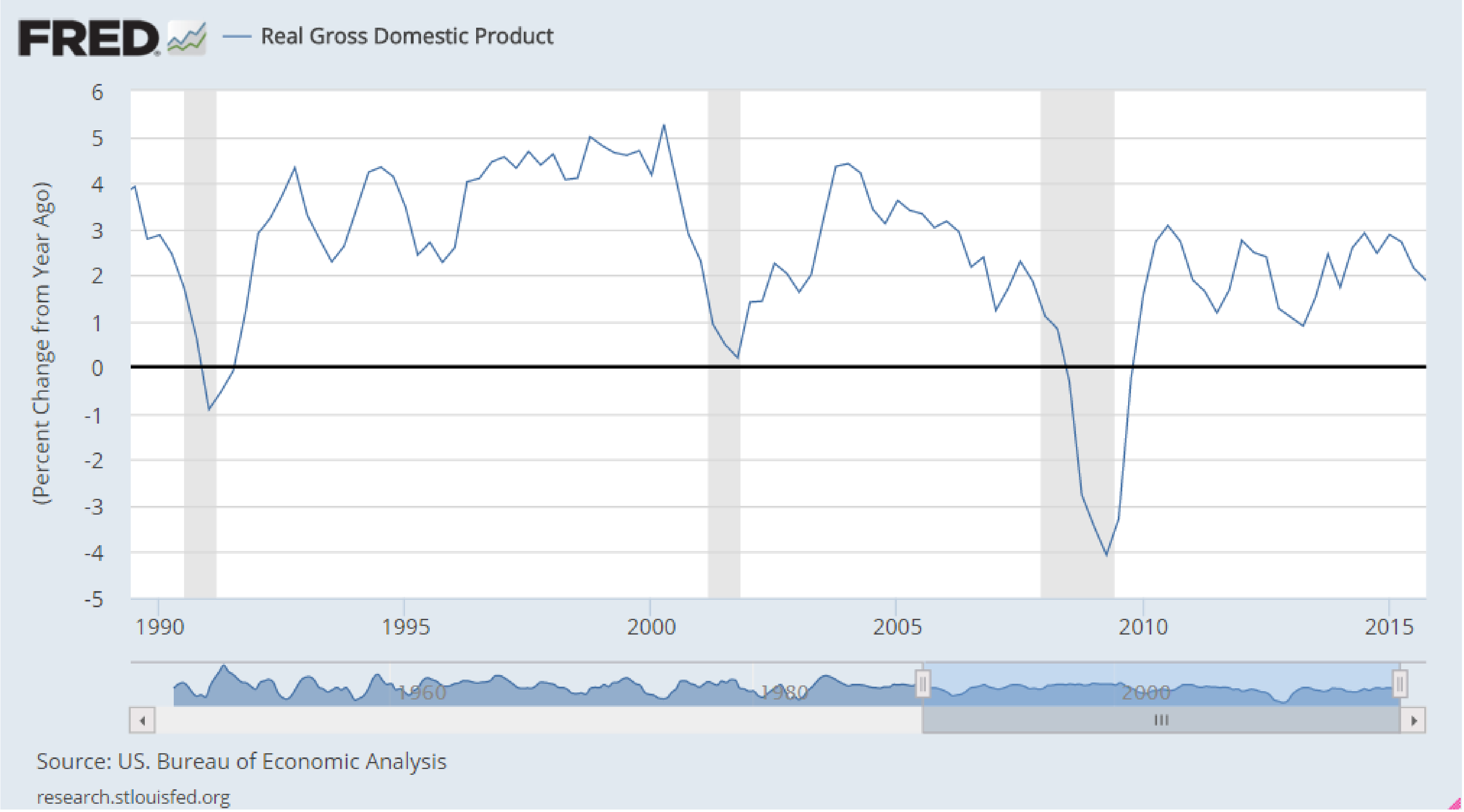
FED Monetary Policy Decision
27 January 2016

(by Alizamin Jafarli)

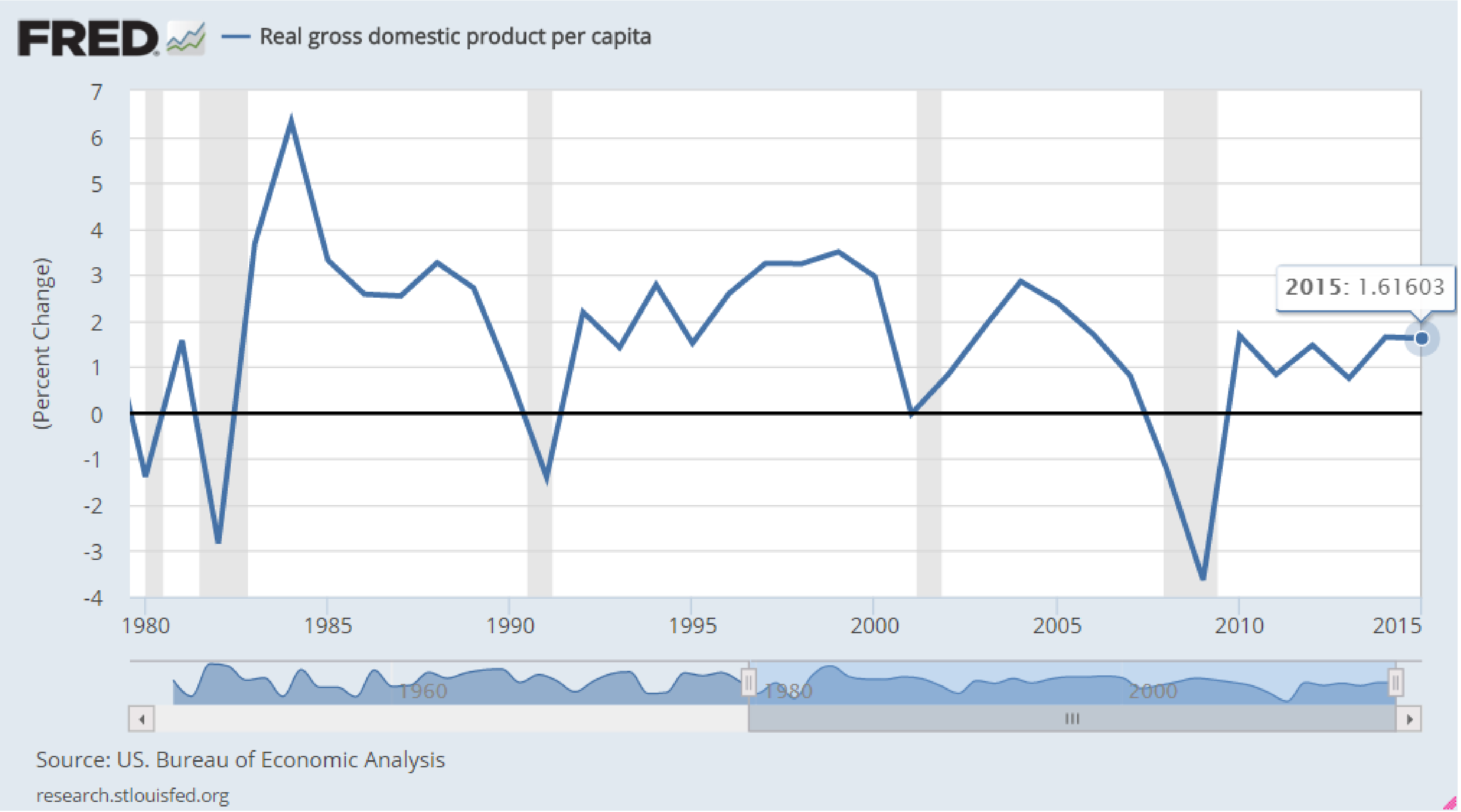
Federal Funds Rate*: Unchanged at 0.50 %



Economic Outlook: Real GDP



Economic Outlook: Real GDP per capita

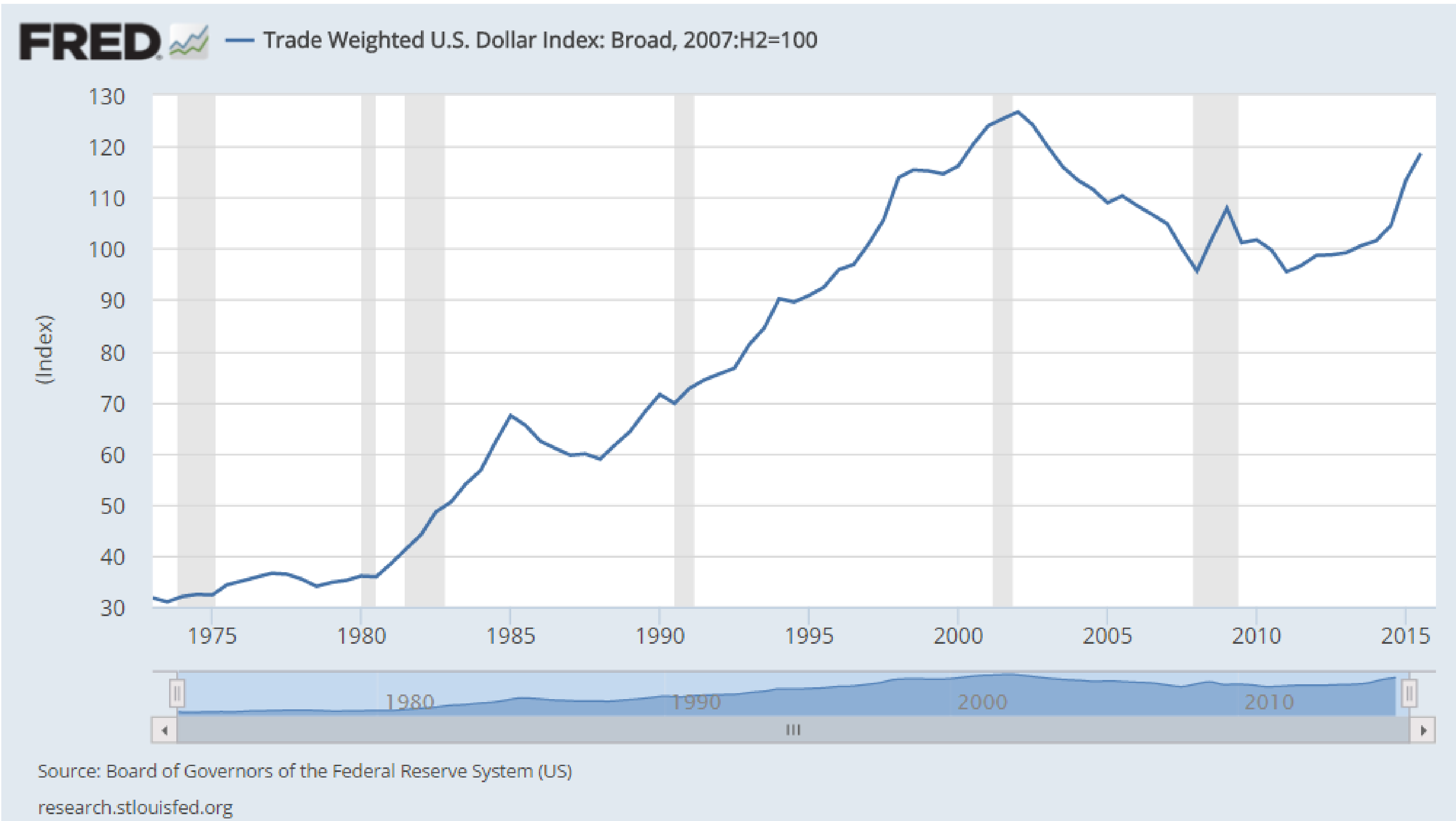


Background for the decision: Bad news

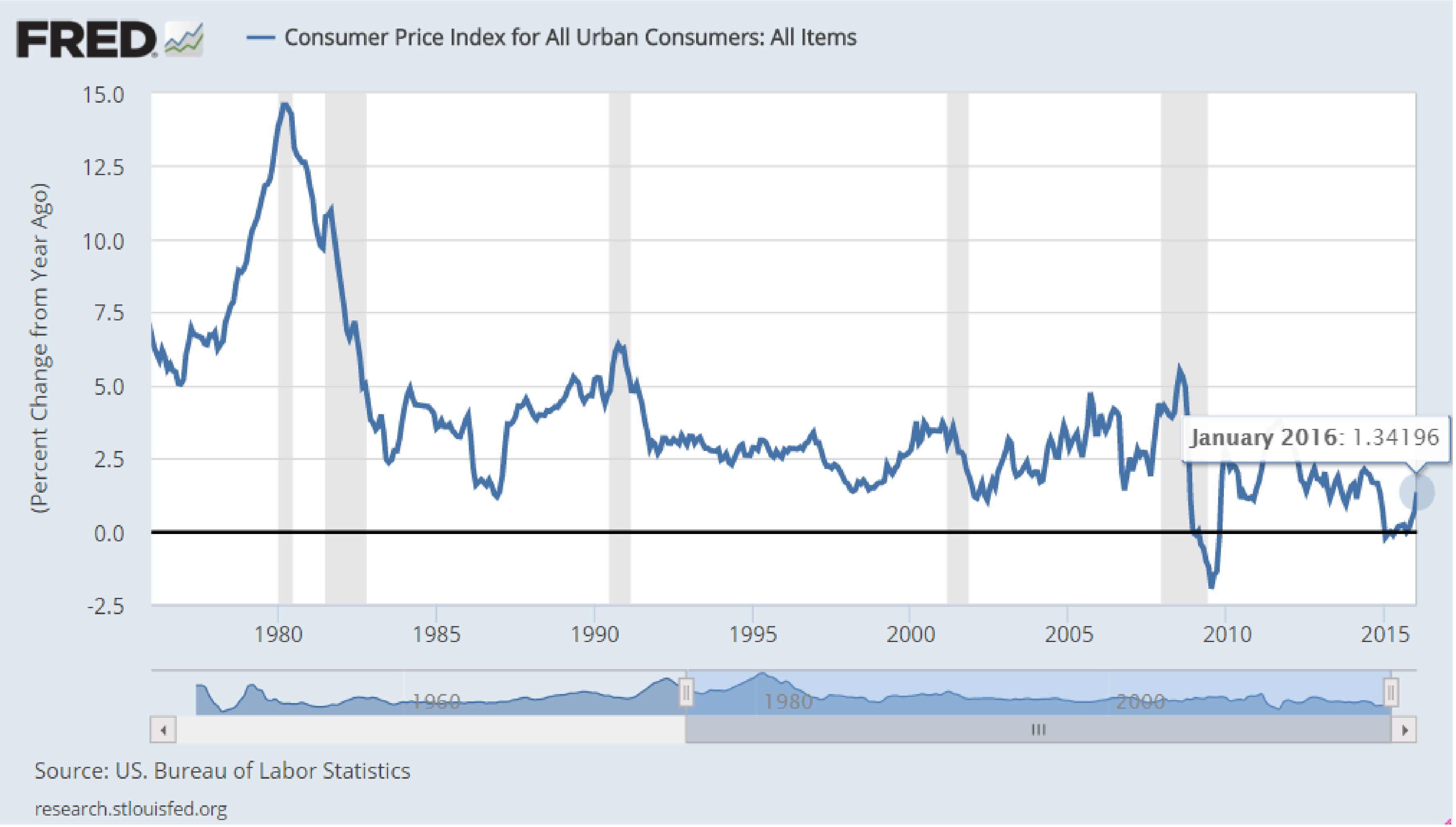
- Slower economic growth
  - *Strong dollar → Soft net export*
  - *Low inventory investment*

- Declines in energy prices and in prices of non-energy imports → Inflation under 2 %

Strong dollar



Price Index

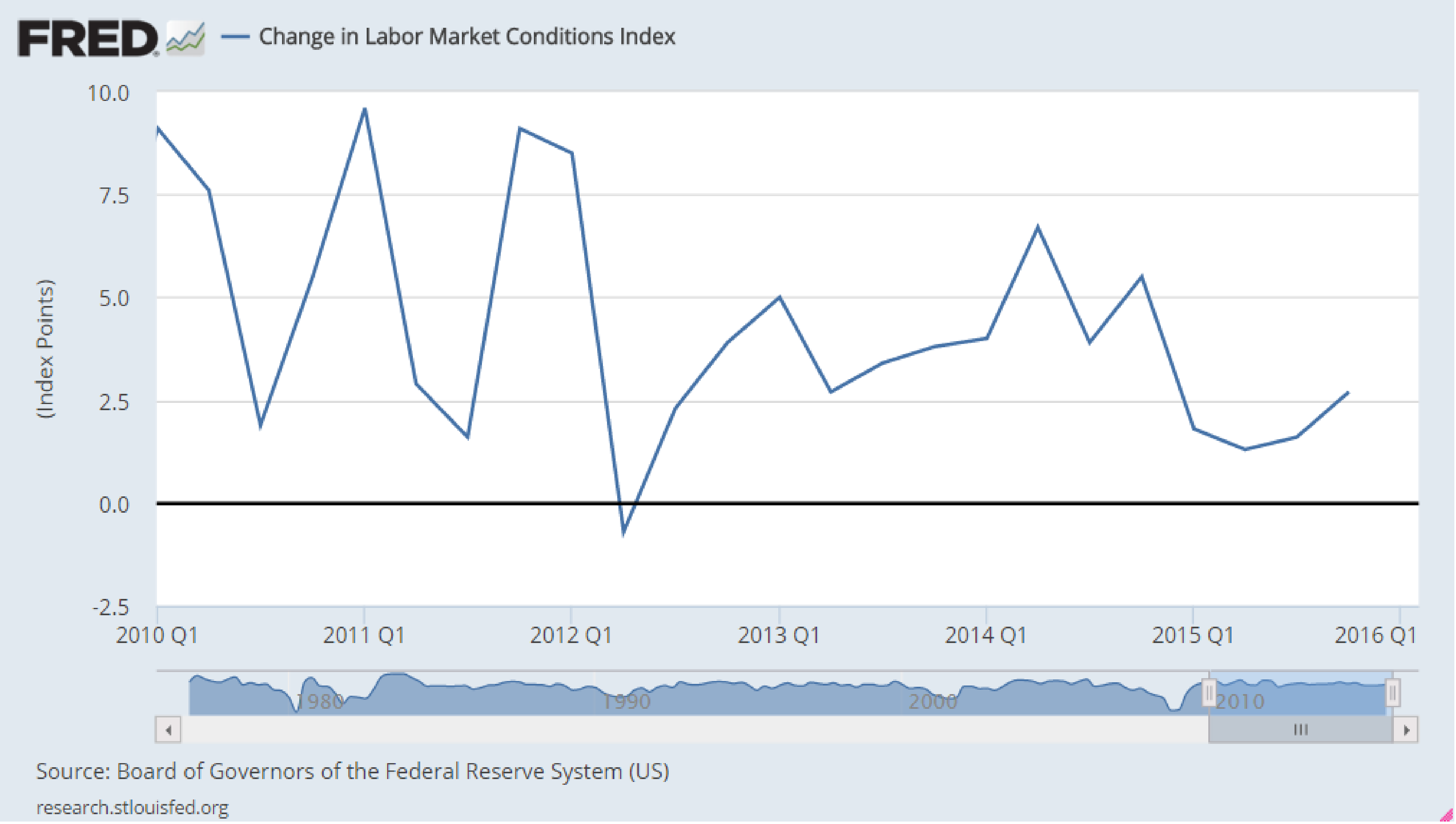

FRED
Consumer Price Index for All Urban Consumers: All Items
(Percent Change from Year Ago)
15.0
12.5
10.0
7.5
5.0
2.5
0.0
-2.5
1980
1985
1990
1995
2000
2005
2010
2015
January 2016: 1.34196
1960
1980
2000
Source: US. Bureau of Labor Statistics
research.stlouisfed.org

Background for the decision: Good news

Improved labor market conditions:

- Household spending
- Housing sector
- Business fixed investment*
- Strong job gains → Decline in underutilization of labor resources

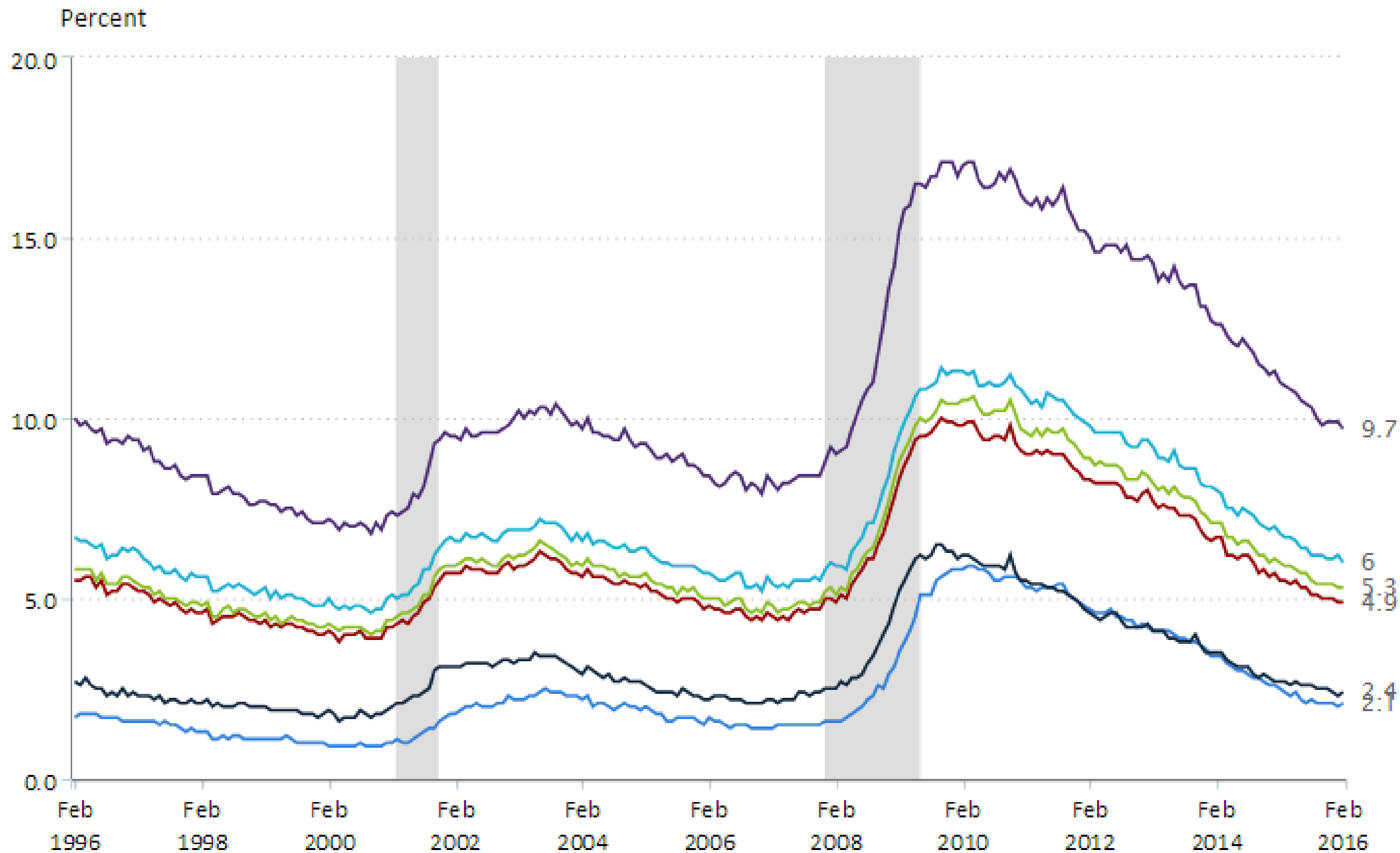
Change in Labor Market Conditions Index*



Alternative measures of labor underutilization, seasonally adjusted

Click and drag within the chart to zoom in on time periods

- U-1, persons unemployed 15 weeks or longer, as a percent of the civilian labor force
- U-2, job losers and persons who completed temporary jobs, as a percent of the civilian labor force
- U-3, total unemployed, as a percent of the civilian labor force (official unemployment rate)
- U-4, total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers
- U-5, total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus marginally attached workers
- U-6, total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers



Hover over chart to view data.
Note: Shaded area represents recession, as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics.

Expectations

- *“… with **gradual adjustments** in the stance of monetary policy, economic activity will **expand at a moderate pace** and labor market indicators will continue to strengthen…”*
- *”… **inflation** is expected to **remain low** in **the near term** (further declines in energy prices), but to rise to **2 percent over the medium term** as the transitory effects of declines in energy and import prices dissipate and the labor market strengthens further*
- *”… given the economic outlook, the Committee decided **to maintain the target range** for the federal funds rate at 1/4 to 1/2 percent…”*

And…

- *"…. the Committee expects that economic conditions will evolve in a manner that will warrant only **gradual** increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run…"*

- *"…. the Committee is maintaining its existing policy of **reinvesting** principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction…"*

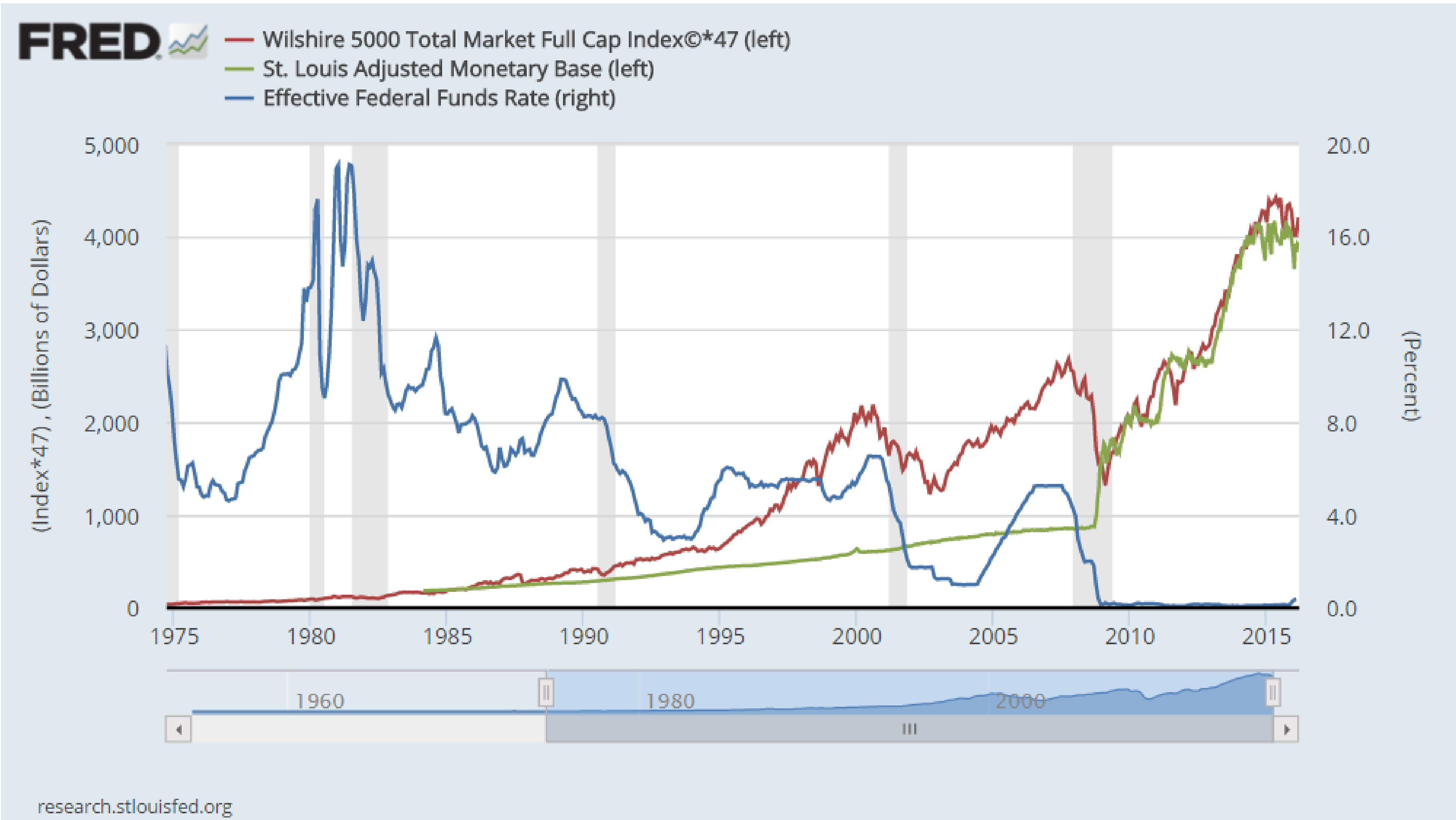
Oppa Bernanke Style!

What has changed since December 2015?

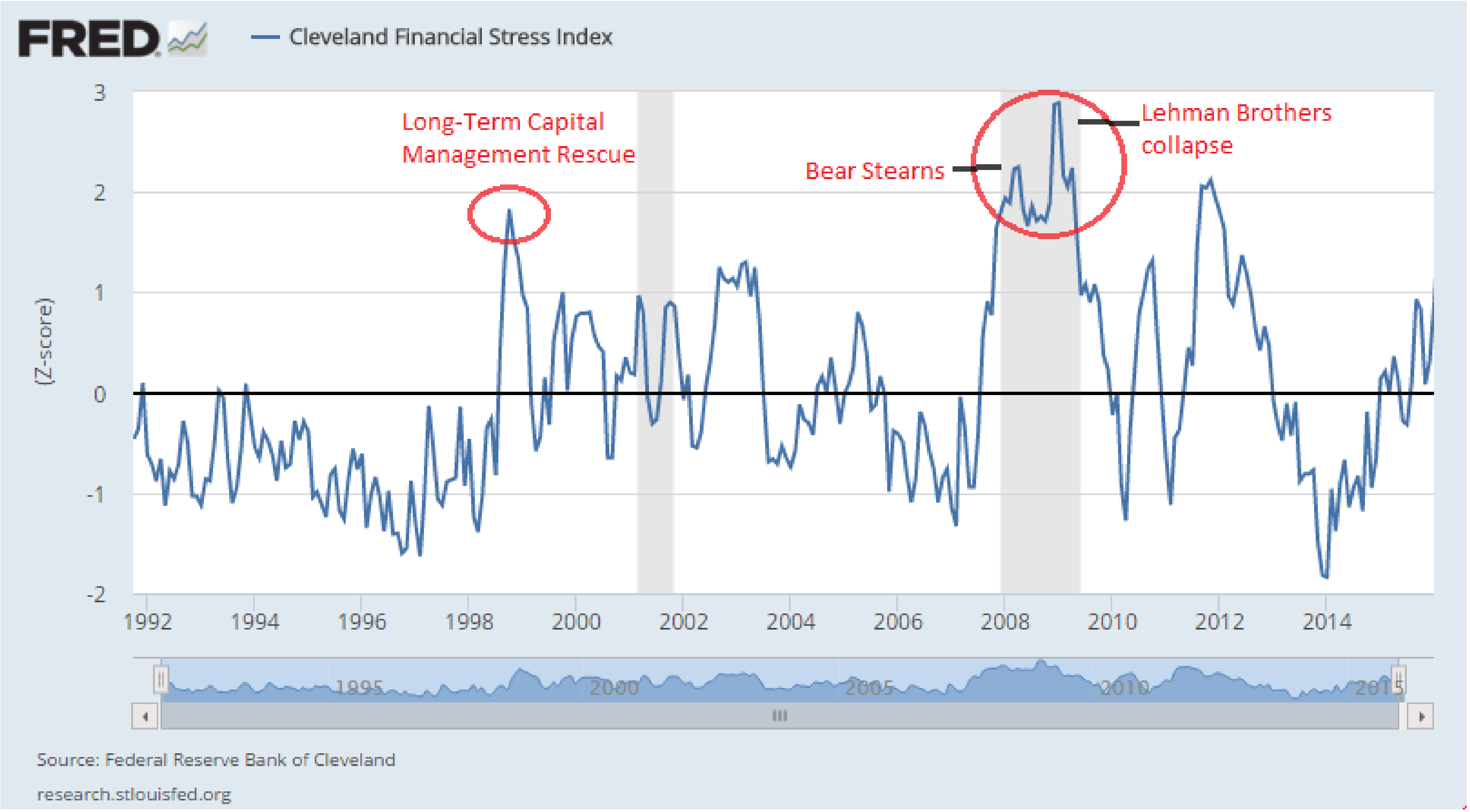
WSJ Fed Statement Tracker:

Information received since the Federal Open Market Committee met in ~~Octo~~December suggests that ~~economic activity has been expanding at a moderate pace~~labor market conditions improved further even as economic growth slowed late last year. Household spending and business fixed investment have been increasing at ~~solid~~moderate rates in recent months, and the housing sector has improved further; however, net exports have been soft and inventory investment slowed. A range of recent labor market indicators, including ~~ongoi~~strong job gains ~~and declining unemployment, shows further improvement and confirms that underutilization of labor resources has diminished appreciably since early this year~~, points to some additional decline in underutilization of labor resources. Inflation has continued to run below the Committee's 2 percent longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation ~~remain low; some~~declined further; survey-based measures of longer-term inflation expectations ~~have edged down~~are little changed, on balance, in recent months.

Coincidence?

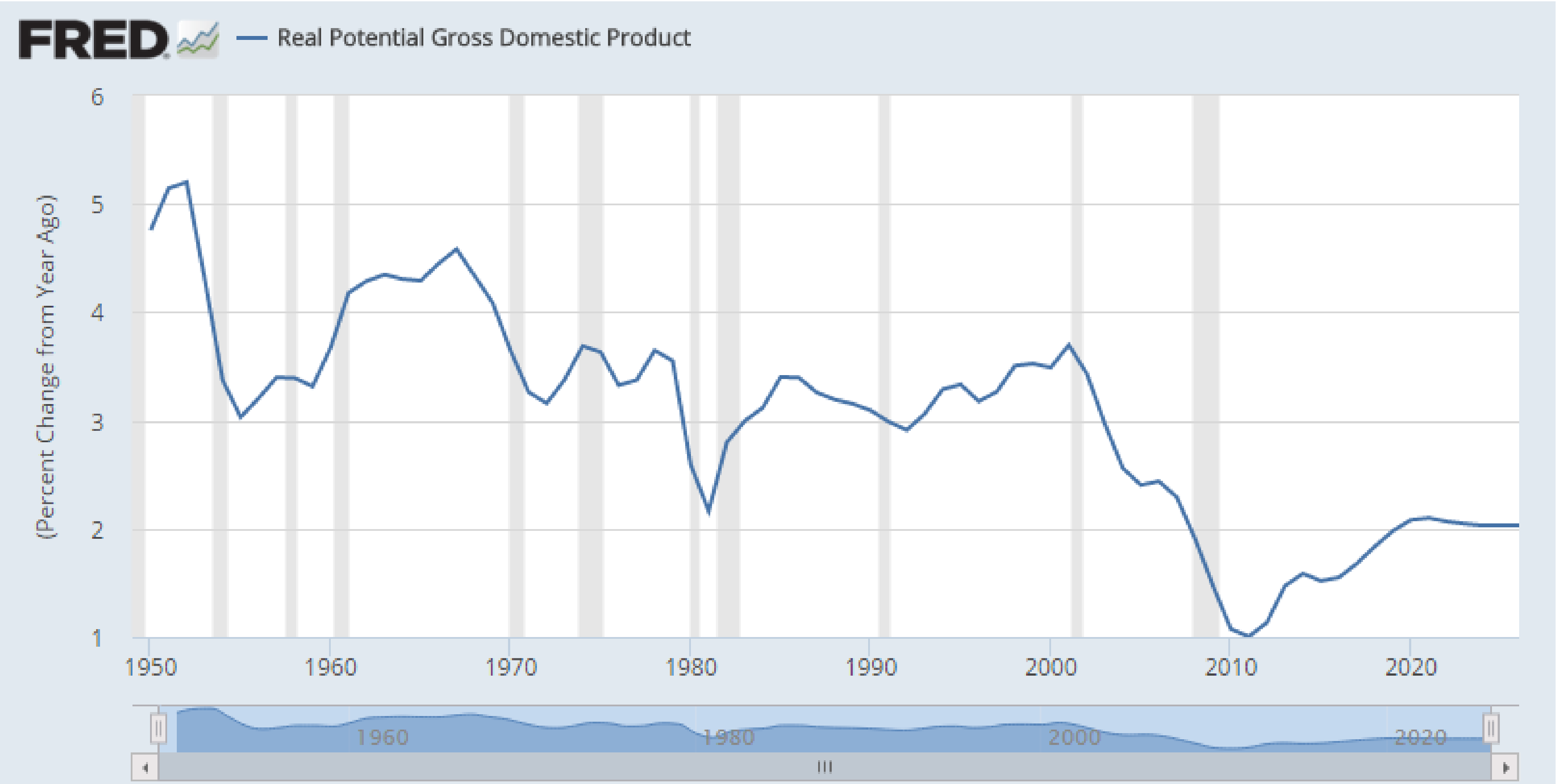


Cleveland Financial Stress Index*



Gold – uptrend?

Real Potential GDP*



Source: US. Congressional Budget Office

research.stlouisfed.org

Veronica

ECB Meeting March 10 2016

Monetary policy decisions

- MRO Interest rate lowered from 0.05 to 0.00
- Increase use of Quantitative Easing (QE)
  from EUR60million to EUR80million
- A new series of four Targeted Longer-Term Refinancing Operations (TLTRO II)
- The interest rate on the marginal lending facility lowered from 0,3 % to 0.25%
- The interest rate on the deposit facility lowered from -0.3 % to -0.4 %

Monetary policy strategy to recover the euro area's economy

- Before:

  change the interest rate to affect the exchange rate – increase competitiveness

Negative net exports
Weakned world economy growth prospects
Lower inflation than projected
(high unemployment and low output growth)
Low loan growth

- Now:

  focus on boosting lending to the domestic real economy

Use of conventional & non-conventional instruments- why?

- The Zero Lower Bound

- Lowering expectations for future rates

“… we don't anticipate that it will be necessary to reduce rates further. “

“… rates will stay low, very low, for a long period of time …”

Use of conventional & non-conventional instruments- why?

- Profitability of the banking system

- Non-conventional instruments: QE & TLTRO

«… more and more the emphasis will shift from rates instruments to other, non-conventional instruments.”

- Is ECB showing muscles?

Is ECB showing muscles?

- "… exploit the synergies between the different instruments and has been calibrated to further ease financing conditions, stimulate new credit provision and thereby reinforce the momentum of the euro area's economic recovery and accelerate the return of inflation to levels below, but close to, 2%."

- Still lags in the loan dynamics – new policy intend to reduce these lags

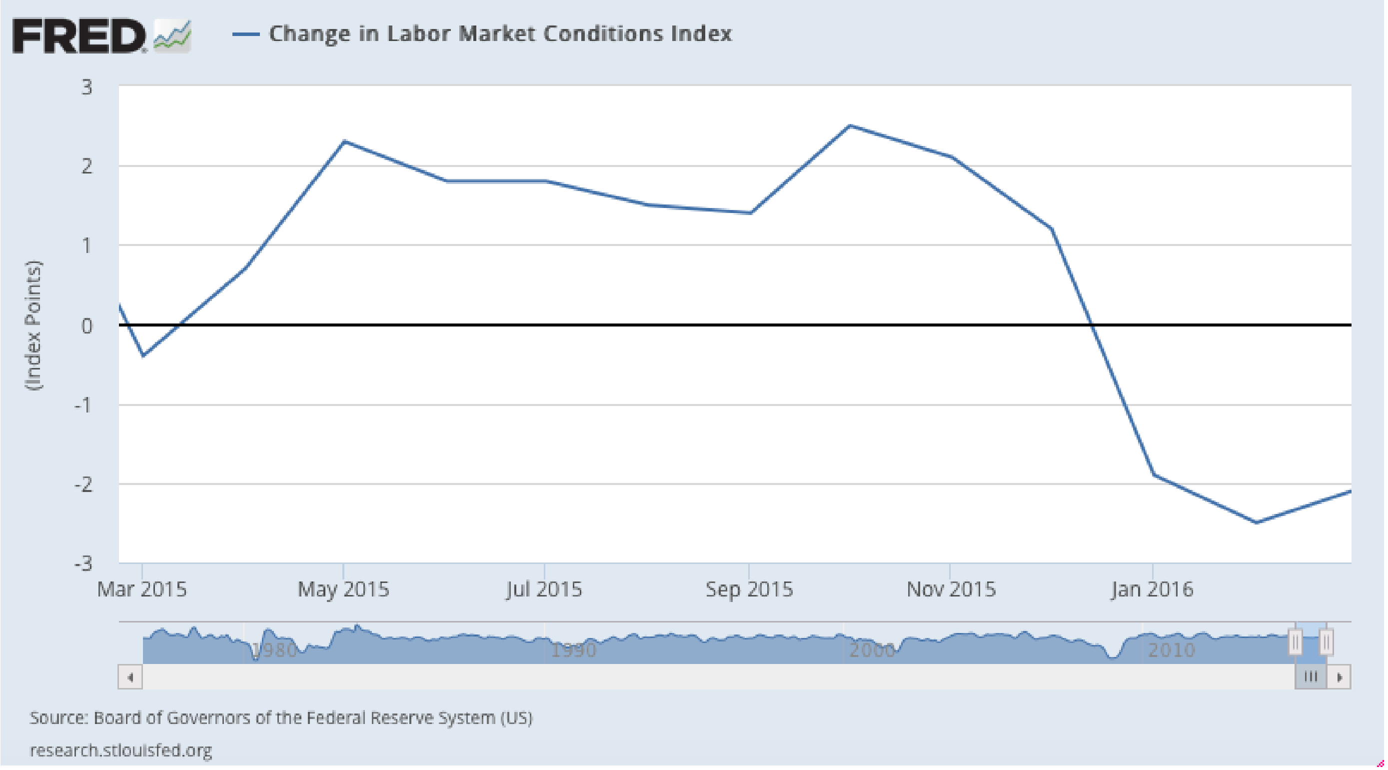
FED Monetary policy decision March 16th

The March decision

- Maintained the target range for the federal funds rate at 0.25-0.5 %
- Decision reflects economic outlook and the risk associated with that outlook
- the Committee continues policy of purchasing Treasury securities and principal payments from agency debt and mortgage-backed securities

Background for the decision: Good news

- *“Job market **continues to strengthen**, but there´s still room for improvement. “*
- *"Household spending is **expanding** at a moderate rate, supported by continued job gains and increases in inflation-adjusted incomes”*



Background for the decision: Bad news

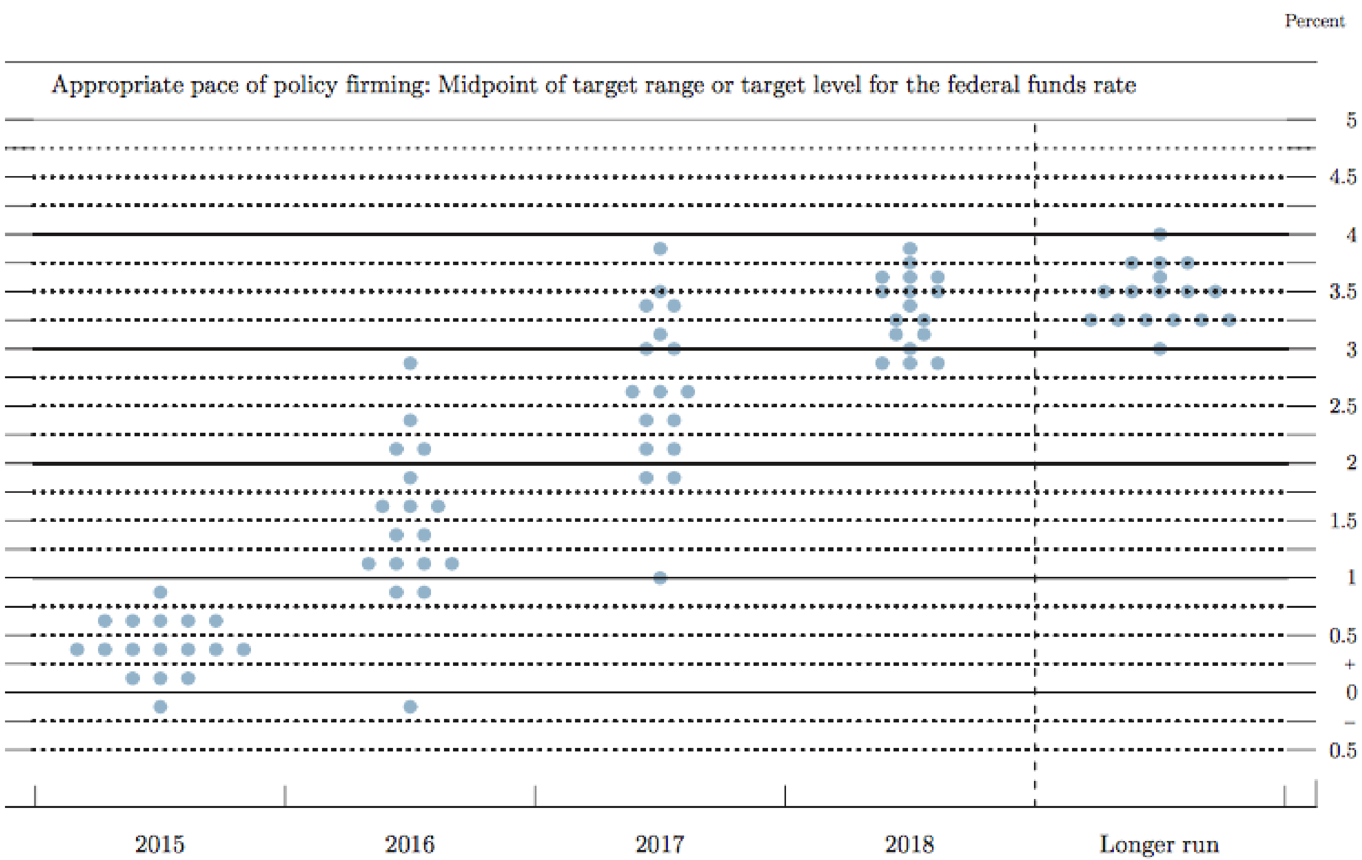
*"... business investment has been **weak**, in part reflecting further reductions in oil drilling as a result of low oil prices. Net exports also **remain soft** as a consequence of subdued foreign growth and the earlier appreciation of the dollar. "*

- global economic and financial developments continue to pose risks

- Inflation picked up in recent months;
  - however: still run below the Committee's 2 percent longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports.

Fed´s projections at March meeting

- Gradual increases in interest rate reduced from four to two increases in 2016
- Monetary policy remains <<accomodative>>



Does the FED have a credibility problem?

- Yellen stressed that *"policy is not a pre-set course"*
  - forecasts represent **individual** assessments of what appropriate policy would be. However, **considerable uncertainty** attaches to each participant's forecasts of economic outcomes.

Fed statement tracker

Information received since the Federal Open Market Committee met in ~~December~~January suggests that ~~labor market conditions improved further even as economic growth slowed late last year. Household spending and business fixed investment have~~economic activity has been expanding at a moderate pace despite the global economic and financial developments of recent months. Household spending has been increasing at a moderate rate~~s in recent months~~, and the housing sector has improved further; however, ~~net exports have been soft and inventory investm~~business fixed investment and net exports have been~~t~~ s~~lowed~~oft. A range of recent ~~labor market~~ indicators, including strong job gains, points to ~~some~~ additional ~~decline in underutilization of labor resources. Inflation has~~strengthening of the labor market. Inflation picked up in recent months; however, it continued to run below the Committee's 2 percent longer-run objective, partly reflecting declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation ~~declined further~~remain low; survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.

ECB Meeting April 21 2016

ECB decision from April 21st

- “Based on our regular economic and monetary analyses, we decided to keep the **key ECB interest rates** unchanged”

- 0.00% , 0.25%. -0.40%.

- “Regarding **non-standard monetary policy measures**, as decided on 10 March 2016, we have started to expand our monthly purchases under the asset purchase programe to €80 billion, from the previous amount of €60 billion”

Following the “path” from the 10th of March

- “The reported interest rate path will be the expected path if no shocks”
- From march 10th: (…) the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time (…)
- No change means that the path is expected and that inflation is on path to its medium term target of about 2% (If not so, then ECB should increase QE- spending)
- Inflation expected to be around 2% in 2018
- (…) the ECB believes that its current policies are sufficient to ensure medium-term price stability. Should adverse developments render additional accommodation necessary, the ECB’s policy approach can still go a long way in providing this.

Economic recovery expected to proceed

- RGDP up 0.3% in Q4 2015 supported by domestic demand
- Cheap capital and low oil prices should boost investment and household spending
- Economic recovery dampened by balance sheets adjustments (structural reforms)
- Downside risk related to the global economy and geopolitical risk
- Inflation rate in March of 0.0% (expected to be negative, so good news)
- Inflation rate in February of -0.2%
- The low oil price an important factor

Inflation forecast

- "Looking ahead, on the basis of current futures prices for energy, inflation rates could turn negative again in the coming months before picking up in the second half of 2016. Thereafter, supported by our monetary policy measures and the expected economic recovery, inflation rates should recover further in 2017 and 2018."

- (…) The Governing Council will continue to monitor closely the evolution of the outlook for price stability and, if warranted to achieve its objective, <u>will act by using all the instruments available within its mandate </u>(…)

A credibility issue for ECB?

- **Question: My first one is on inflation expectations, and they have failed to pick up since the March package. I just wanted to know how disappointed or frustrated you are about this reaction.**

- When we had low inflation for a long time – and we are going to have low inflation for a long time – we should be patient (…) The future path of inflation is going to be supported by our monetary policy measures, first and foremost, by the recovery, and by the expected recovery and by base effects. We will see, as the first will more and more show its beneficial effects, as the second will more and more materialise, and the third, the base effects, will come true in the second part of this year, we will see that actual inflation will increase, and expectations will also follow that

The Norges Bank Monetary Policy decision, March 17th

Decision

Key policy rate lowered by 0,25 % to 0,5 %

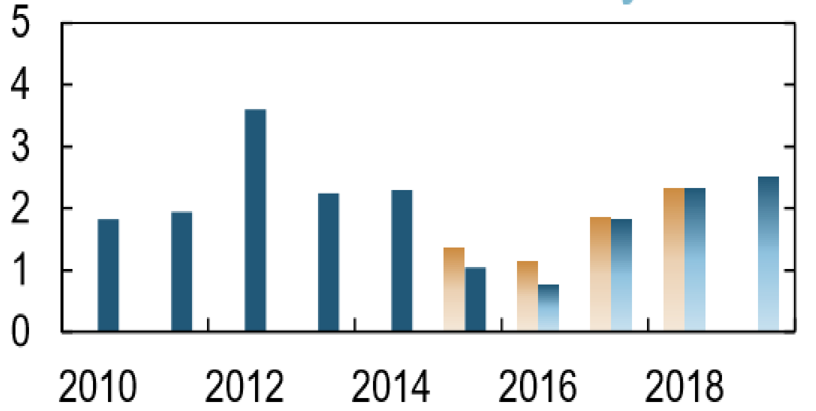
Background

Developments in the Norwegian economy have been weaker than foreseen.

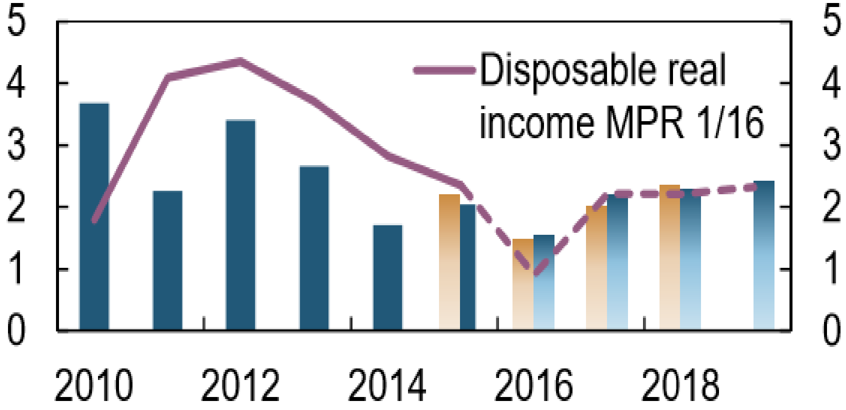
Projections for key economic aggregates

Change from previous year. Percent. 2010 – 2019

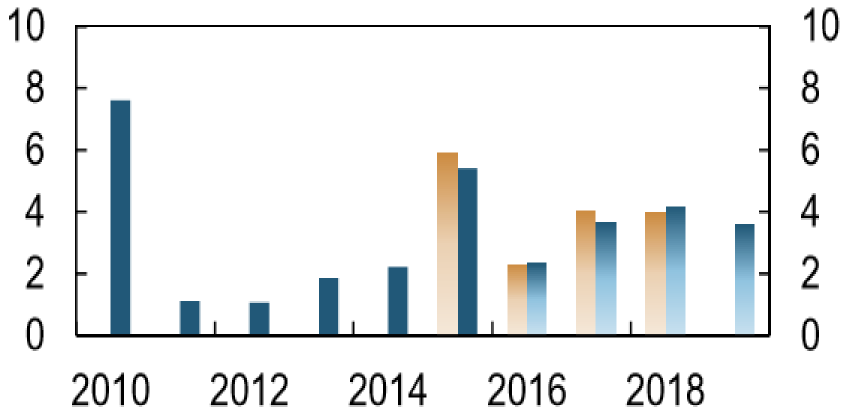
GDP mainland Norway



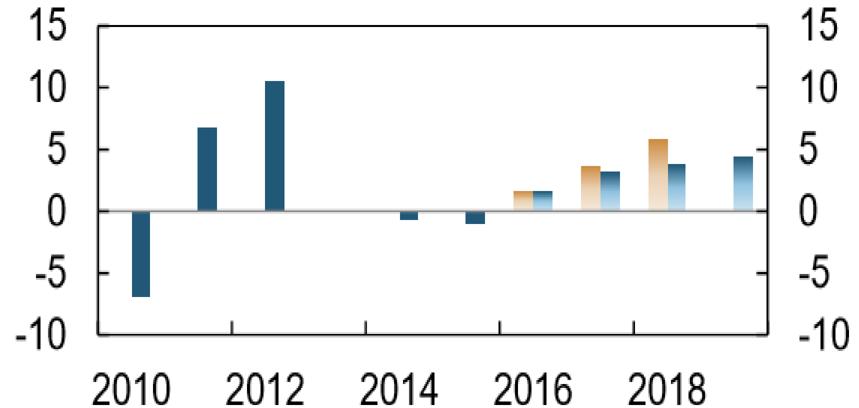
Private consumption and disposable real income



Mainland exports



Private investment

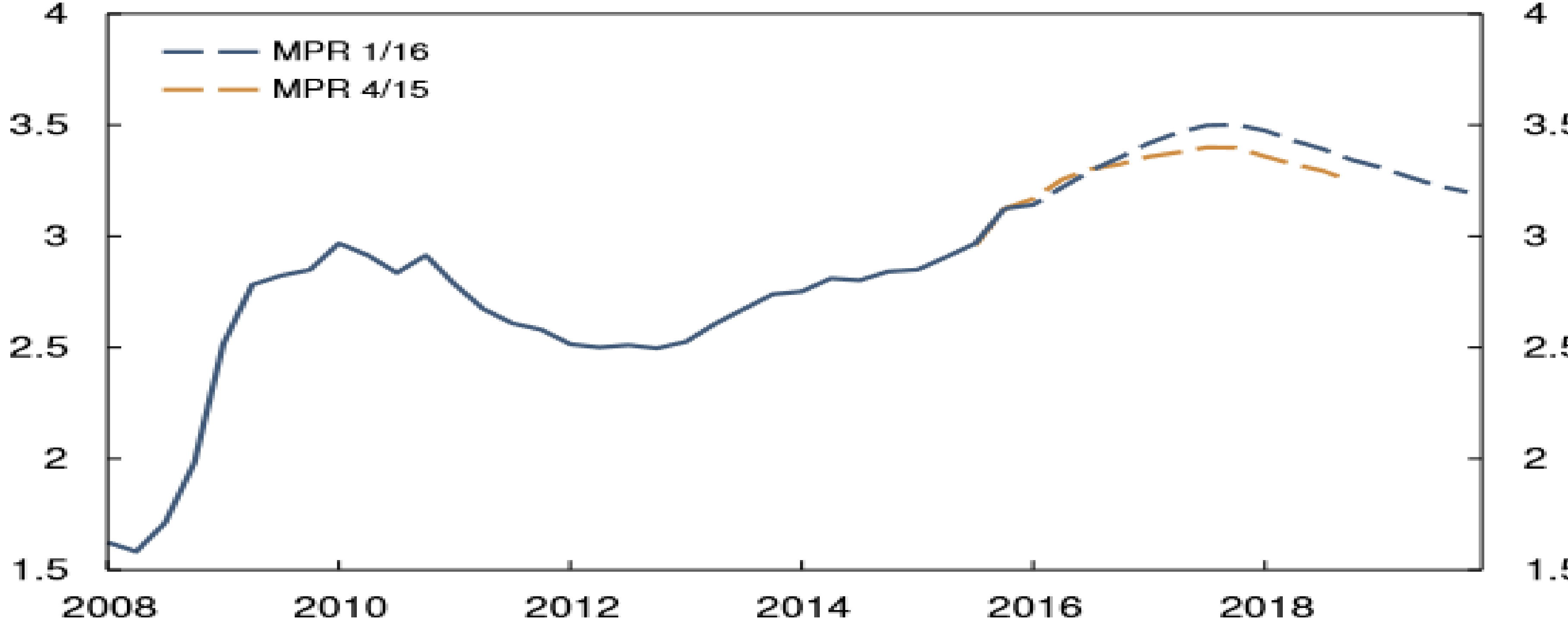


Sources: Statistics Norway and Norges Bank

■ MPR 1/16 ■ MPR 4/15

Background

Chart 2.6 Registered unemployment in percent of labour force. Seasonally adjusted. Percent. 2008 Q1 – 2019 Q4 1)



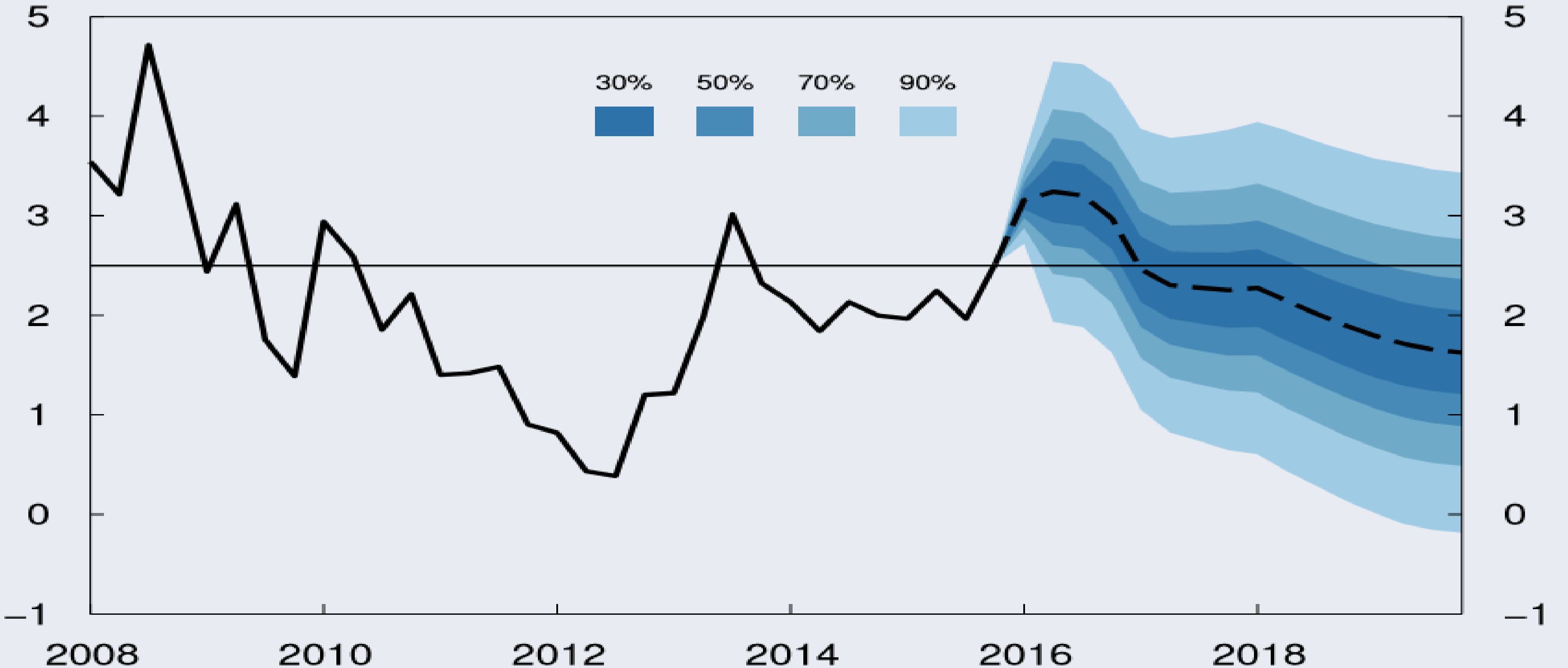
1) Projections for 2016 Q1 – 2019 Q4 (broken lines).
Sources: NAV, Statistics Norway and Norges Bank

Background

The krone depreciation has pushed up consumer price inflation. There are prospects that wage growth will be lower in 2016 than in 2015. As the effects of the krone depreciation unwind, inflation will drift down.

Background

Chart 2.4c Projected CPI in the baseline scenario with fan chart.
Four–quarter change. Percent. 2008 Q1 – 2019 Q4[1)]



1) Projections for 2016 Q1 – 2019 Q4 (broken line).
Sources: Statistics Norway and Norges Bank

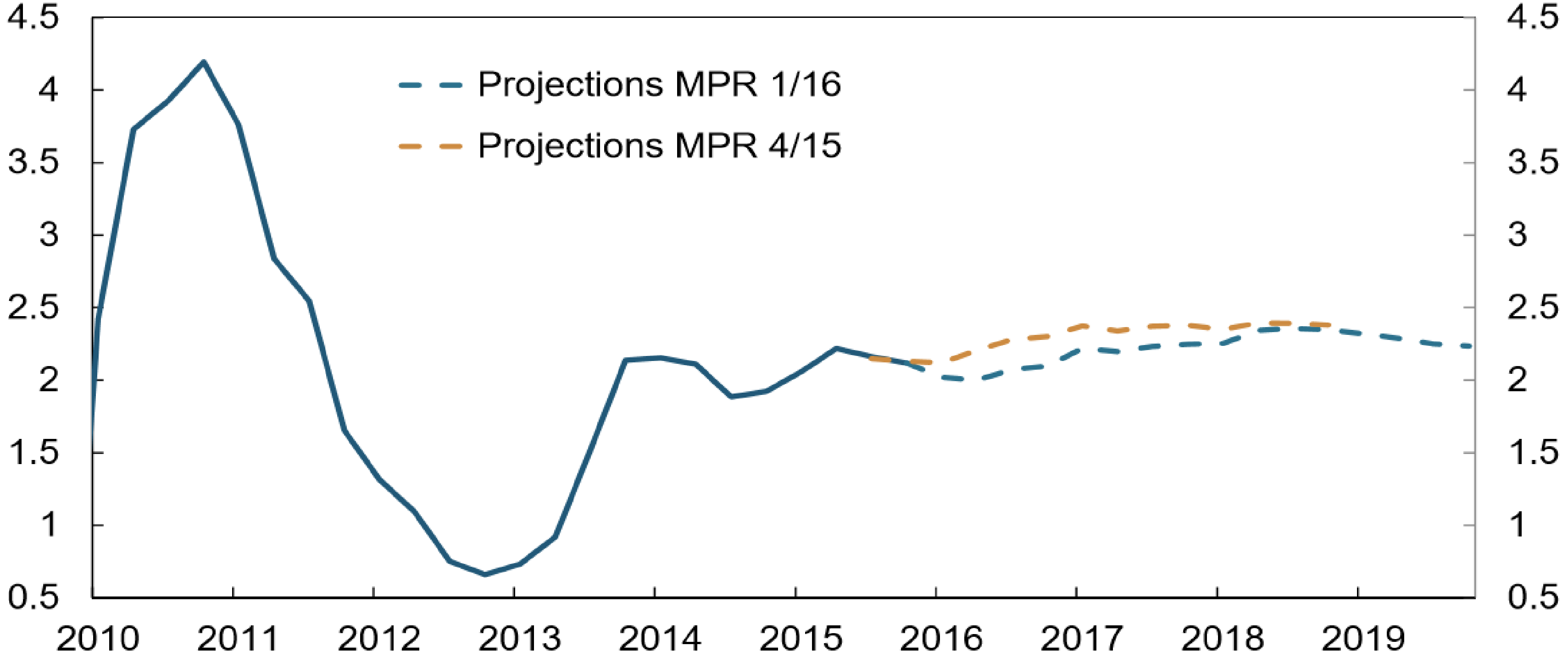
Background

It appears that global growth will be somewhat lower than expected and interest rates abroad have fallen.

Background

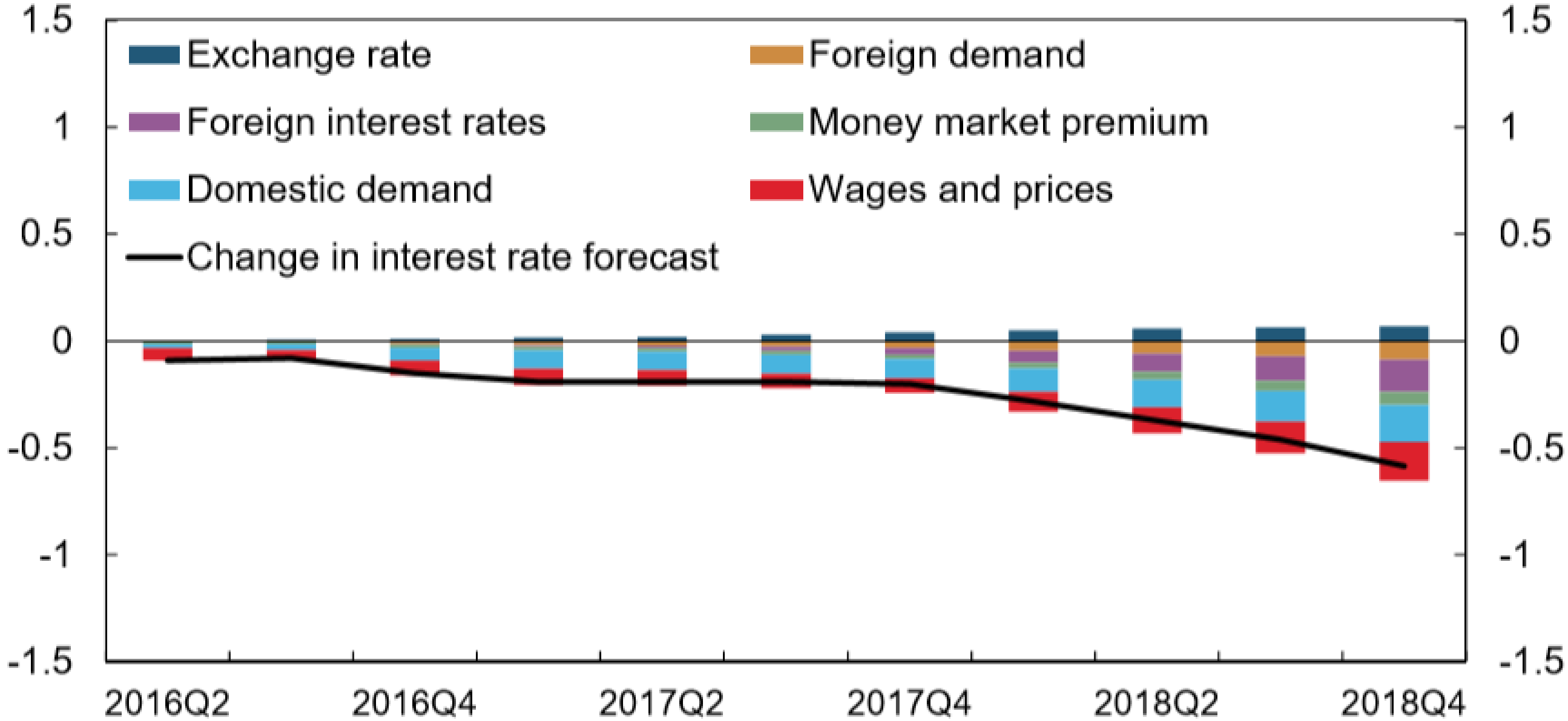
GDP growth for trading partners

Volume. Four-quarter change. Percent. Export weights. 2010 Q1– 2019 Q4



Factors behind changes in the interest rate forecast since MPR 4/15

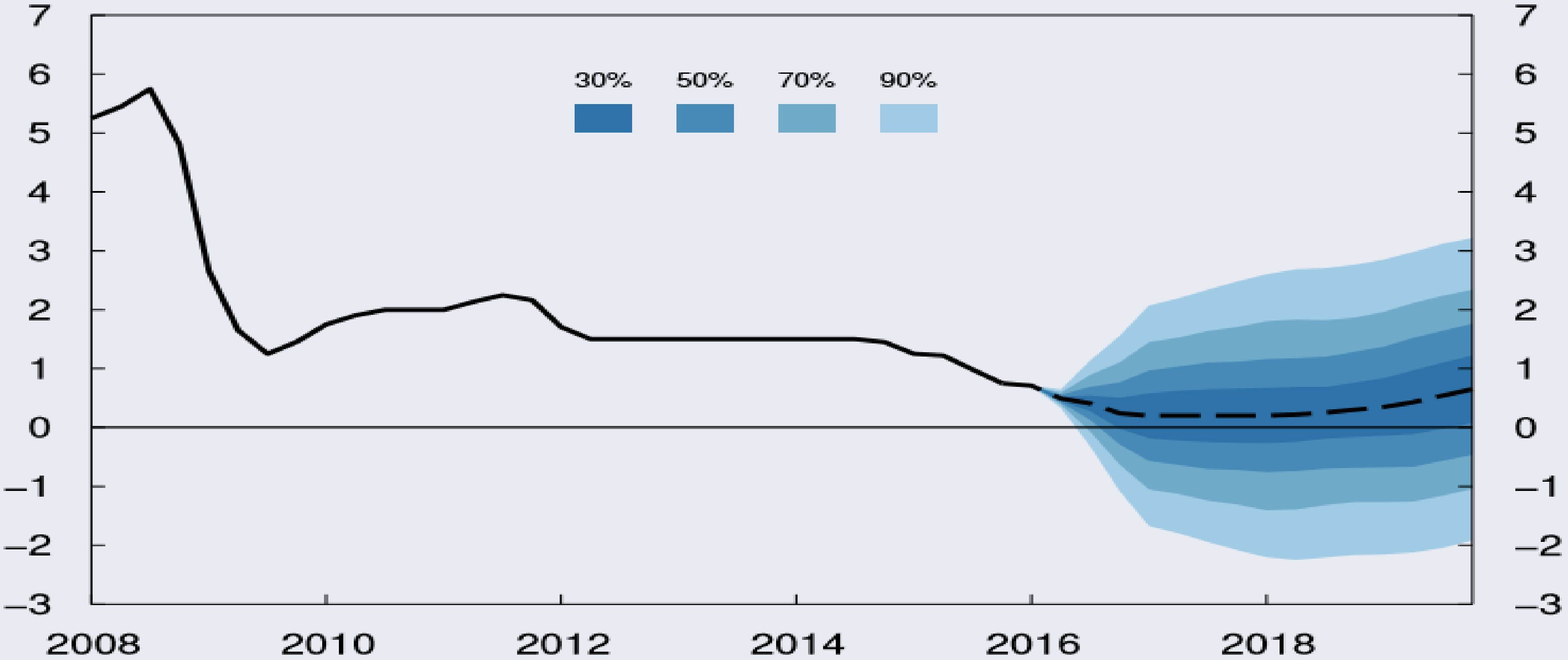
Cumulative contribution. Percentage points. 2016 Q2 – 2018 Q4



Source: Norges Bank

Future policy

Chart 2.4a Projected key policy rate in the baseline scenario with fan chart.[1)]
Percent. 2008 Q1 – 2019 Q4 [2)]



1) The fan charts are based on historical experience and stochastic simulations in our main macroeconomic model, NEMO. The fan chart for the key policy rate does not take into account that a lower bound for the interest rate exists.
2) Projections for 2016 Q1 – 2019 Q4 (broken line).
Source: Norges Bank

Future policy

«As the key policy rate approaches a lower bound, the uncertainty surrounding the effects of monetary policy increases. This now suggests proceeding with greater caution in interest rate setting. ”

Future policy

«Should the Norwegian economy be exposed to new major shocks, the Executive Board will, however, not exclude the possibility that the key policy rate may turn negative.»

Sjeføkonom Kjetil Olsen (t.v.) og sjefanalytiker Erik Bruce i Nordea Markets tror utviklingen i kronen vil være avgjørende for om Norges Bank innfører minusrente. Foto: Fredrik Bjerknes

Økonomi Norges Bank

De tror de vet svaret på spørsmålet sentralbanksjefen nektet å svare på