



FEDERAL
RESERVE
BANK
of ATLANTA

Interpreting Central Bank Objectives: New Challenges to Old Ideas

Bank of Canada, Federal Reserve
Banks of Atlanta and Cleveland,
and Swiss National Bank Day-
Ahead Conference

Nashville, TN

November 14, 2016

The St. Louis Fed's New Characterization of the Outlook for the U.S. Economy*

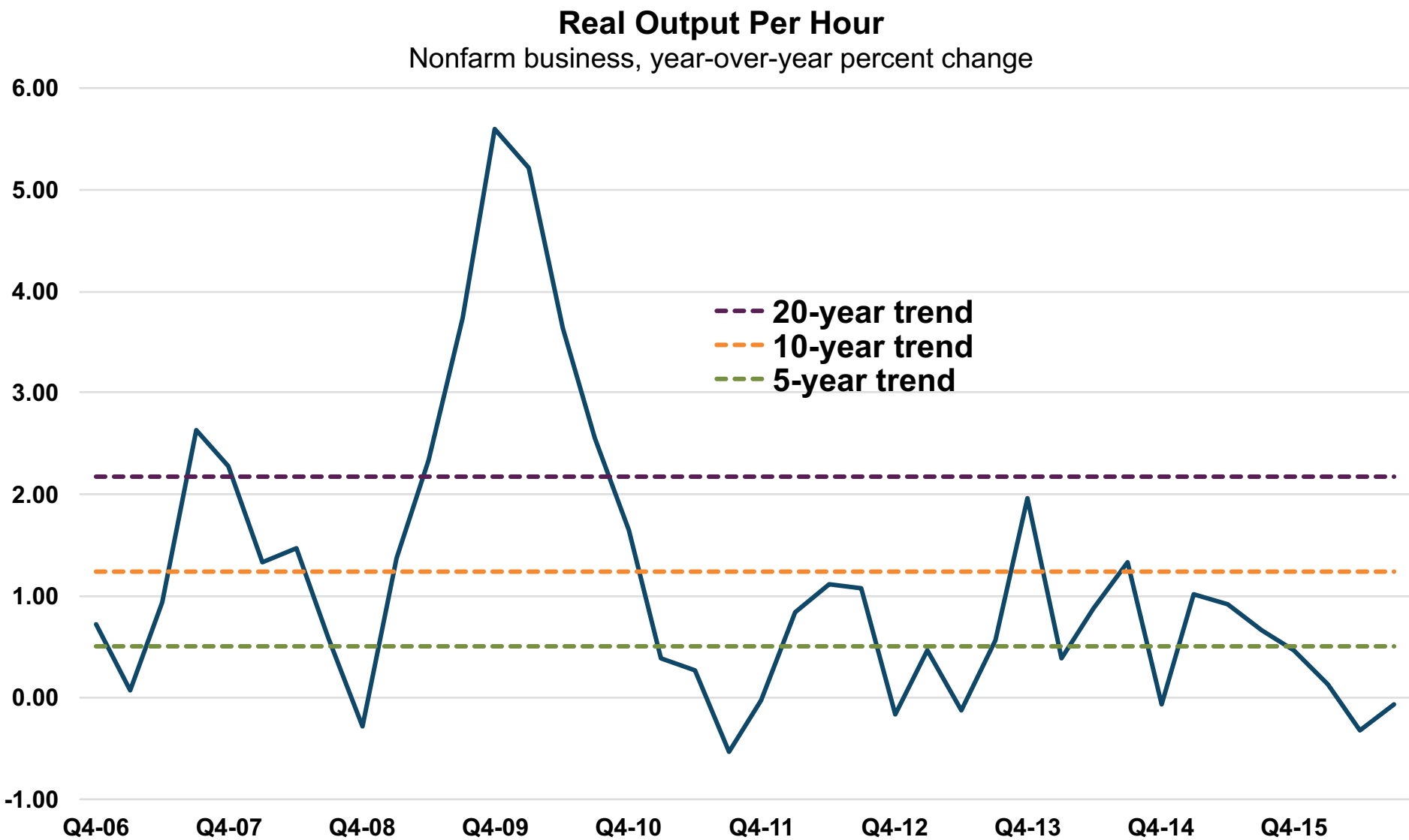
“The hallmark of the new narrative is to think of macroeconomic outcomes in terms of regimes... Regimes are generally viewed as persistent, and optimal monetary policy is viewed as regime dependent. Switches between regimes are viewed as not forecastable.

... we view the low productivity regime as very persistent...”

* James Bullard, Federal Reserve Bank of St. Louis:

<https://www.stlouisfed.org/~media/Files/PDFs/Bullard/papers/Regime-Switching-Forecasts-17June2016.pdf>

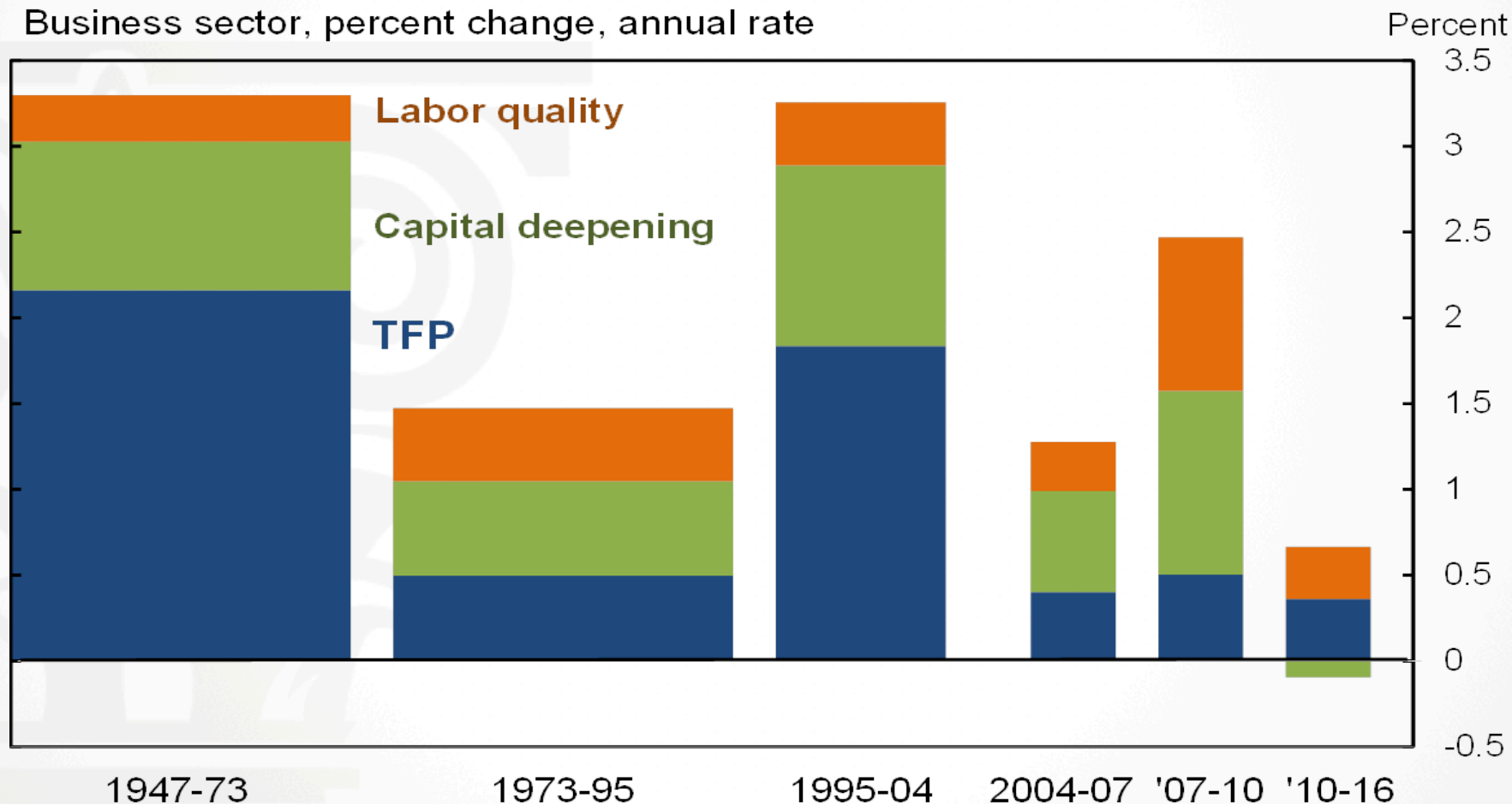
The very weak labor productivity trend convinces us that two-percent GDP growth is above current potential.



Weak investment is a big part of the story regarding weak productivity growth.

Contributions to growth in U.S. output per hour

Business sector, percent change, annual rate



Source: Fernald (2014a). Quarterly; samples end in Q4 of years shown except 1973 (end Q1) and 2016 (end Q2). Capital deepening is contribution of capital relative to quality-adjusted hours. Total factor productivity measured as a residual.

Uncertainty is a reasonable candidate – but does this just beg the question?

The Traditional Model

- Bernanke “wait and see” effects
- Leduc and Liu (2015): Uncertainty shocks as demand shocks

Uncertainty and Persistence

- Bachman, Eltsner, and Sims (2013): Evidence from survey data
- Christiano, et al (2014), Gilchrist, et al: Financial frictions and uncertainty

**A policy question disguised as
modeling question:**

**What should we assume is
exogenous?**

The Jackson Hole Questions #1:

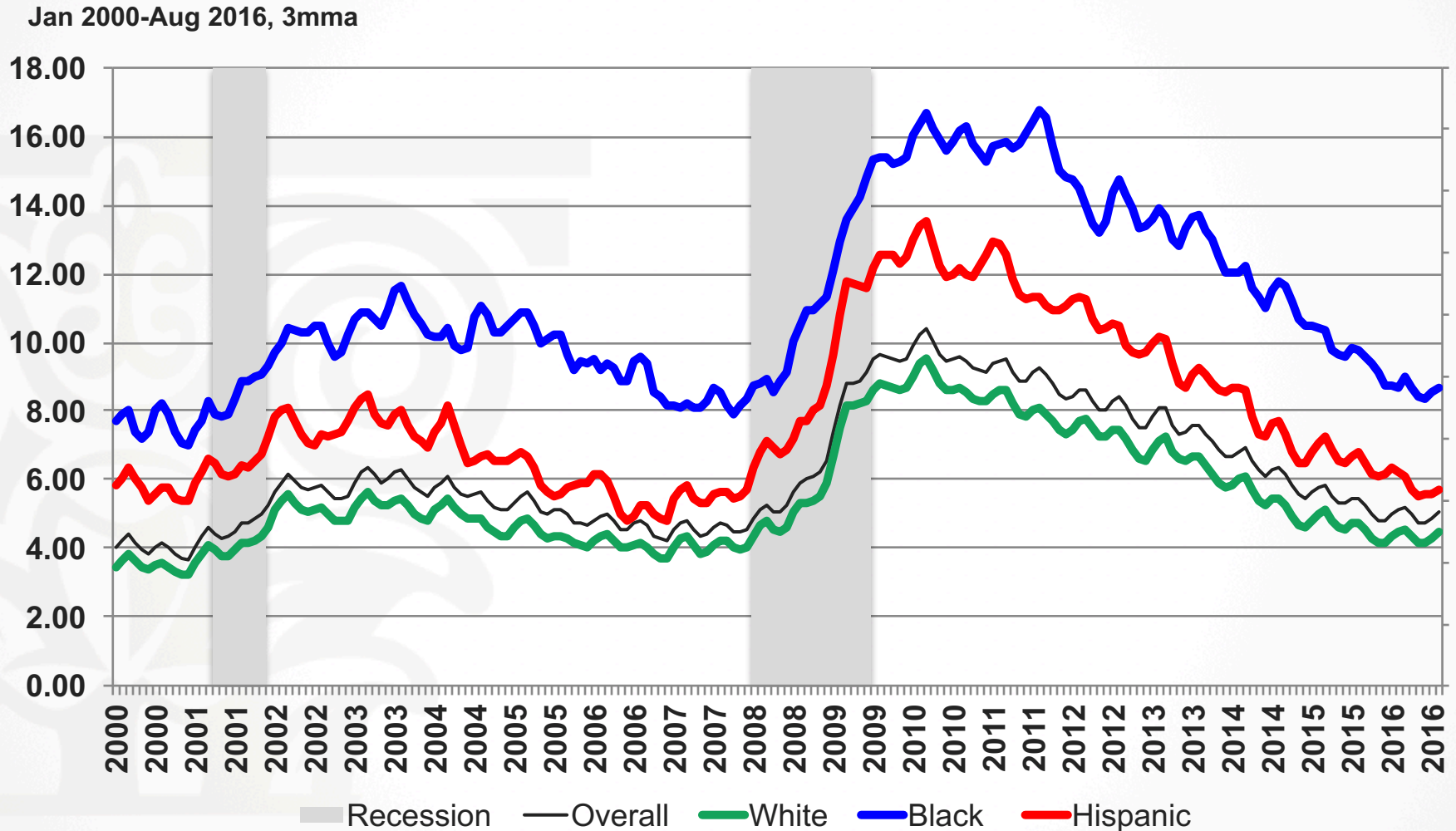
Are we defining the employment mandate too narrowly?

From the “Statement on Longer-Run Goals and Monetary Policy Strategy”:

The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market.

Source: Federal Open market Committee, January 26, 2016;
https://www.federalreserve.gov/monetarpolicy/files/FOMC_LongerRunGoals_20160126.pdf

A well-known fact: Minority unemployment rates are higher than white unemployment rates.

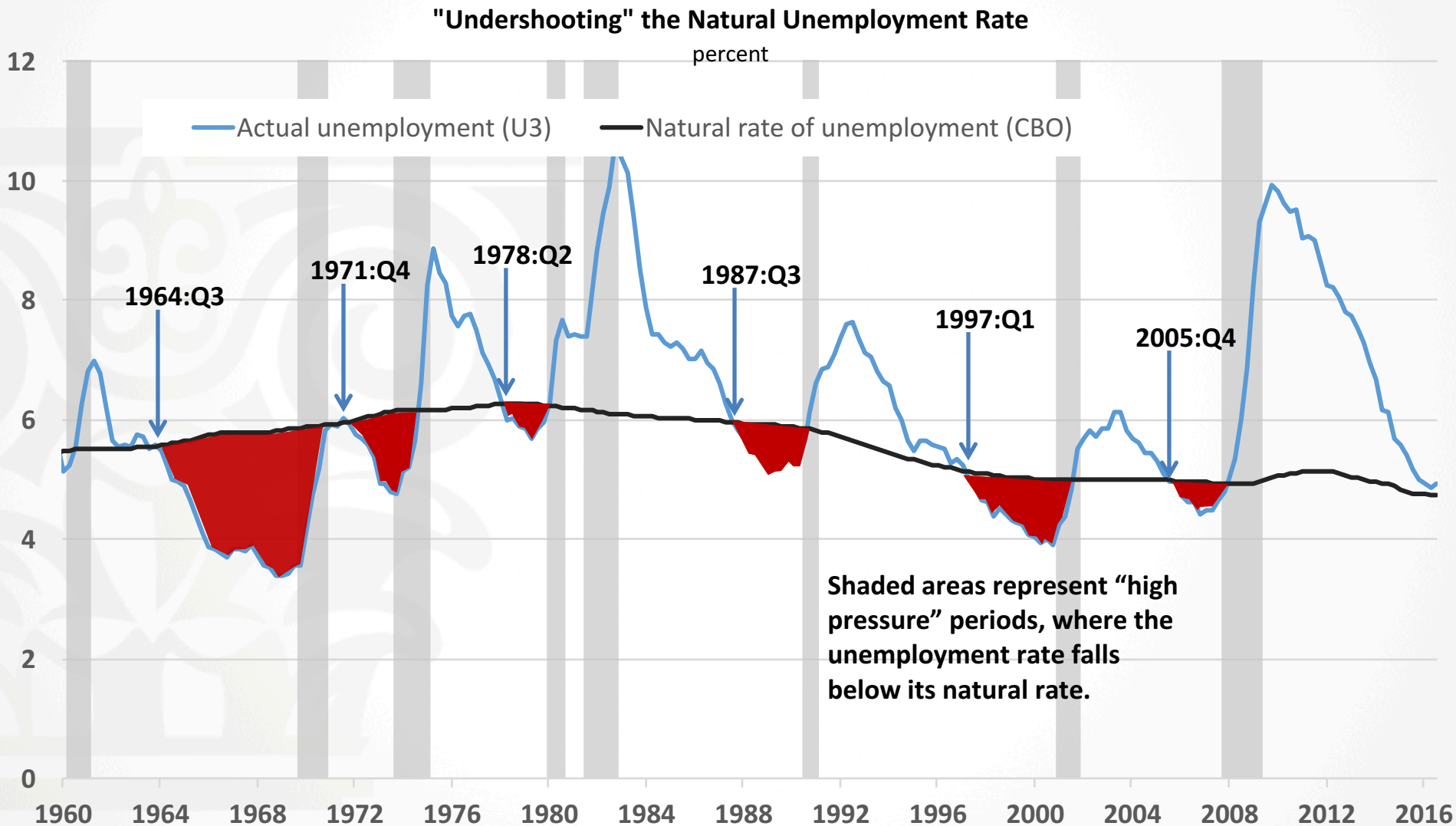


Do “high pressure” economies improve broader labor market performance?

“High Pressure” Period	Gap between African-American and White unemployment rates
1978Q2-1979Q4	-0.8
1987Q4-1990Q3	-0.3
1997Q2 -2001Q3	-1.8
2005Q4-2007Q4	-0.9

Note: “High pressure” periods are defined as periods when the unemployment rate falls below the Congressional Budget Office’s estimate of the “natural” rate of unemployment.

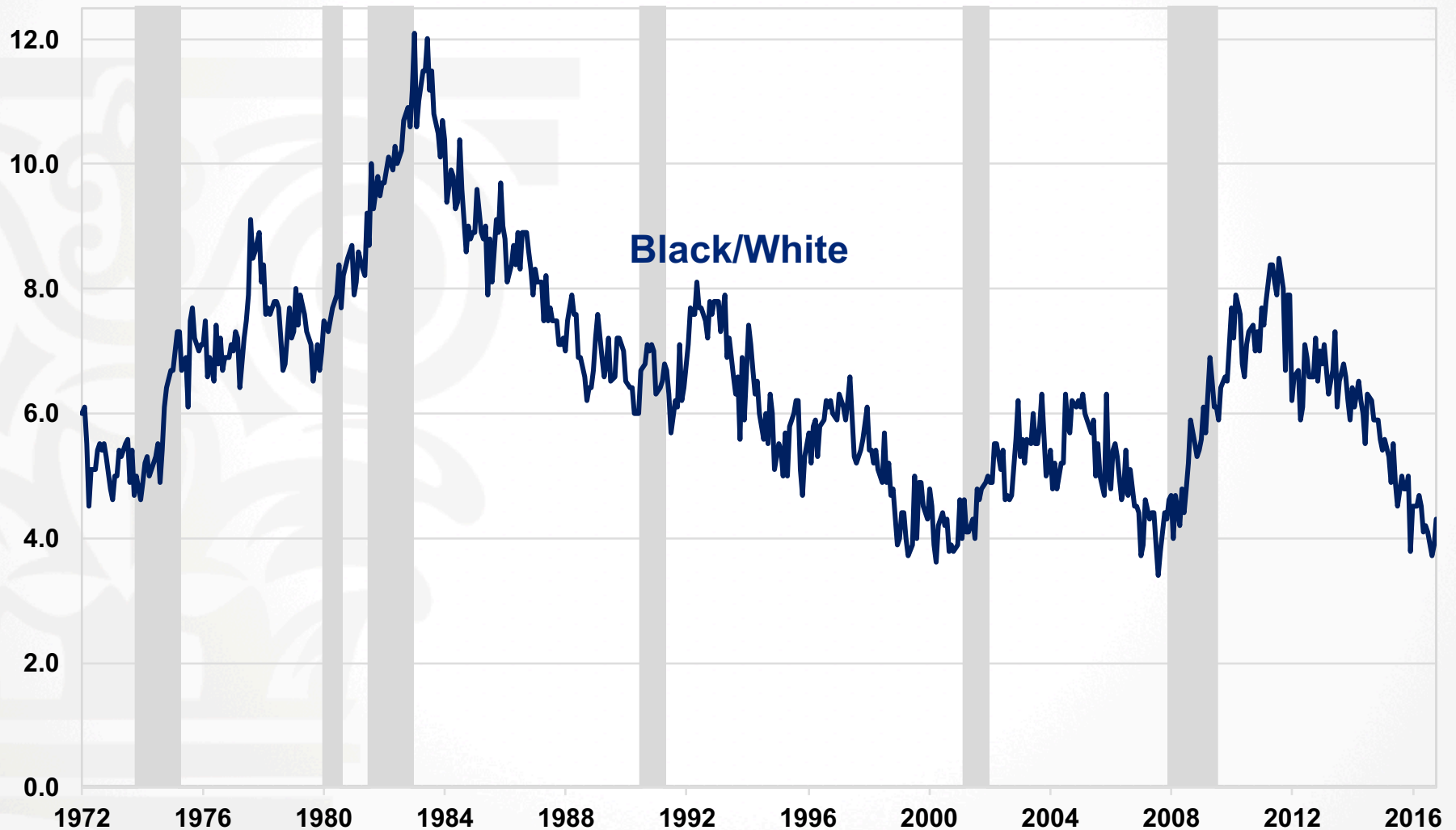
The U.S. has experienced 6 of these periods since 1964 -- they tended (*eventually*) to end in recession.



Sources: Bureau of Labor Statistics; Congressional Budget Office (CBO); BEA; Federal Reserve Board

African-Americans on average clearly fair worse than White-Americans during recessions.

Unemployment Rate Differentials



Did the “high pressure” improve broader labor market performance? Take 2.

“High Pressure” Period	Gap between African-American and White unemployment rates	Gap between African-American and White unemployment rates (5-years after high-pressure period)
1978Q2-1979Q4	-0.8	1.7
1987Q4-1990Q3	-0.3	-2.0
1997Q2 -2001Q3	-1.8	-0.7
2005Q4-2007Q4	-0.9	2.3

Note: “High pressure” periods are defined as periods when the unemployment rate falls below the Congressional Budget Office’s estimate of the “natural” rate of unemployment.

Alan Auerbach, Laurence Kotlikoff, and Darryl Koehler:

Calculate *net* remaining lifetime tax rates taking into account “all major federal and state tax and transfer programs, including the federal personal income tax, the FICA payroll tax, state income taxes, state sales taxes, the federal corporate income tax, the federal estate tax, TANF welfare benefits, Food Stamps, Supplemental Security Income , Social Security retirement and auxiliary... benefits, Social Security disability benefits, Medicaid benefits, Medicare benefits, and Medicare Part B premiums.”

Source: “U.S. Inequality, Fiscal Progressivity, and Work Disincentives,” NBER Working Paper 22032, , Feb. 2016:

[http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16 NBER%20version.pdf](http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16%20NBER%20version.pdf)

Current-period net marginal tax rates for 40-49 year olds, broadly defined, show little progressivity.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%		
Second Quintile	31.4%		
Third Quintile	32.3%		
Fourth Quintile	40.0%		
Highest Quintile	38.2%		

Source: “U.S. Inequality, Fiscal Progressivity, and Work Disincentives,” NBER Working Paper 22032, , Feb. 2016:

http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16_NBER%20version.pdf

Net tax rates at the individual level show enormous dispersion, and are prohibitive at the high end.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%	-22.6%	934.6%
Second Quintile	31.4%	2.8%	506.9%
Third Quintile	32.3%		
Fourth Quintile	40.0%		
Highest Quintile	38.2%		

Source: “U.S. Inequality, Fiscal Progressivity, and Work Disincentives,” NBER Working Paper 22032, , Feb. 2016:

http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16_NBER%20version.pdf

Dispersion in net tax rates is most dramatic for the least wealthy.

Dispersion in Current-Year Net Marginal Tax Rates, Ages 40-49

	Median Marginal Current Year Net Tax Rate	Minimum Marginal Current Year Net Tax Rate	Maximum Marginal Current Year Net Tax Rate
Lowest Quintile	33.3%	-22.6%	934.6%
Second Quintile	31.4%	2.8%	506.9%
Third Quintile	32.3%	-37.6%	46.2%
Fourth Quintile	40.0%	16.6%	55.1%
Highest Quintile	38.2%	3.0%	69.0%

Source: "U.S. Inequality, Fiscal Progressivity, and Work Disincentives," NBER Working Paper 22032, Feb. 2016:

http://www.ncpa.org/pdfs/U.S.%20Inequality,%20Fiscal%20Progressivity,%20and%20Marginal%20Taxation%203-14-16_NBER%20version.pdf

The Jackson Hole Questions, #2:

**Can monetary policy be
separated from fiscal policy?**

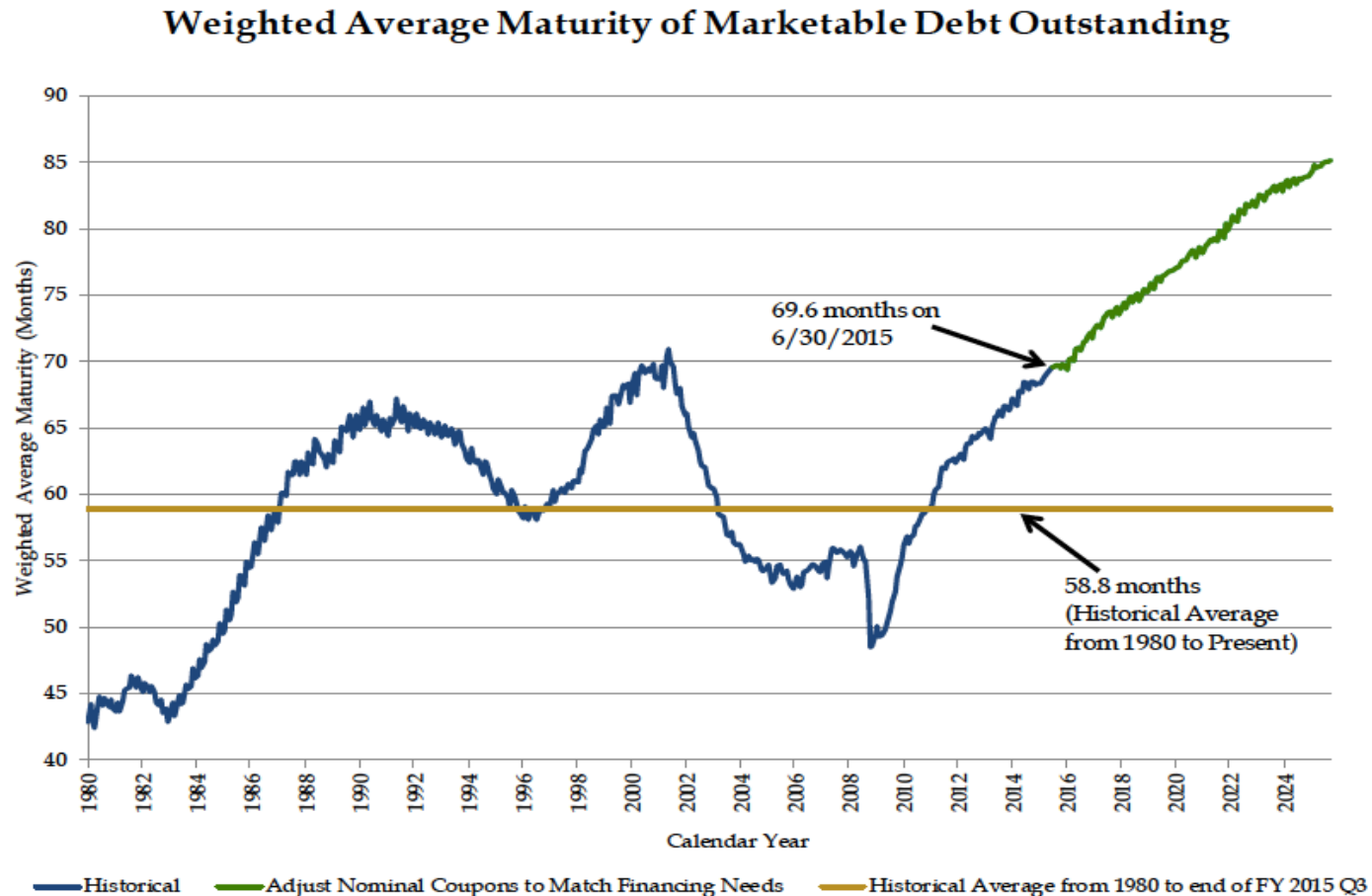
Chris Sims:

“Central bank independence attempts to separate monetary and fiscal policy, but it is not a complete separation, because every monetary policy has fiscal consequences. During rapid inflations or long periods of very low inflation and interest rates, coordination of fiscal and monetary policy is necessary.”

Source: “Fiscal Policy, Monetary Policy, and Central Bank Independence,” Federal Reserve Bank of Kansas City, August 2016:

<https://www.kansascityfed.org/~media/files/publicat/sympos/2016/econsymposium-sims-paper.pdf?la=en>

Mechanically, Treasury debt management policy is on a track to dramatically add market duration.



This scenario does not represent any particular course of action that Treasury is expected to follow. Instead, it is intended to demonstrate the basic trajectory of average maturity absent changes to the mix of securities issued by Treasury.

25

The Jackson Hole Questions, #3:

Should regulatory policy be a constraint?

Darrell Duffie and Arvind Krishnamurthy:

“We show how passthrough efficiency into repo markets is degraded by the Supplementary Leverage Ratio (SLR) Rule, which reduces the incentives of bank-affiliated dealers to reserve space on their balance sheets for repo intermediation. We then explain how the Liquidity Coverage Ratio (LCR) Rule can raise dispersion in money markets by reducing the supply of safe assets...”

Source: “Passthrough Efficiency in the Fed’s New Monetary Policy Setting,” Federal Reserve Bank of Kansas City, August 2016:

<https://www.kansascityfed.org/~media/files/publicat/sympos/2016/econsymposium-duffie-krishnamurthy-paper.pdf?la=en>



FEDERAL
RESERVE
BANK
of ATLANTA

Interpreting Central Bank Objectives: New Challenges to Old Ideas