The Federal Reserve Bank of St. Louis Presents:

"MONETARY-POLICY UPDATE: RETURNING TO NORMAL SOON?"

Recorded on Tuesday, October 14, 2014

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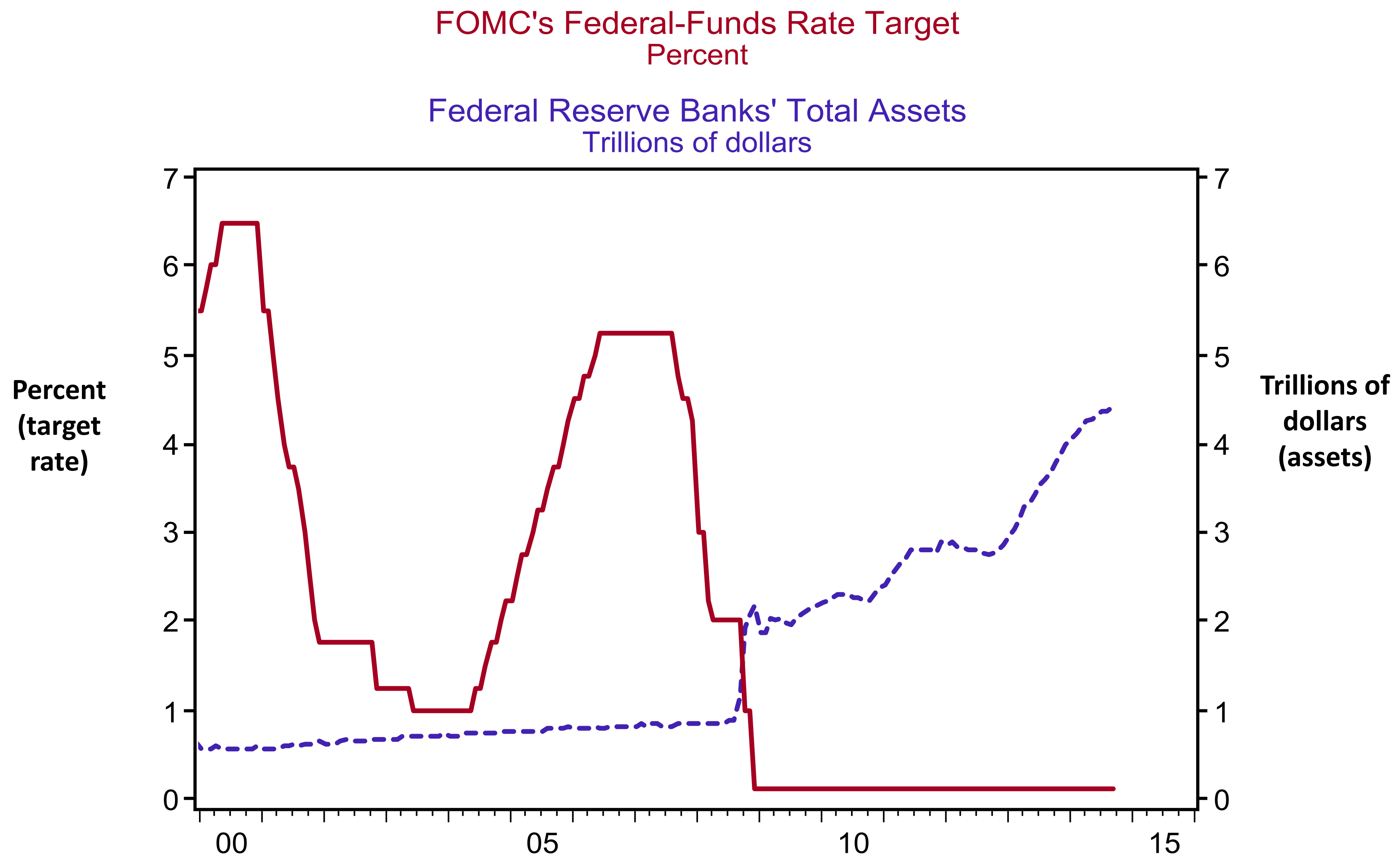
Monetary-policy Update: Returning to Normal Soon?

- The Fed's "unconventional" monetary policy continues after almost 6 years.
- The FOMC expects to end asset purchases next month but return to neutral conventional policy settings no sooner than the end of 2017.
- Considerable uncertainty surrounds monetary policy's "return to normal."

What Is Unconventional Policy?

- Conventional monetary policy (before 2008):
  - Occasional changes in the Fed-funds target rate
  - Statements describing the Fed's risk assessment
  - Became impossible when Fed-funds rate hit the zero lower bound (ZLB) in late 2008
- Unconventional monetary policy (since 2008)
  - Large-scale asset purchases (LSAP)
  - Forward guidance about future asset purchases and target-rate changes
  - Risk assessments

Asset Purchases Replaced Target Changes



Source: Federal Reserve Board

Monthly data through Sept. 2014

Key Instances of Forward Guidance

- Aug. 9, 2011: FOMC projects near-zero funds rate “at least through mid-2013.”
- Jan. 25, 2012: FOMC projects near-zero funds rate “at least through late 2014.”
- Sept. 13, 2012: FOMC projects near-zero funds rate “at least through mid-2015.”

Risk Assessments Also Matter: From the Aug. 9, 2011, Post-meeting Statement

- “Information received since the FOMC met in June indicates that economic growth so far this year has been considerably slower than the Committee had expected. Indicators suggest a deterioration in overall labor market conditions in recent months, and the unemployment rate has moved up. Household spending has flattened out, investment in nonresidential structures is still weak, and the housing sector remains depressed....”

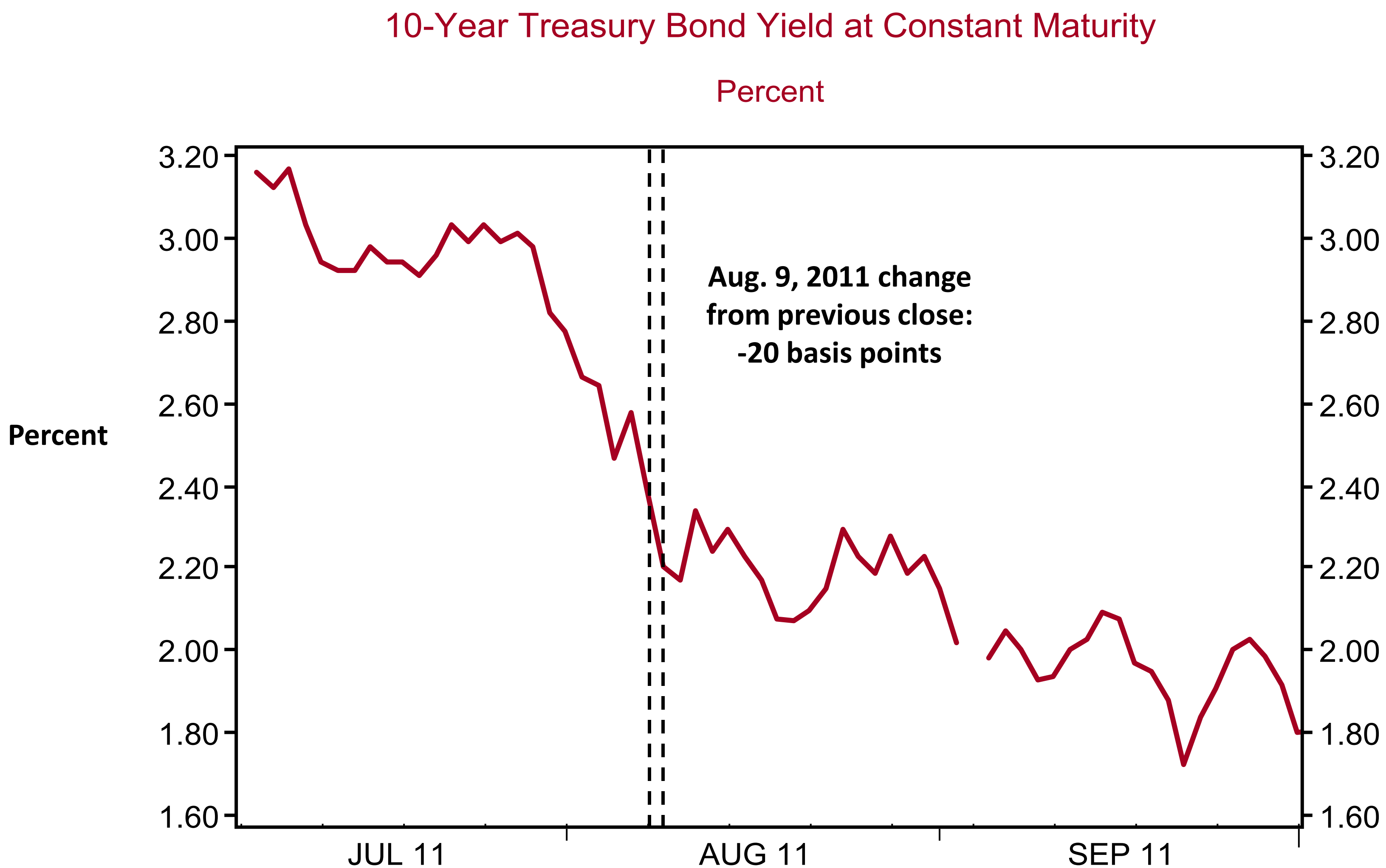
Risk Assessments Also Matter: From the Aug. 9, 2011, Post-meeting Statement

- "…. The Committee now expects a somewhat slower pace of recovery over coming quarters than it did at the time of the previous meeting…. Moreover, downside risks to the economic outlook have increased."

Then Came the Forward Guidance

- "…. The Committee currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013."

Did Markets React to Risks or Guidance?

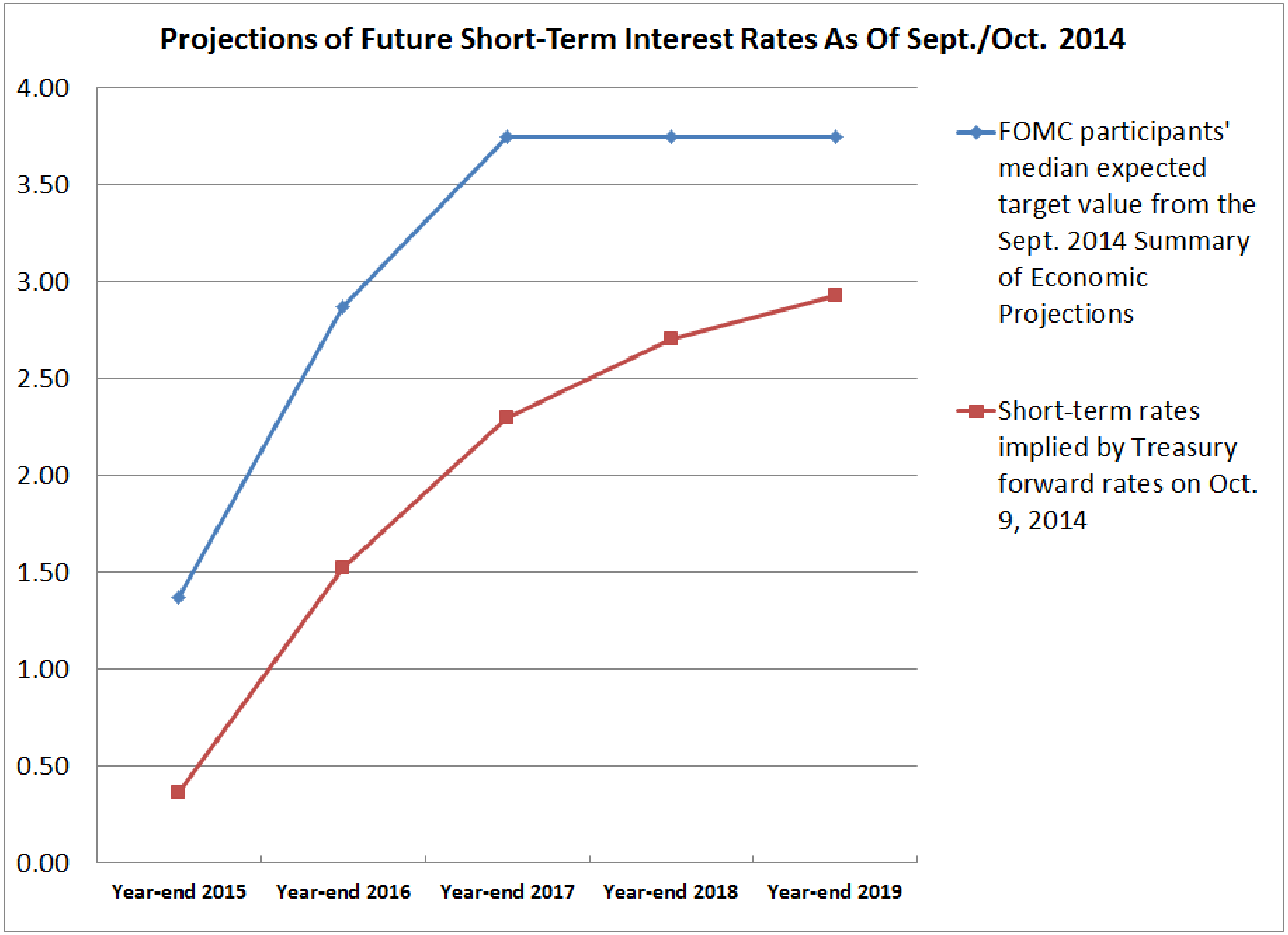


Source: U.S. Treasury **Daily data**

Returning to Conventional Policy

- FOMC participants' median forecast includes:
  - First increase in Fed-funds target during 2015
  - More than 100 basis points of tightening in each of 2015 and 2016 (total increase of 275 b.p.)
  - Neutral funds rate of 3.75%, reached in 2017
- Financial-market implied forecasts
  - First increase in target during 2015
  - Only 150 basis points of tightening during 2015-16
  - Neutral funds rate below 3.50%, reached sometime after 2017

FOMC and Treasury Rate Forecasts



In Sum: How and When Will the Fed Return to Conventional Policy?

- Large-scale asset purchases will end next month but the Fed's large balance sheet will persist for many years.
- The Fed-funds target rate is likely to increase in 2015, continuing upward for several years.
- FOMC participants' median forecast is for a target rate of 3.75% by year-end 2017.
- Market-based forecasts suggest a slower pace of tightening and a lower long-run level.