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Cleveland Fed Conversations on Central Banking: The Fed's Dual Mandate: Recent Progress and Challenges

Welcome:
Damjan Pfajfar, Vice President, Center for Inflation Research, Federal Reserve Bank of Cleveland

Moderator:
Michael Derby, *Reuters*

Panelists:
Alan Blinder, Gordon S. Rentschler Memorial Professor of Economics and Public Affairs, Princeton University
Jon Faust, Center for Financial Economics, Johns Hopkins University
Ellen Meade, Research Professor of Economics, Duke University

Damjan Pfajfar:

Welcome everyone to the Cleveland Fed Conversations on Central Banking series. I'm Damjan Pfajfar with the Cleveland Fed Center for Inflation Research. Thank you all for joining us today. This conversation is part of the work that we are doing at our Center for Inflation Research to help researchers, policymakers, and the public understand inflation and the monetary policy.

Today our topic is the Fed's dual mandate recent progress and challenges. In 1997, Congress amended the Federal Reserve Act directing the Board of Governors of the Federal Reserve System and the Federal Open Market Committee to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

But how did the Fed set their objectives and weigh them when they are in conflict? The policy framework changed considerably in the last decades, most recently in August 2020 with the updated FOMC's statement on longer-run goals and monetary policy strategy. Given the recent surge in inflation, should the framework be updated again, we have an outstanding panel today and in a short format. We'll jump into that in just one moment.

Before we start, please ensure that you're muted and your video is turned off. If you are not a presenter, we'll have time for questions at the end. If you have a question, please feel free to put it in the Q&A box anytime during the course of this conversation. You don't have to wait until the last minute.

We'll now turn to Michael to introduce our panelists.

Michael Derby:

Hi, I'm Mike Derby. I'm a reporter with Reuters and I will be your moderator today, and so we're going to begin first with going through three panelists discussing the history of the Fed's dual mandate.

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To begin with, we're going to start with Alan Blinder of Princeton University, who was also Fed vice chair during the 1990s. Mr. Blinder, I leave it to you for the next five minutes.

Alan Blinder:

I just want to say it's a pleasure to be here at this program sponsored by the Cleveland Fed and particularly about the topic, which has been near and dear to my heart for a long time, as you'll see on one of these charts to come.

Let's just get right to it. I want to start with ancient history and in this case, ancient history means not the Roman Empire but before 1994. The Fed had a very clear policy about the dual mandate, which is to say nothing and say it cryptically. In fact, that was the Fed's policy about everything: say nothing and say it cryptically. Now, it's worth remembering course that nobody in 1913 when the Federal Reserve Act was passed was thinking about what we would now call monetary policy. I don't think you'll find that term anywhere. Rather, the Federal Reserve Act was according to its preamble an act to provide for the establishment of Federal Reserve banks. Here I put in italics the act is not an italics, but I did to furnish an elastic currency and blah, blah, blah. That phrase is about as close as you could come to monetary policy in the 1913 act, and it's not about monetary policy. It was about making sure the currency didn't collapse during panics and things like that.

We go to the next slide, and in particular there was no mention. There's about the dual mandate. Neither inflation nor unemployment was mentioned in the Federal Reserve Act. Now, in 1977 in the Federal Reserve Reform Act, that was changed. I must have heard a thousand times this attributed to the Humphrey-Hawkins, which came a year later. That's not accurate. It actually was the 1977 Act, which amended the original Federal Reserve Act by giving the Fed a clear mandate for what we of course in 1977 like now called monetary policy, and that was to maintain long run growth of the monetary and credit aggregates.

Notice that that was part of the monetarist period, where the Fed was being pushed to pay attention and publish monetary aggregates. "Commensurate with the economy's long run potential to increase production," and there's the phrase that was read to you before, "so as to remote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." It's worth pointing out in this context that the Employment Act of 1946, 30 years earlier, had vaguely committed the whole US government, and that includes the Federal Reserve, to pursuing conditions under which they'll be afforded useful employment for those able, willing, and seeking to work. You could say the government was already committed to full employment or maximum employment or something like that, but still until 1977 seems strange. There was no mandate for stable prices in the Federal Reserve Act.

Until the mid-1990s and beyond, that's a picture of Jackson Hole by the way, the Grant Tetons, the maximum employment part of the dual that was put in the law in 1977 was pretty much ignored at least verbally. I wrote here "took a distant back seat to the stable prices," but that's an understatement, I think. In fact Paul Volcker and Alan Greenspan barely ever mentioned the dual mandate. I can't actually think of a time in which either one of them did, but I must say I didn't trace every word both gentlemen ever said. But if they did, it was very, very rare.

The reason I put the Grand Tetons up there is in the summer of 1994 when I was vice chairman of the Fed, I gave a speech that is either famous or infamous depending on your point of view, which had the temerity to point out, and there's the quote, this is a quote from my Jackson Hole speech, "the charge given by the Congress to the Federal Reserve calls upon us to pursue both maximum employment and stable prices." The emphasis on both. You might be interested to know at that time, August '94, the

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unemployment rate was 6%. I just dropped a hint. I didn't actually say we could push it lower, but if you read between the lines and people did, there was a hint that I thought we could perhaps go lower than 6% as the definition of maximum employment.

Well, this set off a furor in some circles. I'm not going to go into the details. I have a whole binder of press. I only give you an example of where it almost ended. Robert Samuelson, who was then writing both in the Washington Post and Newsweek, started his column one day in September '94 with the nice phrase, "Alan Blinder bombed in Jackson Hole." I still remember vividly going out to my front porch that morning pulling in the Washington Post and opening it and finding that it was a nice way to start breakfast and he concluded, if I could go back, with a dual insult. I haven't to this day figured out which was the more insulting that "Blinder lacks the moral or intellectual qualities needed to lead the Fed." Mind you what I had done is pointing out that we had a dual mandate, so things have changed from then. That was 1994 from then to now.

What about numbers? Congress in that 1977 act put no numbers on the word stable prices or maximum employment. Probably a good thing. Who knows what they might've written, and certainly a good thing from Paul Volcker and Alan Greenspan's point of view because the last thing on earth they wanted was numbers for those. They were free to interpret the two pieces of the dual mandate as they would.

Ben Bernanke on the other hand, who of course followed Greenspan, believed in inflation targeting. He had been clear about that before he became chairman of the Fed. If you're going to do inflation targeting, you at least need a number for the inflation target so you have to translate stable prices into a number for inflation. It took several years under Bernanke before the FOMC eventually did that, but they did eventually do it with a 2% inflation target. The rest of that paragraph so to speak is going to be up to Ellen Meade, who's going to follow me.

Last point, maximum employment was trickier to make numerical much trickier since the Fed doesn't get to choose the full employment unemployment rate, the natural rate, whatever you want to call it. That was the Fed provided wording and Ellen is going to talk about this more I'm sure, that was readily interpretable by people in the know that we're translating maximum employment into getting to the natural rate of unemployment. They left it at that with the notion that that would change over time. Unlike the 2% inflation target, they were not etching it in stone.

Last point is that just as a by the way, Bernanke unlike Greenspan and Volcker before him believed in more Federal Reserve communication in general. Unlike the two esteemed gentlemen that preceded him, he uttered the phrase dual mandate early and often as they say. I didn't make an exhaustive look to see when it started, but certainly by 2009 he was saying it frequently and I think before.

Michael Derby:

Great, so that moves us towards the future here. And so we're going to pass the baton to Ellen Meade of Duke University, also a former top Fed advisor.

Ellen Meade:

Thanks very much, and what a great background set of comments to follow on.

I'm going to start with the statement that the committee issued in January 2012, so that would be the next slide. The statement on longer-run goals and monetary policy strategy, this was a landmark document for the FOMC and this is the document in which they first articulated the goal for inflation. The 2% is measured by the annual change in personal consumption expenditures index as well as the

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broad strategy for monetary policy. It provided context and background around the dual mandate goals. It set inflation over the longer run as primarily determined by monetary policy and then went on to articulate that goal.

But maximum employment is largely determined by non-monetary factors that affect the structure and dynamic of the labor market, and therefore it wouldn't be appropriate to specify a fixed goal for employment. Then it says that they consult a wide range of indicators for the labor market, and it's certainly true that there are many indicators of labor market developments.

And then it went on as Alan Blinder just alluded to talk about and insert the median of the longer-run estimates for the unemployment rate that come out of the policymakers' summary of economic projections, the SEP, which is a quarterly set of projections that policymakers fill out. This number was in the document and updated once a year to show that U-star did in fact move over time. As Alan intimated, there was this sleight of hand between maximum employment as the goal and then the interpretation or the articulation of maximum employment in terms of the longer run median U-star.

Getting to this document was no easy feat. The FOMC, it started earlier in the year with some things that were being passed around, Charlie Plosser, president of the Philadelphia Fed, passing around to other presidents. Wound up with the FOMC in the spring and the subcommittee for communications headed then by Vice Chair Yellen to take it forward. There were two very interesting FOMC meeting discussions in the fall of 2011, and they characterized this statement as a quasi-constitutional document requiring a high degree of consensus, a high bar for change. The statement itself provided a large tent for housing diverse points of view.

The history of how that document comes together, it took almost a year. It's an interesting process of debate and discussion. Note that in it the goals were ordered with inflation first and maximum employment second, and I'm not quite sure. I have some hypotheses of why that was the case, but it wasn't the ordering that was in the Federal Reserve Act or in other Federal Reserve communications, which by that time did refer to both maximum employment and price stability and the dual mandate goals quite often, as Alan Blinder said.

Now I'll go to the next slide. Thank you. If we think about the period so after the 2012 statement was issued and before leading up to the 2020 statement, we have a period that we can look on the left panel here. My red graph, inflation is consistently underperforming the FOMC's 2% goal. The blue line is headline 12 month PCE inflation. The red line is core 12 month PCE inflation over that period starting in January 2012. But at the same time the labor market, the unemployment rate, the green line there is gradually and steadily falling over the entire period, starting out in January 2012 at 8.3% and ending 2019 at 3.6%.

The right panel there is estimates of longer-run U-star or the longer-run natural rate of unemployment showing that they were revised down over time. This panel comes from Chair's Powell famous Jackson Hole speech in August 2018, the so-called star's speech. The FOMC downward revisions of the median U-Star are the black line, blue chip is there in the blue dashed line, and the CBO in the red dots.

Jackson Hole Chair Powell says, "We now know that the level of the unemployment rate relative to our real-time estimate of U-star will sometimes be a misleading indicator of the state of the economy or of future inflation," referring to the downward revisions over time.

Now I'll go to the next slide, please. Between 2012 and 2020, it's important to think about the evolving thinking of the FOMC and the staff research and all the dialogue that was going in both inside the building, externally through research speeches, the monetary policy report, and so on. For instance in

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October 2015, the FOMC took up, I think it was the first deliberative discussion of the lower level of the neutral rate of interest, or R-star, and its implications for the lower level for meeting the Fed's dual mandate goals. A lower level of R-Star implied a reduction in the policy space that the Fed had for reducing interest rates, and it posed challenges for meeting the dual mandate goals because of the lack of policy space. Persistent undershooting of 2% could lead to downward drift in inflation expectations and further erode policy space.

So then there was a lot of discussion, and I date this a lot to some of the Tealbook materials starting in mid-2016 strategies for getting inflation up to 2%, including a consideration of a shortfalls approach. The idea was that policymakers would not react to unemployment below U-star, only unemployment above U-star, and you can see that discussion in the Tealbooks. Also, an apparent flattening of the Phillips curve. Lower inflation cost of running the labor market below U-star and making U-star less successful at less useful as a guidepost for policy as Chair Powell said in his Jackson Hole speech or intimated.

And then in 2019 as part of the framework review, there was a Fed Listens initiative where the Fed went out and started listening to the broader public, a lot of different groups, and hearing what they had to say. As a person who worked very closely on that initiative, I can tell you it was difficult to get people at the time to have anything at all to say about inflation. All they wanted to do was talk about the labor market, which was very strong, but businesses were having trouble finding workers. Workers were experiencing things they hadn't experienced before. When Chair Powell issued a report in June of 2020 about the Fed Listens initiative, this quote at the bottom here, he says, "Generating employment opportunities for many Americans who had not found jobs readily available in the past." That's what we were learning in 2019. One clear takeaway from these events was the importance of sustaining a strong job market, particularly for people from low and moderate income communities.

Now let's go to the next slide, please. Now I'm going to turn to all of that as background in leading to the update that the Fed issued in August 2020, the new statement on longer-run goals and monetary policy strategy. That statement really was a revolution, not an evolution, even though those two words have been used in reverse order to describe what might be the likely outcome. There were implications really taking on board the implications of the low neutral rate, the decline in R-star. The statement changed the ordering of the goals in how they were treated and written about in the statement to reflect the Federal Reserve Act.

I'm going to assert that that's exactly why the ordering of those goals were changed, and I know that some people have found that to be something that was surprising. I'm surprised by that reaction. It retained the 2% inflation goal in exactly the way it was defined before, but it added a provision saying that policy would aim to achieve inflation averaging 2% over time, the flexible average inflation targeting that was introduced. It would make up for persistent inflation misses, undershoots, and likely aim to achieve inflation moderately above 2% after a period of persistent inflation undershoots.

It was not intended to be symmetric. This updated statement doubled down on the importance of meeting the inflation goals for inflation expectations. There were also notable changes to the maximum employment language, all of which seemed to have been interpreted in some circles as elevating the priority of the goal. I would just say that some change along these lines should have been anticipated if you were listening to what the Fed was saying in minutes and speeches and monetary policy reports over particularly the last five years heading into 2020. Much of the original language was retained on the labor market around non-monetary factors and the inappropriateness to specify a fixed goal.

But a significant change was that policy decisions would be informed by shortfalls of employment from its maximum, not deviations, which was the word used in the 2012 statement. In addition, estimates of

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U-star of that median longer-run unemployment rate from the SEP were removed. I think perhaps reflective of the successive downward revisions over time and the lower reliability of U-star. And then finally, maximum employment was said to be a broad-based and inclusive goal.

And then finally I'll end here. There's no slide for this. In September and December following the release of the statement, the FOMC changed the forward guidance around interest rates and asset purchases to really implement it was more implementing language for this new statement. And so the Fed enters 2021 very specifically focused on problems of lower star and challenges for policy in that environment with a statement that's much more narrow, not as general as the 2012 statement. That leaves the FOMC exposed. To me it's very reflective of a specific mindset, and I'll leave it to Jon Faust to take it forward from here.

Michael Derby:

We'll move to the more recent history with Jon Faust from Johns Hopkins, also a former top Federal Reserve advisor. So onto you, sir.

Jon Faust:

Thanks Alan and Ellen for a very interesting prep. I missed the meeting where the portions of history were sliced up, and I ended up with the third section. I don't know whether to thank people for giving me the most interesting section or to complain a bit about getting the section that was probably most complicated and certainly the most raw in people's minds.

In August of 2020, as Ellen just said, the Fed adopted revisions to its policy framework, which explains how it thinks about the dual mandate. These changes were designed to address chronically low inflation. With more than a bit of irony, inflation immediately shot up, peaking in June of 2022 at over 7%, a four decade high. Inflation then promptly fell back and now stands just above the Fed's 2% target.

This tragic burst of inflation greatly challenged conventional economists inside and outside central banks. These folks very generally failed to predict the severity of inflation's rise and then seriously over-predicted the unemployment cost of bringing inflation down. Now when events occurred that are both confusing and tragic as these were, psychologists warn us that there's a natural tendency to grasp for a simple explanation, an explanation that reassures us that we actually understand the world pretty darn well and that with some simple steps we could have avoided the problems. You won't be surprised to hear that experts tend to suffer from these cognitive biases more than regular folks. I believe that this type of bias has infected the diagnosis about this inflation. In short, many have gravitated to the explanation that it was the Fed's adherence to its revised framework that kept it from responding appropriately to inflation. Without the revisions, the argument goes we could have much of the misery.

I don't believe this, but lest I fall victim to the cognitive biases of experts, let me simply state three conjectures for your consideration and then perhaps we can discuss more.

Figure two, please. Focus on the one-year period between March of 2021 and March of 2022. This was the period when the March of '22 was when the Fed began rapidly raising the policy interest rate. As you can see from the figure, the bulk of inflation arrived during this year I'm talking about. At the start of the period, however, inflation was just rising about 2% and the unemployment rate was still over 6%. I think it's very implausible that with or without the framework the Fed would've tightened policy significantly before March of 2021. My first conjecture then is that by this time, the die was already cast on the burst of inflation. Put another way, only Draconian and painful monetary tightening would've

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blunted inflation surge. This conjecture is broadly consistent with conventional views about the strength of and timing of monetary policies effects. Those effects tend to be weak and drawn out. Dave Reifschneider has recently provided some rigorous support for this conjecture using a conventional simulations and a conventional macroeconomic model.

My second conjecture then is the timing of policy firming was not significantly affected by the revised framework or by the forward guidance that Ellen's just discussed. As someone who participated in and was a close observer of the policy process over this period, I'm pretty confident of this conjecture. It's simply not the case that the FOMC foresaw the magnitude of the inflation that was coming but rejected doing something about it because it felt constrained by its framework or forward guidance. Indeed, for most of the year beginning in March 2021, the FOMC minutes and the policymaker projections suggest they saw no strong need to exploit the escape clauses that they had to get around the forward guidance and the framework document.

My third conjecture is that from liftoff onward, the FOMC got the disinflation roughly right, although I caution that this story is not yet complete. The FOMC rapidly raised the federal funds rate by 525 basis points and held it at that level for more than a year. I believe the strong reaction was very important for keeping longer term inflation expectations anchored and that this in turn helped inflation to fall with unemployment remaining near historic lows. In contrast to the predictions of conventional thinking, the unemployment rate never significantly exceeded standard estimates of its natural rate. Indeed, even in the face of policy restraint, the labor market continued to heal from the pandemic. For example, the prime age labor force participation rate rose from the start of the tightening through most of this year. It now stands near peaks last seen in the boom times of the 1990s. This has been a very successful disinflation.

The Fed is now embarking on another review of its policy framework and during this review competing conjectures about this period will I'm sure will be given thorough vetting by a wide range of interested parties. While I do not believe that the framework revisions played a central role, I do believe that some aspects of the framework have been difficult for the public to understand and that this may partially explain the blame the framework gets for the bought of inflation. Indeed, there are several aspects of the framework that I believe should be clarified, strengthened, and/or better explained to the general public.

That's my view, anyway. I'll be interested to hear how Alan and Ellen feel about these views, and I'd like to enjoy the discussion with the audience today on the same topics.

Michael Derby:

Great, excellent.

All right, well, great. Well, so we have moved into the present timeframe and we're doing so at a point in which the Fed is expecting next year to do its big framework review and look at how it implements monetary policy. Given the experience of the last few years or the period in which we've seen since the last framework review happened, I'm curious what kind of innovations or changes or modifications you expect to happen with the Fed's framework review. Is there anything that's going to happen in terms of the dual mandate, in terms of how it's communicated, specified? Any technical details around it? What are you looking for, or what kind of outcomes are you expecting from the upcoming framework review?

And so whoever'd like to jump in please, please do so.

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Alan Blinder:

I'll start.

I want to say at the outset Jay Powell did not whisper this in my ear, so it's not like I know or anything like that. This is just a guesstimate. I think they have taken so much slack from the asymmetry in the maximum employment, the shortfalls versus the deviations. Maybe they won't go back exactly to where they were before, but I think they're going to back off of that very substantially.

What I don't think they'll do is the other part of it, which Ellen was touched upon barely, is the FAIT, the average inflation over some unspecified period by some unspecified amount would bother them. My guess is they leave those unspecified and don't want to pin themselves down to... If inflation is above two point something for this many quarters or years, that will be a signal to tighten monetary policy. I don't expect that, but I do expect the backing off somewhat of the very dovish approach to the maximum employment piece that was embodied in the 2020 statement.

By the way I should add, I don't necessarily relish that. That's what I think they will do.

Michael Derby:

You do think FAIT survives in some form then, or flexible average inflation targeting that at least rhetorically that survives in some fashion?

Alan Blinder:

Yeah, I think so.

Michael Derby:

Okay.

Ellen Meade:

I think you could see though at the very beginning of the statement there are these sentences that basically define the risks around a lower neutral rate of interest. Now we have a lot of debate about whether the neutral rate of interest is higher either in the short term or could be higher in the long term. We have a lot of policymakers opining on that. We see increases in the longer run R-star that's in the summary of economic projections.

They might want to make clearer than I think the 2020 statement did the circumstances under which FAIT applies and the circumstances under which it doesn't and how they see the world there. I think I agree that I don't expect them to drop FAIT for persistent undershooting of inflation, but I know Powell would respond in press conferences sometime when asked about how the statement addressed too high inflation and he said, "Well, we just raised interest rates. We have the tools for that. We just raised rates." Somehow the balancing in the statement needs to be adjusted, I think.

On the maximum employment side, I kind of agree with Alan. I think there could be something around trying to explain when you think the Phillips curve might be flat and when you think it might steepen. Not using those words of course, but that I think there will be a backing off in some way around the changes to maximum employment, not broad based and inclusive. That's a statement of fact in my view or the reordering but in the shortfalls piece.

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Michael Derby:

Mr. Faust?

Jon Faust:

I'm going to agree that there'll be some modification around the unemployment shortfalls language.

I think mainly that I think like Alan I would hate to see it be too far backed away from that, but I think that they could clarify the meaning a good deal. If you take the meaning a little more narrowly, it doesn't have the same dovish ring. For example, it in no way forbids preemptive action to stem inflation based on the labor market. If you think that there's a Phillips curve that causes and low unemployment is going to cause inflation, you can go ahead and forecast inflation and base policy on that under this framework. That's pretty clear from reading the minutes. That's how people were thinking over this period, but I think this really needs to be clarified because otherwise it does sound awfully dovish.

Second, I consider this, I haven't thought this through as carefully as they will need to, but I try to think about removing the asymmetry about inflation by simply stating that if longer term inflation expectations appear to drift away from 2% in either direction, the committee will do what it takes to re-anchor them. Now, what people actually believe is that the reason they would drift away downward is because of the effective lower bound and there's not such a reason above, but it's still true. If the longer-run expectations drifted in either direction, the Fed would take the necessary steps. I think that that actually get you what you want without seeming to be so asymmetric.

Finally, I think the statement probably needs to mention asset purchases more than just saying the Fed will use its full range of tools. For the past 25 years, they've been the prominent part of policy and it's probably time that something explicitly is said about them. I don't know if that will happen, but I think it's time for it.

Michael Derby:

I track balance sheet issues a lot in QT and QE types of policies. Is there a way to bring into the communication of this of monetary policy? Is there a way to better link at balance sheet policies and not just interest rate policies as the Fed pursues its dual mandate?

Alan Blinder:

I'm not sure who you were addressing that to, but let me pipe in. Jon should certainly pipe in since he brought it up.

I think the QT, QE is pretty problematic in terms of getting anywhere close to numerical about that. Very problematic. Secondly, even problematic though you wouldn't know it if the only thing you read with things the Fed says about its effectiveness.

There is a school of thought with plenty of academic support, I wouldn't say uniform academic support but plenty, that says QE one, which came in to rescue dead markets from the grave when there was practically no buyer other than the Fed, was highly effective. But the other QEs maybe not much. I would offer that as a quasi consensus of the views of a lot of academics but not a Fed economist.

There's a fascinating paper by I think a quartet of authors, I can't remember their names now, that actually drew the distinction, looked at the studies of QE that came out of central banks and came out of academia and found this kind of divide there. The Fed is aware of that, that the very effectiveness not to

mention the numerical effectiveness, the multipliers are under some controversy. I don't think we'll want to put that in their framework in any way.

Ellen Meade:

I think another aspect of this one-year period that Jon focused on, and I totally agree with him, that when we're talking about it, we're focusing on that one-year period is the inaction that the Fed was exposed to in terms of interest rates because of the need to taper and then fully stop asset purchases before it lifted rates.

I mean, that to me is another bringing forward of a mindset that had been completely well tested and worked well in the 2014-2015 time range for lifting off but wasn't really appropriate here. I don't think the statement though is necessarily the right place to address that.

Michael Derby:

Okay.

A question I wanted to ask the panel. Throughout the effort to combat inflation, the Fed talked about balancing its mandates and when the two sides were in conflict or not in conflict with each other. Fed officials have also talked a lot about how the public really hates inflation. Inflation really, really drives people crazy, and I'm wondering if there's any experiential thing that's come out of the experience of the last few years with how inflation is an impacted sentiment and how people approach things that will make them change the weightings or the balancing of the two mandates going forward. I mean, does the experience of the last few years give them additional ammunition or desire to maybe weight it a little bit more in inflation control even if it brings less favorable employment outcomes?

Obviously, it was the fear that that was going to come to pass in the tightening cycle and it didn't. But going forward, do you expect Fed officials to weight the balancing act in any different way?

Jon Faust:

I think I don't expect it to be a lot different. I think that they'll take on board this experience with inflation, but that there's loosely speaking nothing wrong with the weighting. It wasn't the weighting of the two objectives I think that caused a problem in this case, and I'm if it ain't broke, don't fix it kind of guy.

Ellen Meade:

I think there's a tremendous public confusion around levels of prices and rates of change. We observed that through the election. I think Chair Powell said it really well in his most recent press conference. Prices went up. They're not going to come back down. We're not talking about an environment where we're going to generate deflation in order to return prices to that original level. It's just that people haven't had experience with inflation in a long time, so I agree with Jon.

Alan Blinder:

I certainly I was going to underscore that point.

I think one thing we all learned, and that includes Powell and his colleagues at the Fed, is that the price level matters to people more than we thought. We write models always it's the inflation rate, so bygones are bygones on the price level. It is what it is. We thought that was the right way to think about

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it. The language in the framework, even the earlier language in the 2010 language, and certainly the 2012 language and certainly the 2020 language is built around that, that the two evils are inflation and unemployment, not the price level and unemployment. I think at minimum there will be some rethinking of that as Fed staff and Fed decision-makers think about the framework. I don't think they'll change it to the price level, but it could be, as you were hinting Michael, that that winds up putting a bit more rhetorical weight and policy weight on inflation. Maybe through what Jon mentioned earlier, banging hard on inflationary expectations and just keep saying that all the time.

The other thing I wanted to add about that I'm among the many that were surprised that so much of the public attention went on the price level, not on the inflation rate. I mean, if you went around America now quizzing people on that up and down chart that Jon and Ellen both showed, is inflation back down to where it was before you were worried about inflation, they would say, "No, no, no, the price of eggs is whatever it is compared to whatever it was three years ago." People noticed that. It's not something we'd seen before. I've often pointed to the last big inflation Reagan was president. When he ran for reelection in 1984, inflation was down from its peak but not as low as it is now. People were not screaming about what the price of eggs were like three years ago. They just weren't.

Michael Derby:

We're coming up towards the end here, and there's a question from someone who's watching stream here about whether or not they change the 2% inflation target because that's been a matter of debate on and off at various points. Do you expect any changes in either part of the framework review or in any other time capacity or timeframe? Do you think they will change the target?

And maybe as an additional thing, as a communications thing, is there any space to better define in a numerical term, say, the employment part of the mandate?

Jon Faust:

I think there'll be no change in the 2% target whether there should be or not. I've heard a lot of people argue that the statement of longer-run goals and monetary policy strategy should actually make a case for 2%. Loosely speaking, that's a charge that says if you're not willing to change it, why don't you make a persuasive case that you should leave it where it's at? I think that they can make that case, but I don't think they're interested in changing the target.

Ellen Meade:

I agree with that.

Alan Blinder:

I agree with that as a prediction of what the Fed will do. I don't agree with it as policy.

I have said both in print and verbally on the air any number of times that I think they should change it to one and a half to two and a half, that it is being crazy to think that we could hit the second decimal point on the inflation rate. If you do one and a half to two and a half, you're not retreating from two. The markets are going to look at the middle and not see this as a big change.

But you won't get into the what to me was the craziness in the period that Ellen was talking about running up the very low inflation period. In those two, three, four years, the inflation rate averaged 1.7%

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and the Fed's getting all aggravated about that. No human being could tell the difference between 1.7 and two on the annual inflation rate, and if it was 1.5 to 2.5, nobody would've bothered with it.

Ellen Meade:

But that was really the argument I think was really around the accumulation of the undershoots over time on the level of prices, sort of similar to the argument that we've just spoken about.

I think though that now is a time that our putting a range around 2% could be entertained. When we were in 2020 and the committee did discuss this in the January 2020 meeting ranges, if one of the reasons for going to FAIT was because you were persistently undershooting and then at the same time you adopted a range that went from one and a half to two and a half, it's almost like you would be endorsing those undershoots. I think it was confusing at the time. If you think you're in a world of a persistently no neutral rate, you maybe wouldn't want to do it with two as the center, although I think now you might have more ability to argue it in the public sphere.

Michael Derby:

So then I guess this is the last question. Can they do a target unemployment rate or for the unemployment rate? Is that a possibility? Is there a way to do that, or is that just it can't be done?

Jon Faust:

I think they'll stick with the view that they have that it really can't be done. I think our confidence that it can be done if anything has been eroded over the last period, where we weren't certain where the natural rate of unemployment was. Our ability to measure that certainly hasn't been strengthened since Powell spoke of it in 2018.

Alan Blinder:

I'm going to both agree and disagree with that. I agree with the substance. I disagree with the words. The Fed is in fact publishing its estimate of the natural rate in the SEP four times a year. I read it four times a year and it does change.

Michael Derby:

Fair enough.

Well, we are a little over time here, so I think that is going to wrap it up. I really do appreciate the panelists' contribution. I think we've talked a lot about, I mean, this core issues for the Federal Reserve. With that, I will say thank you to the panelists and then move it over back to the Cleveland Fed.

Damjan Pfajfar:

Yeah, I want to say thank you very much for participating in this panel. We look forward to our next conversations. Thank you very much.

Alan Blinder:

Okay, thank you. Bye.

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Jon Faust:

Thank you.

Ellen Meade:

Bye.

Michael Derby:

Thanks.