Monetary Policy and the Economic Outlook

The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
Today’s Roadmap

• What is monetary policy, why does it matter, and to whom?
• What is the connection between the economy and monetary policy?
• What is the economic outlook?
Recent monetary policy has attracted the public’s attention.

Google Search Occurrences of “Federal Reserve Balance Sheet”

Source: Google Trends
Why does monetary policy matter to individuals or businesses?

• Monetary policy affects interest rates.
Why might the Fed adjust interest rates?
Interest rates have been pushed to historic lows in an effort to stimulate the economy.
Since the 2008-2009 financial crisis, the economy has been recovering at a modest pace.

U.S. Real GDP Growth

Source: Bureau of Economic Analysis and Blue Chip Forecast July 2014
Job gains are closely monitored.

U.S. Non-farm Payroll Employment

Change from previous month (thousands)

Source: Bureau of Labor Statistics
The unemployment rate has also steadily declined, but some indicators generate concern.

U.S. Unemployment Rate and Labor Force Participation Rate

Source: Bureau of Labor Statistics
Inflation has remained relatively low.

Personal Consumption Expenditures Price Index

Percent change from previous year

Source: Bureau of Economic Analysis
The Fed’s balance sheet continues to expand.

Federal Reserve Balance Sheet

Assets

Liabilities

Billion Dollars

Source: Federal Reserve Board of Governors
With QE winding down, there is a wide variation of beliefs about future short-term rates.

**Appropriate Pace of Policy Firming**

Target Federal Funds Rate at Year-End

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Source: Federal Reserve Board and CME Group
FOMC statements reflect an improving economy and views for the Fed Funds rate.

- August 1, 2012
  - “...economic activity decelerated somewhat over the first half of this year.”
  - “...[economic conditions] are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.”
- July 31, 2013
  - “...economic activity expanded at a modest pace during the first half of the year.”
  - “...a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens.”
- July 30, 2014
  - “...growth in economic activity rebounded in the second quarter.”
  - “...a highly accommodative stance of monetary policy remains appropriate.”
  - “...the Committee will assess progress—both realized and expected—toward its objectives of maximum employment and 2 percent inflation.”
Concluding Points

• The economy appears to be strengthening, albeit with some mixed signals.
• Monetary policy has shifted from date-based guidance to more qualitative guidance.
• With asset purchases winding down, attention to short-term rates will likely intensify.