

Are we ready for the next recession?

Jon Faust

faustj@jhu.edu

CFE/JHU/NBER

Is the Fed ready for recession

- Is the Fed aware of the risks?
- Is the Fed prepared to do what it can?
- Would the Fed's response be powerful and effective?

Is the Fed ready for recession

- Is the Fed aware of the risks?

Yes.

- Is the Fed prepared to do what it can?

Yes.

- Would the Fed's response be powerful and effective?

Only modestly so.

Bernanke 2013 re:fiscal cliff recession

‘I don’t think the Federal Reserve has the tools to offset that event’

Tools

- Things the Fed has tried
- Things the Fed has not tried
- Things folks talk about but are probably not legal

Tools

- Things the Fed has tried
- Things the Fed has not tried
- Things folks talk about but are probably not legal
e.g. helicopter drops

Things tried: forward guidance

- 'Prescriptive' forward guidance
- The idea: dictate policy to future FOMCs that they would not choose.
- This goes in the 'not tried' discussion

Things tried: forward guidance

- Information-only forward guidance
- Example: the thresholds
initiated Dec. 2012

The thresholds

□ —

the Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Underappreciated fact:

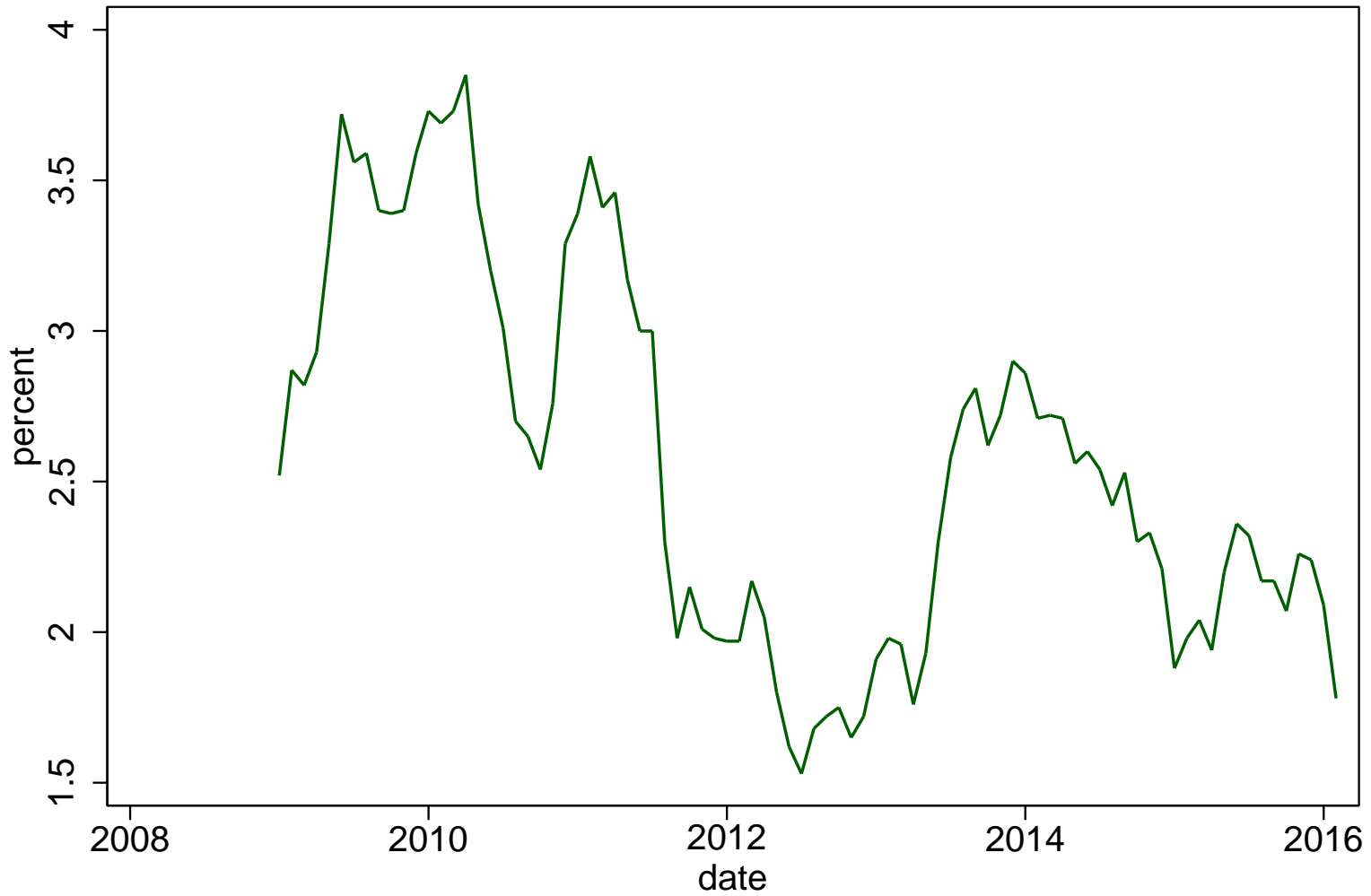
Information-only forward guidance only
ADDS accommodation at times when the
public misunderstands Fed intentions.

LSAPs

- Large-scale purchases of longer-term securities
- The idea: By increasing demand, you drive down the yield
- Is there still capacity?

Still capacity?

U.S. Treasury 10-year Yield



Bottom line on things tried

still useful; arguably a bit less potential than before.

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Things not tried

Prescriptive forward guidance

- Idea: promise an inflationary boom in the future when interest rates not zero.
- The idea: anticipating future good times, households and businesses spend more today.

Why not used?

- Requires private sector to ‘overextend’ itself today, having faith that future good times will come
- Many reasons to be dubious about whether public would do this
- Key reason: current FOMC can’t dictate future policy

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But worth a try if times got tough enough?
Sure.

Close cousins

- Price level targeting
- Nominal GDP targeting
- Raising the inflation target from 2 percent.

Not tried here: Negative rates

- On the table; not favored.

Helicopter drops

- **Peter Praet, ECB**

All central banks can do it. You can issue currency and you distribute it to people. The question is, if and when is it opportune to make recourse to that sort of instrument.

All central banks can do it?

- Central banks have mandates; most could not legally give away cash
- . . . but stealth helicopter drops?
various implicit or explicit subsidies to private sector

All central banks can do it?

- For the Fed: I'd check with the lawyers first.
- Much U.S. legislation has the clear intent of having the Fed operate at market prices and avoid implicit or explicit subsidies.

Bottom line

- Fed is not out of ammunition
- Can still provide meaningful support
e.g., modestly quicken the pace of the recovery
- Could try some of the 'not tried yet'
But there is a reason they have not been tried

Thus,

It'd be nice to have more powerful tools at the ready

subliminal hint: fiscal policy