Key Questions on the Path to “Normal”: The U.S. Case

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The view from the FOMC (as of December): Slow and steady goes the policy rate.

The red line is the median projection; shaded bars represent the “central tendency” of projections.

Sources: FRB FOMC Summary Economic Projections Dec 2017
The watch list

• Will inflation finally (b)reach the 2 percent longer-run target?

• How big a bump from tax reform?

• Whither r*?
A concern: If the inflation goal is 2 percent, we have running soft for 5 years.
An observation: If the inflation goal was 1.75 percent, the inflation rate of the past 5 years would look just about right.
Our survey indicates many businesses believe the Fed is most worried about inflation rising above 2%.

Source: Atlanta Fed Business Inflation Expectations (BIE) Survey, April 2017
Decomposing the recovery’s soft inflation numbers: Expectations, slack, import prices, and we just don’t know.

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve Bank of Philadelphia, Federal Reserve Board FAME Database,
Why was inflation below target in 2017: “We just don’t know.”

Notable: The contribution of import prices (the green areas) has been negative for nearly 5 years – substantially so as the dollar was appreciating.

Also notable: The contribution of ‘slack’ (the red areas) has disappeared.

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve Bank of Philadelphia, Federal Reserve Board FAME Database,
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The question: If passed in its current form, how would the Tax Cuts and Jobs Act affect your capital expenditures in 2018?

Results from the Survey of Business Executives, Nov. 13-24 2017

Percent of total responses

- Decrease by 10% or more
- Decrease by less than 10%
- No material change
- Increase by less than 10%
- Increase by more than 10%

Source: Federal Reserve Bank of Atlanta, Stanford University, University of Chicago.
Survey results: Positive responses to the capital expenditures skewed to smaller firms

Results from the Survey of Business Executives, Nov. 13-24 2017
Percent of responses indicating increases in planned capital spending

Source: Federal Reserve Bank of Atlanta, Stanford University, University of Chicago
Tax reform hits just as the U.S. economy is (arguably) entering the “high pressure” zone.

“High pressure” periods, where the unemployment rate falls below its natural rate.
Historically, “high pressure” periods have not ended well.
Beware the spurious correlation: Case study 2

Source: [http://www.tylervigen.com/spurious-correlations](http://www.tylervigen.com/spurious-correlations)
Worth noting: Historically, expansions have also ended (and inflation has risen) when oil prices spike.

Real Oil Prices
West Texas Intermediate

Note: Real oil prices calculated in 1982-1984 dollars using the consumer price index

Source: Bureau of Labor Statistics; Energy Information Administration; Haver Analytics through December 2017
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Another relevant picture? The term structure of interest rates

Laubach-Williams Estimate of $r^*$
annual percent

Source: This is the one-sided version of the Laubach-Williams estimate. For definitions and data sources see the documentation for the Federal Reserve Bank of Atlanta’s Taylor Rule Utility, https://www.frbatlanta.org/cqer/research/taylor-rule/?panel=1 through Q4 2017.
Another relevant picture? The term structure of interest rates

10 Year / 2 year Treasury Note Spread
percent

Source: Federal Reserve Board; Haver Analytics
data through January 31, 2018
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