Minutes of the Economic Advisory Panel Meeting

April 15, 2016

Present: William Dudley, Michael Strine. External Panelists: Alan Blinder, Julia Coronado, Marvin Goodfriend, Austan Goolsbee, Gita Gopinath, Jan Hatzius, Peter Henry, Peter Hooper, Anil Kashyap, Kenneth Rogoff. Guest: Peter Diamond (resident scholar). FRBNY staff: Tobias Adrian, Ozge Akinci, John Clark, Gerard Dages, Domenico Giannone, Linda Goldberg, Tom Klitgaard, Sandra Lee, Jamie McAndrews, Jonathan McCarthy, Meg McConnell, Alberto Musalem, Simon Potter, Richard Peach, Paolo Pesenti, Kevin Stiroh, Andrea Tambalotti, Robert Rich, Aysegul Sahin, Argia Sbordone. Other FRBNY staff, including counsel, observed the meeting.

Presentations on the economic outlook

The meeting started with a presentation on the FRBNY Staff Forecast followed by a presentation on the FRBNY Staff Nowcast.

Austan Goolsbee next provided his views on the staff forecast, focusing on some of the downside risks. Mr. Goolsbee raised four issues. First, the low growth rates of U.S. labor productivity over recent years have been a primary factor behind the solid performance of the labor market, suggesting that a pickup in productivity would restrain future employment growth. Second, multinational firms have been important contributors to U.S. investment spending, and thus a decline in global corporate profits might be a drag on future investment. Third, consumer spending appears to have been less responsive to increases in wealth than suggested by the historical relationship between the two variables, which might indicate continued household caution following the financial crisis. Fourth, another factor behind weak consumption may be that income has not recovered for many households with higher marginal propensities to consume. Mr. Goolsbee concluded by pointing out other risks, including those related to the uncertain outcome of the upcoming presidential election, and risks emanating from the global economy, especially from Europe, which might have a major impact on consumer confidence going forward.

Jan Hatzius followed with his discussion of the staff forecast. He first reviewed analysis suggesting that higher-frequency economic indicators are consistent with a stronger pace of economic growth than measured real GDP growth. Regarding global economic activity, he noted that the recent news has been more positive compared to a few weeks ago based on a Goldman Sachs' macroeconomic surprise index. He also noted that recent tighter U.S. financial conditions, primarily driven by the stronger U.S. dollar, have weighed on GDP growth since the second half of 2015, but the negative impact of this tightening would be expected to dissipate later this year. On inflation, Mr. Hatzius pointed out that underlying inflation has gradually increased over the past year according to a variety of measures. He also noted a tight correlation between inflation expectations measures and gasoline prices, especially in recent years. He concluded that expectations have not become unanchored, but rather that their measurement might have been distorted by the sharp fall in energy prices. Finally, he pointed out that these combined factors suggest that inflation might approach mandate-consistent levels with some momentum, which might require a significant tightening of financial conditions to slow the economy towards its sustainable trend growth rate.

General Discussion

In the general discussion of the economic outlook, several panelists expressed concern about the slowdown in productivity growth over recent years and its implications. Others pointed out that, as economic slack diminishes, firms should increase capital investment, leading to higher labor productivity growth. Panelists then discussed the interpretation of the low level of compensation growth in light of weak productivity growth, which might in part mask the positive effects of reduced slack on wages. One panelist noted the apparently small response of consumer spending to lower gasoline prices, which might represent an upside risk to the forecast if this small response reflects a temporary delay.

One panelist suggested that dollar appreciation should not be overemphasized as the sole source of weakness in U.S. exports, since the exchange rate and exports are determined by global factors such as global aggregate demand. Another panelist argued instead that exports recently have been weaker in the U.S. than in other countries, suggesting that dollar appreciation was indeed an independent factor slowing the U.S. economy. One panelist expressed concern with inflation expectations creeping lower and their possible impact on inflation, and was skeptical of the benign interpretation of attributing the decline in inflation expectations measures to the recent fall in gasoline prices. Several panelists highlighted the recent slowdown in emerging economies as a significant drag on the U.S. economy. Some panelists noted that political risks in Europe, especially connected with the June referendum in Britain, represent further sources of uncertainty for the U.S. outlook.

The conversation then moved to panelists' views on monetary policy issues. The panelists coalesced around two basic views. On the one hand, many panelists saw the risks to the U.S. outlook as mostly skewed to the downside, pointing to international developments as the main source of those risks. Some of these panelists also took a negative signal from low measures of inflation expectations, indicating that the U.S. and world economies suffer from an excess of supply that requires a slow process of structural adjustment to be absorbed. Given the fragility in the global economy, the prospect for continued policy divergence between the U.S. and other advanced economies could contribute to renewed turbulence in financial markets. Therefore, these panelists expressed the view that increases in the federal funds rate should be extremely gradual. On the other hand, some panelists viewed the cyclical position of the U.S. economy more positively and assessed the risks as more balanced. They saw relatively little slack remaining, and inflation starting to show some signs of rising toward mandate consistent levels. With financial conditions relatively stable, they expected that policy normalization would need to proceed somewhat more rapidly to achieve a soft landing.