

Summary of Panel #2: “Transmission of Monetary Policy to the Economy: Beyond the Headlines”

Date: June 5, 2019

Moderator: Eric Rosengren (President, Federal Reserve Bank of Boston)

Panelists: Janie Barrera (President and CEO of LiftFund), David John (Senior Policy Advisor at AARP Public Policy Institute), Maurice Jones (President and CEO of Local Initiatives Support Corporation), and Holly Wade (Director of Research and Policy Analysis at the National Federation of Independent Business)

Summary Prepared by: Antulio N. Bomfim, Senior Adviser in the Division of Monetary Affairs, Board of Governors of the Federal Reserve System

This session assembled a panel on the transmission of monetary policy to the broader economy. The panel was intended to provide non-economists’ perspectives on how monetary policy affects different segments of the U.S. population. The panel began with brief introductions from each of the panelists, followed by a discussion led by moderator President Eric Rosengren.

Panel Discussion

How do people feel the transmission of monetary policy? When the FOMC is raising short-term interest rates, how does that affect your constituencies?

From the perspective of community development financial institutions (CDFIs)—organizations that rely on donations and investments from other entities to fund their lending to financially underserved or low-income constituencies—Ms. Barrera and Mr. Jones emphasized that the level of interest rates matters a great deal. Banks pursuing their community development goals are an important source of CDFIs’ funding, and the cost of that funding is a key consideration for CDFIs. In particular, when market interest rates rise, CDFIs have to either pass on their higher cost of capital to their constituent borrowers or rely more on donations to help defray that cost. At times, higher interest rates result in higher revenues for CDFIs’ donors, which in turn can lead to increased donations, but that benefit needs to be weighed against the possibility that some projects will not get off the ground if their financing costs cannot be kept low enough for CDFIs’ constituencies.

The discussion also addressed some of the potential benefits and costs of higher interest rates to current and future retirees. Mr. John remarked that the low interest rate environment of the past several years has had a decidedly negative impact on earnings on retirement savings. In particular, for a given retirement goal, lower returns on fixed-income investments have required individuals to save a greater share of their income than in previous decades, although, to some extent, the negative implications of this development have been offset by historically low borrowing costs. The discussion also highlighted that individuals are now generally going into

retirement with more debt than in the past, potentially leaving them vulnerable to future interest rate increases.

Addressing the question through the small business lens, Ms. Wade remarked that, although the cost of funding is now a little higher than in the recent past, what matters most for small business owners is the return on investment for the projects they are interested in. While access to credit is generally a lifeline for small firms, she noted that—with the economy currently strong—small businesses' main source of funding has been earnings and profits, with small changes in the general level of interest rates being much less of a concern.

An important part of monetary is not only the actions the Fed takes, but also how the Fed communicates its actions. How do people understand what the Fed does? How can the Fed do better?

The discussion started with a focus on small businesses. Ms. Wade said small business owners rely on radio and TV as their main sources of financial and economic news and, as a result, as their main filters for understanding Fed announcements and actions. Other media were also mentioned; Twitter, in particular, is becoming an increasingly important form of communication. Nonetheless, it was noted that, in general, understanding Fed actions can become very confusing very quickly, given that there is so much uncertainty out there about what the Fed did and why. Ms. Wade noted that NFIB communicates with its membership about interest rates and Fed policy.

With regard to specific Fed communication practices, Mr. John suggested that the Fed's postmeeting policy statement could be improved by clearly reporting in its opening sentences what policy action was taken at that meeting. Instead, the Fed's current practice forces readers to search for the policy action somewhere in the middle of the statement. Still, the discussion acknowledged that most people do not read the statement and will, at best, read about it in the press. As a result, it is important to educate the press on the Fed and the rationale for its monetary policy actions. Ms. Barrera and Mr. Jones emphasized the need to tailor the policy message to different audiences, noting that what works for an academic or professional audience will not necessarily reach the general public. They also highlighted the importance of community events for explaining what the Fed does and why that matters.

In their communications with their own constituencies, all the panelists mentioned their reliance on a variety of media, ranging from email, Twitter, YouTube, and webinars to radio, TV, print-media, and in-person events.

How do people think about the availability of credit? Which one affects your membership more, cost or availability of credit?

Ms. Barrera remarked that, for most financially underserved or low-income communities, bank credit is not an option; it is simply not available in many cases. Those communities either live in a cash-only economy or rely on higher-cost financing alternatives. As a result, for these

communities, the main issue is access to credit at a rate that is not prohibitive. Mr. Jones noted that both price and access are important: the cost of credit is the key consideration for the financing associated with real estate or housing projects, whereas access is the most important consideration for individuals with negative or zero net worth.

With regard to individuals who are in or nearing retirement, Mr. John emphasized that, in the current environment of low interest rates, access to credit has been a more important factor than the price of credit. He noted, for instance, that older individuals are increasingly taking out mortgages that they will carry well into retirement.

Referring to small businesses, Ms. Wade noted that being able to access credit when needed is crucial. While the cost of credit certainly is a factor, changes in that cost can typically be absorbed by businesses, provided they expect reasonable returns on the projects that they are undertaking.

How does your membership think about the tradeoffs between the Federal Reserve’s two goals of low inflation and maximum employment?

Ms. Wade highlighted that having a predictable foundation for inflation is critical for most small business owners. With employment conditions reflecting so many factors that are not directly affected by the Fed, it becomes especially important for the Fed to keep uncertainty on the inflation front to a minimum. That said, she noted little indication that inflation is currently a major concern for small businesses. For instance, while surveys of small businesses show some upward pressure on compensation, businesses have been able to absorb much of that pressure.

Those in the CDFI community offered a different perspective on the relative importance of the Fed’s two goals. Mr. Jones pointed to employment as the best tool for fighting poverty, emphasizing that the prolonged period of low unemployment that we are experiencing has given low-income people a better chance of becoming employed and, as a result, of improving their longer-term economic prospects. He noted that businesses are now digging deeper into the potential hiring pool—bringing in people they would not hire otherwise—and added that many in the CDFI community are skeptical of the fear of high inflation down the road as a direct result of today’s low unemployment numbers.

Mr. John indicated that older Americans might also be more attuned to the Fed’s maximum employment objective than to its inflation goal. Employment was said to have become a more important issue for the current generation of older Americans because they are now retiring later than previous generations. At the same time, older Americans were characterized as being unlikely to see a small overshoot of the Fed’s inflation target as a serious problem, although those living on fixed incomes would be adversely affected if inflation were to rise substantially.

Referring to the population as a whole, Ms. Barrera noted that most people might not know what inflation is, or how high it is, but they certainly do notice when the prices of the goods and services that they buy start rising.

How do you think about longer-term interest rates vs. short-term interest rates?

Ms. Barrera and Mr. John commented that long-term rates matter more than short-term interest rates because the former determine the return on investments. Mr. Jones noted that shorter-term rates are also important because LISC borrows short term. Ms. Wade discussed surveys suggesting that small businesses attach similar importance to short- and long-term rates.

Questions from the audience

Neil Kashkari (President, Federal Reserve Bank of Minneapolis) asked whether Mr. John's constituents at AARP see the economy as being at maximum employment. Mr. John responded that there is still a significant number of older Americans who would like to have a job and, thus, at least from that perspective, the U.S. economy had not yet reached maximum employment.

Jared Bernstein (Center on Budget and Policy Priorities) asked about people who remain out of work even in a very tight labor market and whether there could be a role for government as employer of last resort. Mr. Jones remarked that, even in the current environment, there could be a role for the government to play in offering employment opportunities for those with the poorest employment prospects, but only if those opportunities were focused on providing skills that would allow individuals to move on to sustainable employment in the broader economy.

Randy Kroszner (University of Chicago) followed up about what the broader public understands about inflation and what inflation measures, and whether economists could use clearer vocabulary to communicate in layman's terms. The panelists offered various suggestions regarding the challenges associated with communicating economic concepts to the general public. The suggestions ranged from creating blogs aimed at explaining basic principles to reiterating the importance of getting to know one's audience.