



## MAIDEN LANE DIVISION: 2019 Case Study

### I. Your Role

You are a senior economist at the Federal Reserve Bank of New York, and are tasked to prepare a monetary policy recommendation for the upcoming Federal Open Market Committee (FOMC) meeting in a few weeks. Use the information on current economic conditions described below and your understanding of various economic relationships to inform your analysis.

### II. Hypothetical Scenario

#### GDP

As measured by nominal GDP, economic growth has been moderate to slow in past quarters. However, the most recent data shows stagnant and even decreasing nominal GDP numbers. Real GDP is running below potential GDP, and decreasing. Personal consumption expenditures and gross private investment are flattening or declining. Table 1 presents nominal GDP data over the last three years, while Table 3 shows changes in real GDP. The underlying contributions to overall GDP are shown in Table 2.

#### Labor Market

The labor market has been changing over the last three years. Jobless claims are increasing, and the unemployment rate stands at 6.1 percent. Labor force participation is flat, and the employment to population ratio has fallen to 61.9%. Table 4 presents the unemployment data in more detail.

Consumer confidence in the economy has followed an up and down pattern, from a high of 96.9 sentiment several quarters ago to a recent low of 56.4. However, consumer sentiment has improved considerably in just the past few months, climbing to 70.3, indicating consumers are reporting increased confidence in the economy. Historical trends in consumer sentiment can be found in Table 5.

## Inflation

In recent months, inflation data has changed substantially. Core PCE inflation stands at 2.11, which is slightly above the Federal Reserve System's two percent inflation target. Headline and core measures of inflation over the last three years are provided in Table 6.

## Housing and Manufacturing Data

Production components of the economy include housing and manufacturing. Monthly housing starts for multi-family units seem to increase and decrease somewhat cyclically over the time period, but have fallen to 276 thousand units in the latest reporting data. For much of the reporting period, capacity utilization in manufacturing was stable, but recent months have exhibited a downturn.

Data for these indicators can be found in Table 7 and Table 8.

## Monetary Policy

The effective federal funds rate in the market is shown in Table 9.

### **III. Policy Analysis**

When conducting your analysis, it is always good to keep the overarching goal of monetary policy in mind. This goal is often referred to as the dual mandate, or specifically, the goals of maximum employment and price stability. There are often tensions between these two goals and your role as an economist is to understand how to achieve one without compromising the other.

The hypothetical scenario above described several economic indicators from various sectors of the US economy. A rule of thumb when trying to understand the data (or any type of data) is to ask yourself the following questions:

- What is the data trying to say?
- How will the data inform me about the dual mandate of price stability and maximum employment?
- How will my policy recommendation affect these two goals?

Even the most seasoned central bankers have to keep these basic questions in mind, and it is a good idea to develop this habit. This is especially useful since you will certainly encounter numerous economic indicators and data series coming from various sectors of the US economy, and sometimes even the global economy.

To further guide you with your analysis, use the focus questions below and the accompanying Primer on Monetary Policy.

- What is the overall state of the economy? Are there specific aspects of the economy contributing to the level of growth?
- Why should the Federal Reserve System monitor the different components of GDP?
- What is the condition of the labor market? Why do workers enter and exit the labor market?
- What is the current inflation rate? What factors are affecting the price level? Why should the Federal Reserve System be concerned with the difference between core and headline inflation?
- What is the current household outlook observed in the data and what is the role of consumer confidence in the macroeconomy?
- Given the Fed's dual mandate and your analysis of the economy, what policies would you recommend that the Fed implement?
- How would the Fed implement its monetary policy? What conventional tools does the central bank have at its disposal, and which tools would you use for your policy?
- What is the monetary transmission mechanism of your policy? Specifically, what are the goals of your policy given the scenario above, and how does the policy achieve these goals?