



MAIDEN LANE DIVISION: 2020 Case Study

I. Your Role

You are senior economists at the Federal Reserve Bank of New York, and will prepare a monetary policy recommendation for the upcoming Federal Open Market Committee (FOMC) meeting in a few weeks, based on the economic case data provided. Use the economic data, the Primer on Monetary Policy, and the focus questions below to inform your analysis and make your recommendation.

II. Economic Indicators

GDP

Table 1 and Chart 1 present nominal GDP data over the last three years, while Table 3 and Chart 3 show real GDP and potential GDP. The underlying contributions to overall GDP are shown in Table 2 and Chart 2.

- What do nominal GDP, real GDP, and potential GDP each measure? Why might real GDP and potential GDP be different?
- What is the overall state of the economy? Are there any specific aspects of the economy contributing to the level and pace of growth?
- Why should the Federal Reserve System monitor the different components of GDP?

Labor Market

Table 4 presents the official unemployment rate, the labor force participation rate, the employment to population ratio, and the initial claims for unemployment insurance. Charts 4.1, 4.2 and 4.3 show these data graphically.

- Based on this information, what is the condition of the labor market? Why do workers enter and exit the labor market?
- Why is it important to use and compare these different measures? What does each one tell you?
- Is unemployment a leading or lagging indicator? How can you use this to understand economic trends?
- Why are labor market conditions important to the Fed when making monetary policy decisions?

Inflation

Two price indices measuring inflation are personal consumption expenditure and consumer price index. Headline and core measures of inflation over the last three years are provided in Tables 6 and 7, and Charts 6 and 7.

- Is it important to compare headline and core price indices? What does each one tell you?
- Based on core PCE deflator data, what is the current inflation rate? Do you expect it to change? Why or why not?
- What factors might affect the price level?
- Why are the CPI and PCE price indices different? Which one does the Fed focus on when making monetary policy decisions? What is the Fed's target inflation rate?

Consumer Sentiment

One measure of consumer sentiment and expectations of the economy is the University of Michigan's Consumer Sentiment Index. The data trend in consumer sentiment can be found in Table 5 and Chart 5.

- What is the current household outlook, according to the data?
- What is the impact of consumer sentiment on prices? What is its impact on other parts of the economy?
- Is consumer sentiment a leading or lagging indicator? How can you use this to understand economic trends?

Housing Starts and Manufacturing Data

Different components of the economy include housing and manufacturing. Monthly data for the number of new privately owned housing units and manufacturing capacity utilization in the economy can be found in Table 8, Chart 8, Table 9, and Chart 9.

- What type of good is housing?
- How can the housing market influence the direction of the economy?
- What does the manufacturing capacity utilization data tell you about the economy?
- Is housing a leading or lagging indicator? What about manufacturing capacity? How can you use these to understand economic trends?

Monetary Policy

The effective federal funds rate is the interest rate depository institutions charge each other for overnight loans. These numbers can be found in Table 10 and Chart 10.

- What changes has the Fed made to the federal funds rate over the last three years?
- What is your recommendation for monetary policy? Should the federal funds rate increase, decrease, or remain the same? Why?
- What do you expect to happen in the economy after your recommendation is implemented?
- How does your recommendation achieve the Fed's monetary policy goals?

III. **Monetary Policy Recommendation**

When you prepare to present your analysis, consider the following:

- Have we clearly stated our monetary policy recommendation?
- Have we summarized the key issues affecting this economy?
- How do the data support our story?

We look forward to hearing your thoughts, senior economists of the Federal Reserve Bank of New York. Best of luck – the economy is counting on you!