

US MONETARY POLICY GOES INCLUSIVE

Over the past 10 years, fostering inclusive growth has moved higher up the agenda of governments, international institutions and, increasingly, companies. Under Chairman Powell, it has become a key topic for the Federal Reserve through the focus on the heterogeneity of the labour market situation of different socio-economic groups. It has led to the view that pre-emptive tightening based on a declining unemployment rate is unwarranted. On the contrary, it may very well stop people from finding a job. It will be interesting to see whether other central banks and in particular the ECB in the context of its strategy review, will follow in the Fed's footsteps.

Inclusive growth can be defined as "growth that is both sustainable and broad-based in terms of employment opportunities"¹. Over the past 10 years, fostering inclusive growth has moved higher up the agenda of governments, international institutions and, increasingly, companies

Under Chairman Powell, it has become a key point of attention of the Federal Reserve. Powell's introduction to the press conference following the latest FOMC meeting perfectly illustrates the focus on the heterogeneity of individual situations: "The economic downturn has not fallen equally on all Americans, and those least able to shoulder the burden have been hardest hit. In particular, the high level of joblessness has been especially severe for lower-wage workers in the services sector, for women, and for African Americans and Hispanics."² This focus was also an integral part of the Fed's strategy review.

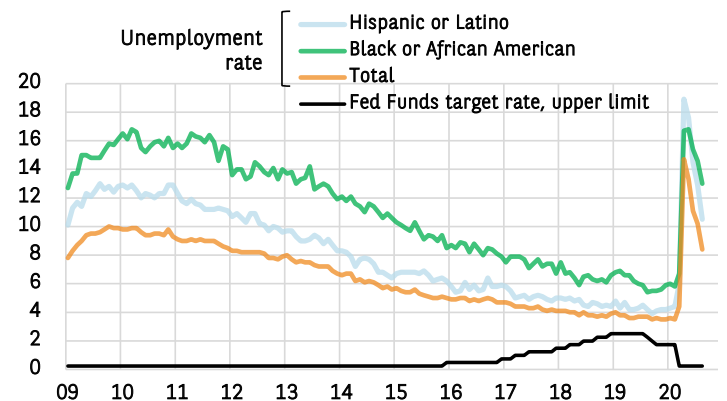
To this end, between February and October 2019, a large number of 'Fed Listens' meetings have been organised throughout the United States allowing a cross-section of American society to express views on the economy, inflation, monetary policy, etc.³ The insights are fascinating to say the least and reveal the gap between theoretical concepts like the Phillips curve or the natural rate of unemployment and the reality on the ground. Participants wondered why the labour market was characterised as 'hot' while in their own communities unemployment remained structurally high.

Business representatives explained they had developed training programmes to cope with recruitment difficulties in a tight labour market. Interestingly, raising wages was not considered as a means of attracting and retaining workers. Rather, the emphasis was put on training programmes, health care, or other benefits. Another striking observation was the fact that inflation was less discussed than the labour market. Against this background, the change in the longer-term strategy of the FOMC is all the more understandable. "A robust job

market can be sustained without causing an outbreak of inflation"⁴. To put it technically, when the Phillips curve is flat, a decline in the unemployment rate is insufficient a reason to tighten monetary policy because this decline does not convey information about the future development of inflation. The central bank can afford to wait before tightening policy. In the old days, when the Phillips curve was upward sloping, rate hikes were pre-emptive. Alan Greenspan's preferred metaphor was that of bringing an oil tanker to port, a manoeuvre which needs to start well before seeing the harbour. Now, monetary policy can be reactive with central bankers waiting to see a sufficient pick-up in inflation before getting into action.

4. New Economic Challenges and the Fed's Monetary Policy Review, Remarks by Jerome H. Powell, Chair Board of Governors of the Federal Reserve System at "Navigating the Decade Ahead: Implications for Monetary Policy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, 27 August 2020

US: UNEMPLOYMENT RATE VS FED FUNDS RATE



SOURCE: BLS, FEDERAL RESERVE, BNP PARIBAS

1. De Mello, L. and M. A. Dutz (eds.) (2012), *Promoting Inclusive Growth: Challenges and Policies*, OECD Publishing

2. Federal Reserve, Transcript of Transcript of Chair Powell's Press Conference, 16 September 2020

3. Fed Listens - Perspectives from the public, June 2020 provides a detailed report (131 pages) on the results of this project.

Under Chairman Powell, inclusive growth has become a key topic for the Federal Reserve through the focus on the heterogeneity of the labour market situation of different socio-economic groups. It will be interesting to see whether the ECB, in the context of its strategy review, will follow in the Fed's footsteps.



There is little or no downside in doing so. On the contrary, this approach allows people to enter the labour market which otherwise would not have found a job or would not even have considered joining the labour force. For a central bank like the Federal Reserve with a double objective, this is an important consideration. When the natural rate of unemployment cannot be determined with a sufficient degree of confidence and when the relevance of the concept is put in question due to the flatness of the Phillips curve, monetary policy should focus on inflation directly, rather than on labour market indicators.

On 21 October, the ECB will organise its own 'listen' event during which President Christine Lagarde and Chief Economist Philip Lane will meet with representatives from a range of European-level civil society organisations⁵. It is part of the work conducted in the context of its strategy review. One can assume that the 'ECB listens' event will provide insights, which have a lot in common with those of the 'Fed listens' events. The more important question is whether and how this will influence the decisions at the end of the ECB's strategy review. Although the ECB only has an inflation objective, a labour market which is functioning in an optimal way –which can be defined as high employment levels across regions and socio-economic categories– should facilitate reaching the inflation objective. Considering that there are dedicated workstreams on climate change and globalisation, which are closely linked to some aspects of inclusive growth, one can hope that the heterogeneity of labour market situations –another key dimension of inclusive growth– will also be taken on board in the discussions.

William De Vijlder

5. Source: ECB website

