

CAN THE FED CONTROL INFLATION AND MAINTAIN FULL EMPLOYMENT?

Story 2

Data 608

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HAS THE FED FULFILLED ITS DUAL MANDATE?

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The Federal Reserve's **dual mandate** from Congress is to control inflation and to maintain low unemployment.



The **federal funds rate** is the average interest rates at which banks trade federal funds with each other.



The Fed can **raise interest rates** to slow the economy and **bring inflation down**.

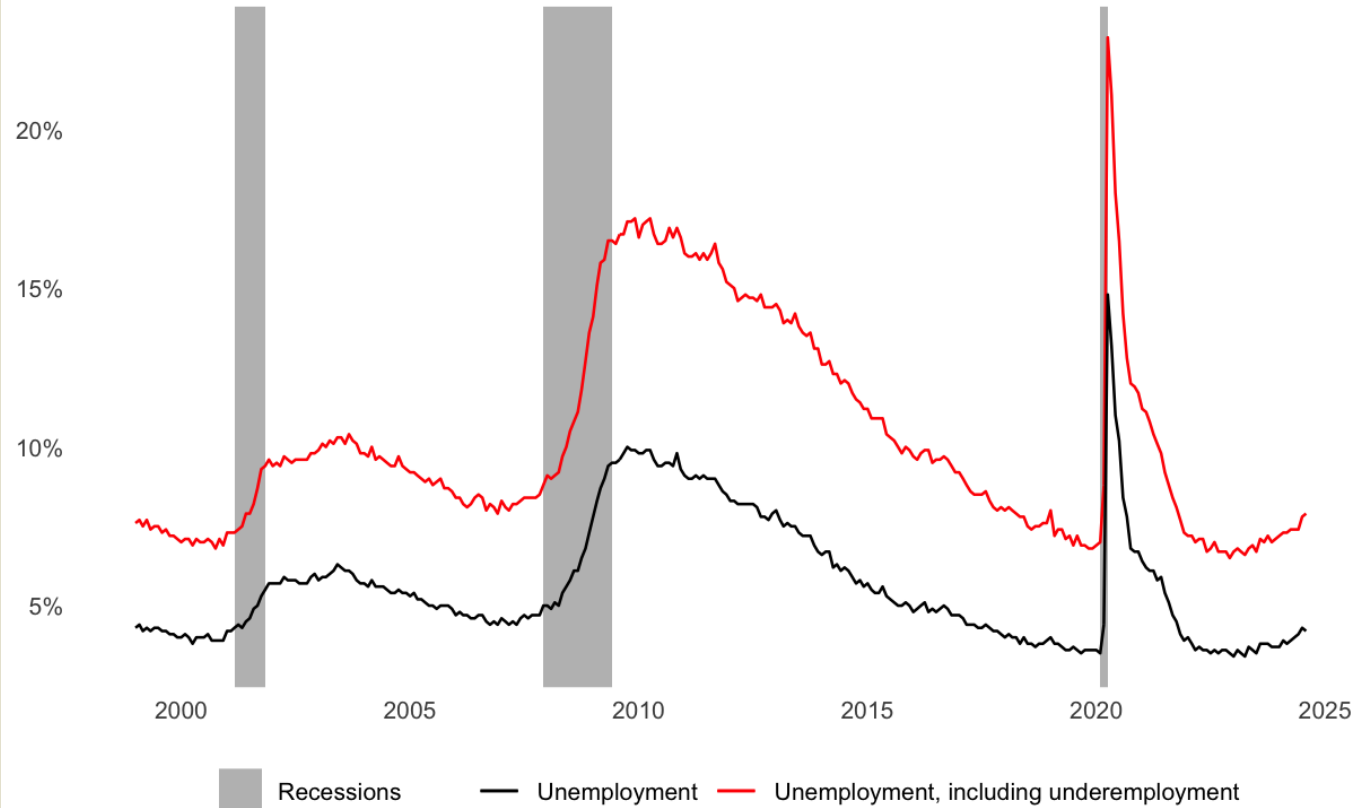


The Fed can **lower interest rates** to make it cheaper for businesses to borrow money, which can **lead to more hiring** and higher wages.

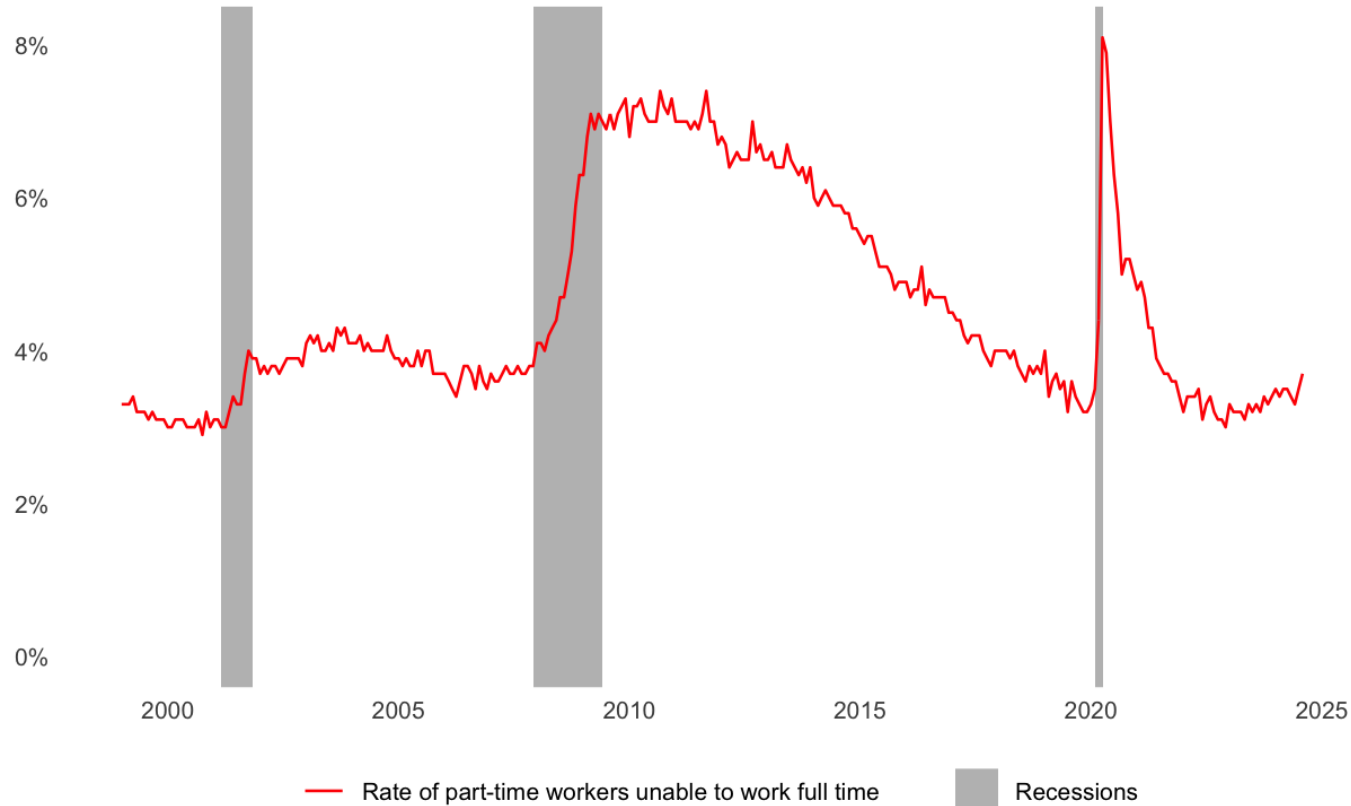
This broader employment measure, U6, includes the underutilized **part-time workers who would prefer to work full time**, as well as **individuals who are too discouraged to try to find work**.

The Fed **does not take underemployment into account** when adjusting the Federal Funds Rate.

The real unemployment rate is higher than the official rate, which fails to capture labor market slack.



The FED was unable to keep underemployment low, especially after the Great Recession.



Underemployment spiked during recessions and remained elevated long after (breached pre-crisis level of 4% at the end of 2017).

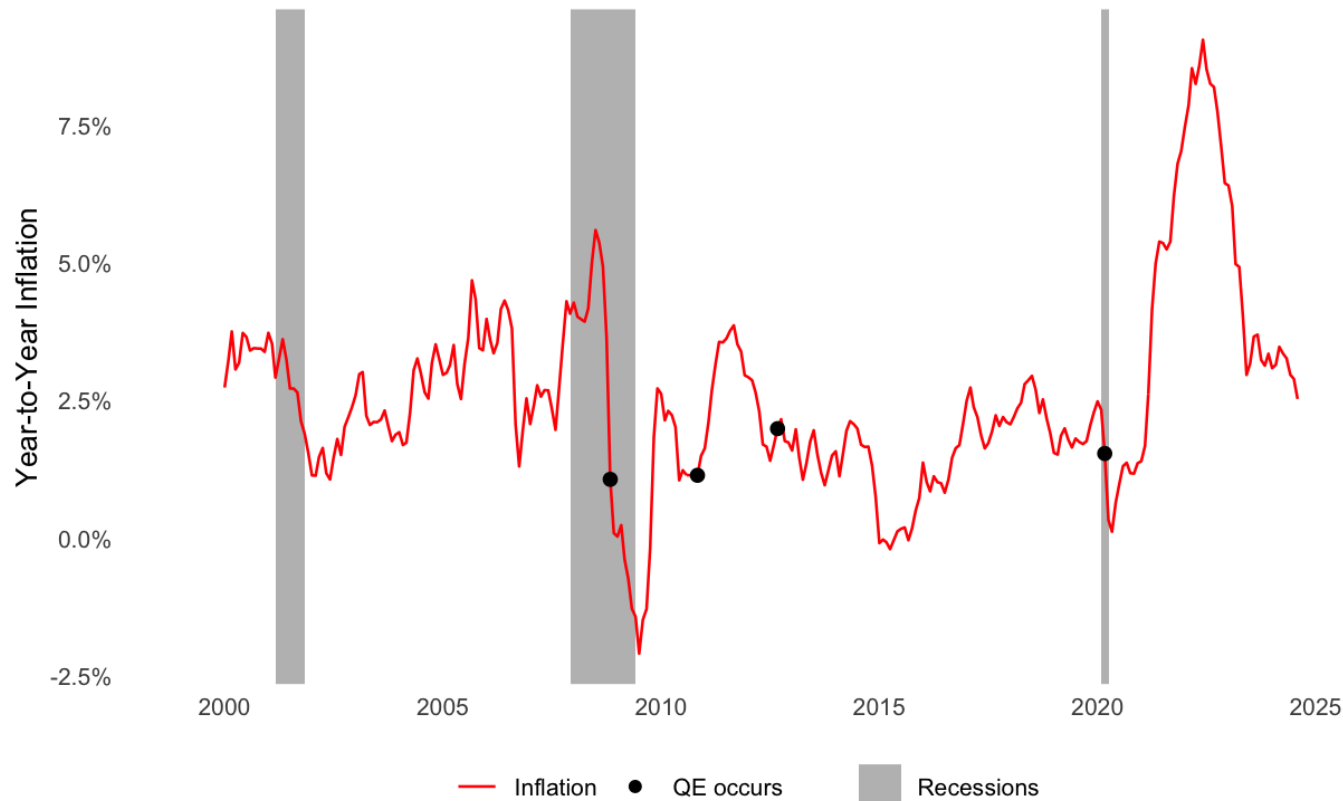
Could the FED have lowered rates further to combat unemployment?

Federal interest rates bound by zero inhibit the FED from performing effective monetary policy.



- No, the Fed could not have lowered interest rates further to combat persistent unemployment and underemployment.
- Monetary policy becomes ineffective in stimulating the economy when rates approach zero (a **liquidity trap**).
- The Fed raised rates in 2015 before underemployment had fully recovered.

Quantitative easing may cause inflation.



- **Quantitative easing (QE)** is a novel monetary policy tool.
- With rates already low, the Fed injected trillions into the economy by buying assets.
- QE mainly inflated asset prices as banks invested in the stock market.



CONCLUSION

No, the FED has not fulfilled its dual mandate.

- It was unable to keep unemployment low and neglected persistent underemployment when deciding to raise rates again.
- When federal interest rates were already low, injecting money into the economy using QE caused inflation without significantly reducing unemployment.

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