Title: **THE EQUILIBRIUM REAL FUNDS RATE: PAST, PRESENT AND FUTURE**

Speaker: **Kenneth D. West, University of Wisconsin**

Importance: Why this matters:

The macro-economists' consensus is that we are heading towards a "new neutral" Federal Reserve policy, an era of lower equilibrium real Fed funds rate. The authors analyze past behavior of the real short-term interest rate to develop and estimate of the prospective equilibrium value – full employment and stable inflation – of the real rate 5 to 10 or 12 years from now.

The New Keysenians relate consumption growth to trend or equilibrium growth rates. Unfortunately, the historical interplay between economic growth/consumption and Fed funds rate is tenuous, leading toward a policy of heading toward a rate of 2-4%. Uncertainty about equilibrium suggests that the Fed should prefer later and steeper normalization of the Fed funds rate.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."

The paper looks at developed market data going back as far as 150 years, including discount rates, commercial paper rates and Fed funds rate. The data show decades long swings in nominal and real rates. Looking at seven peak-to-peak periods since 1969 shows that GDP growth occurred when real rates were 1, 3, and 5 percent. Not very helpful to forecasters.

Innovation: Are there new techniques of interest in the data or approach to the problem?

Unfortunately, the data do not lead to strong empirical relationships. Other factors, difficult to isolate, play a large, perhaps dominant relation to real rates. Intuition abounds where formal analysis flounders. According to the authors, it's a tough time to pin down an equilibrium rate.

Insights: 1-2-3, what are the three most important things the speaker offered?

1. If you're uncertain move slowly.
2. An "inertial" rule that puts more weight on lagged rates leads to adaptive policies that depend on observed inflation and employment rates.
3. When the starting point for funds rate is zero, an inertial policy yields a later but steeper normalization. In the authors' opinion, the risks to global growth and inflation suggest that hiking rates too early is riskier than hiking too late.

Audience rating: 3.04