Osher Lifelong Learning Institute, Winter 2026

Critical Economic Topics for 2026

Bradley University

Host: Jon Haveman, Executive Director
National Economic Education Delegation

Course Schedule

The Economics of Public Policy Issues

- Week 1 (2/04): Economic Update, Geoffrey Woglom, Amherst College
- **Week 2 (2/11): Monetary Policy, Geoffrey Woglom, Amherst College**
- Week 3 (2/18): U.S. Federal Budget, Jon Haveman, Executive Director NEED
- Week 4 (2/25): International Institutions, Alan Deardorff, University of Michigan

Monetary Policy & The Fed

Geoffrey Woglom
Amherst College, emeritus
National Economic Education Delegation
February 11, 2026

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Submitting Questions

- I encourage questions. Raise your digital hand or put questions in the chat
- We will do a verbal Q&A once the material has been presented.
- Slides will be available from the NEED website tonight https://needecon.org/delivered_presentations.php.
- My Google site: https://sites.google.com/view/macro-current-issues/home

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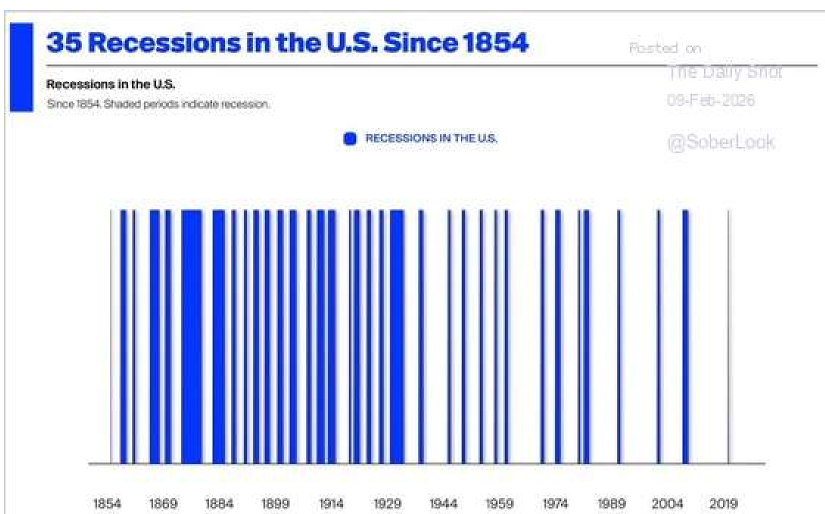
Outline

- Facts about the Fed; and its historical performance.
- The short-run determinants of inflation and unemployment.
- The Fed's policy tools.
- Central Bank Independence: what it is and why it is important.
- Where does the Fed go from here: until May and after?

Cool Slide: On Why We Need a Central Bank



Source: https://x.com/MichaelAArouet

The Evolution of the Fed's Role in the Macro Economy

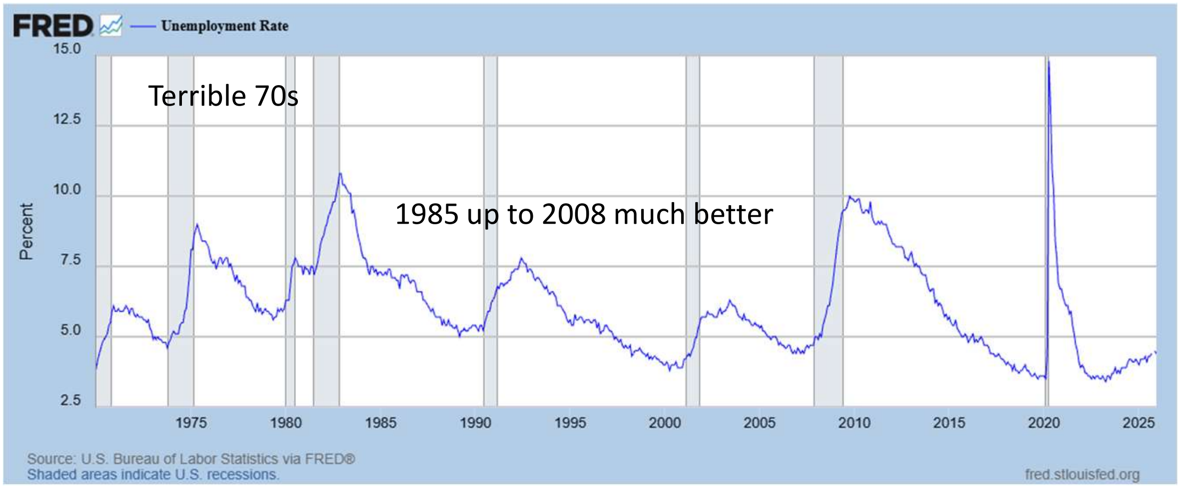
- **Federal Reserve Act of 1913 – "furnish an elastic currency"**
- **Employment Act of 1946**
  1. "Full employment" is a Executive Government Responsibility.
  2. Council of Economic Advisors.
  3. Economic Report of the President.
- **Humphrey Hawkins Act 1978 & the Fed's "Dual" mandate**
  - Full employment
  - Price stability
- **Division of Labor between Monetary and Fiscal Policies.**

Stabilizer in Chief: the Fed

Kevin Warsh
May 2026 (?)

- **The Fed's Dual Mandate:**
  1. "Stable prices" which means 2% rate of inflation in tl on Price Index (which corresponds to about 2.3% inflation in the mo
  2. "Maximum employment" which means the highest level of employment (lowest unemployment rate) consistent with mandate 1.
- **Monetary policy is made by the Federal Open Market Committee (FOMC), comprised of the 7 Fed Governors and 5 of the 12 Presidents of the Regional Federal Reserve Banks on a rotating basis.**
- **The FOMC has scheduled meetings 8 times a year, but can hold unscheduled meetings at a moments notice (e.g., March of 2020)**

Track Record on Unemployment



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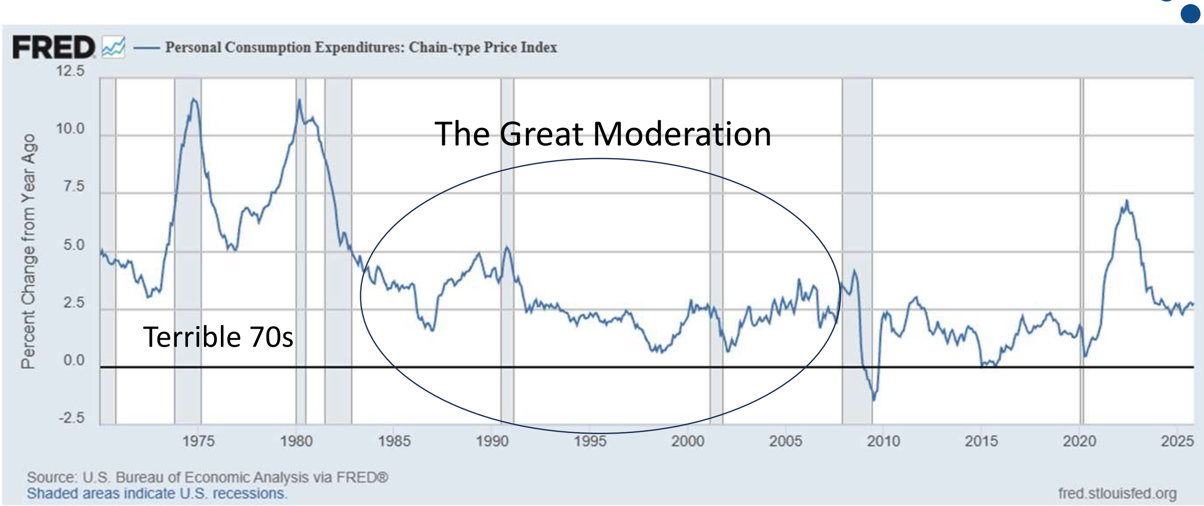
Track Record on “Price Stability”



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Determinants of Unemployment & Inflation

Short run:

- **Unemployment: The higher the level of total spending the lower the unemployment rate.**
- **Inflation:**
  1. "Too much Spending:" Total spending ***above*** the economy's normal capacity ("potential output") tends to ***increase*** inflation (Vietnam War) .
  2. Increase in production costs (e.g., "supply chain bottlenecks;" stagflation of the 70s)
  3. Expectations of high inflation can cause inflation to be high (persistence of high inflation in early 80s).
- **The Fed can affect 1, influence 3., but has no effect on 2.**

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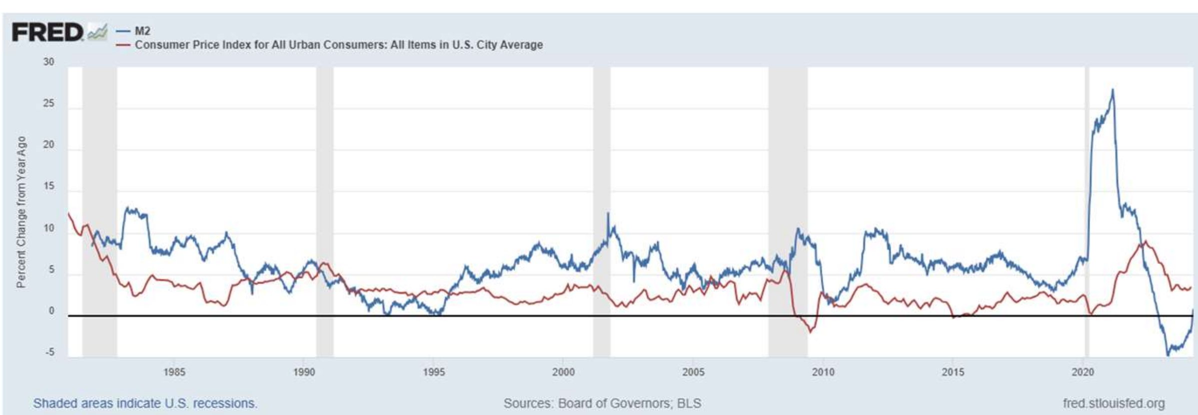
Do You See a Relationship?



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The Fed's Affects the Economy via Interest Rates

- Higher Interest rates discourage firms from buying new plant and equipment, households from buying new homes, and tend to lower stock and housing prices (!).
- Lower spending tends to raise unemployment and eventually lowers inflation.

Become a Central Banker in One Slide!

- If you are more concerned that inflation is too high, raise interest rates to lower total spending below potential output.
- If you are more concerned that unemployment is too high, lower interest rates to raise total spending.
- Inflation and unemployment just right: keep rates the same.

Sounds Easy! But…

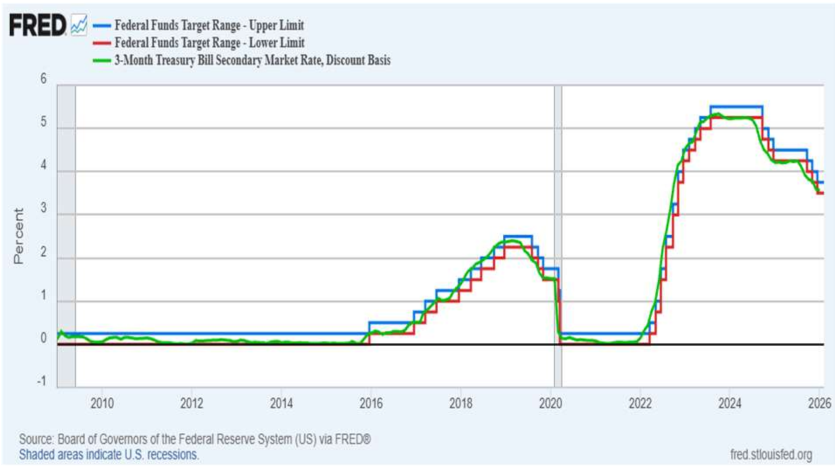
Two Big Complication: Lags & Dual Problems

- Milton Friedman: Monetary Policy affects GDP and Inflation with Long and Variable (Unpredictable) Lags.
- Raising interest rates today does nothing to spending today nor to inflation.
- But over time spending slows and eventually inflation falls.
- Friedman believed that lags led the Fed to "oversteer" the economy consistently.
- What does the Fed do when, like the current moment, when the Fed is worried about both rising unemployment and inflation?

A Closer Look at Interest Rate Control

- *Primary Tool*: the Fed targets the *federal funds rate (*or fed funds rate for short), the interest rate on overnight loans between banks.
- The Fed adjusts bank reserves so that the federal funds rate is within a target range 25 basis points wide; e.g., 3.5-3.75%
- From the bank's perspective these loans are very close substitutes to other short-term, safe assets such as Treasury Bills.
- Therefore, controlling the fed funds rate gives the Fed close control over all safe, *short-term* interest rates.

The Fed and Short-term Interest Rates



Blue is the upper-target fed funds rate.
Red is the lower-target fed funds rate
Green is the rate on 3-month Treasuries.

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The Importance of Long-Term Interest Rates

- Nobody buys a house because of the level overnight interest rates.

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Long-Term Interest Rates

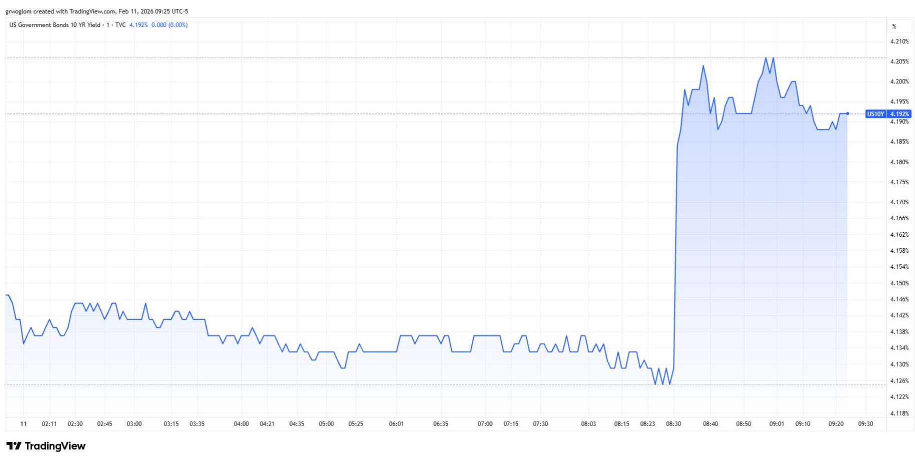
- **Unfortunately, the current fed funds rate has much less influence on long-term interest rates.**
- **Instead, long-term interest rates depend on two factors**
  1. The average of expected, future short-term rates over the life of the long-term bond. Friday, US Treasuries: 1-Yr 3.36; 6-mo 3.53. Why?
  2. "Risk" premia that reflect the possibility of unexpected changes in interest rates and the possibility of default.
- **The Secondary Tools are aimed at affecting these factors.**

Two Secondary Tools to Affect Interest Rates

1. **Forward Guidance: Communicating the Fed's intentions for the *future path of short-term interest rates*.**
2. **Long-term Asset Purchases better known as quantitative easing or QE.**

Both of these tools also affect interest rates, and thereby aggregate demand. But their effect is on interest rates for longer-term and riskier assets.

The Importance of Expectations of Future Fed Actions

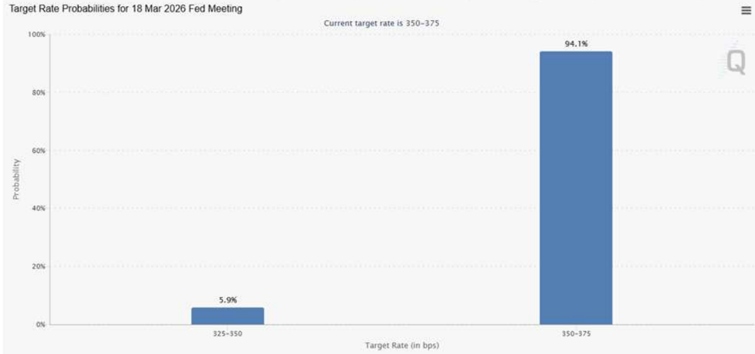


Predicting Future Fed Actions

18 Mar26	29 Apr26	17 Jun26	29 Jul26	16 Sep26	28 Oct26	9 Dec26	27 Jan27	17 Mar27	28 Apr27	9 Jun27	28 Jul27	15 Sep27	27 Oct27	8 Dec27

MEETING INFORMATION						PROBABILITIES		
MEETING DATE	CONTRACT	EXPIRES	MID PRICE	PRIOR VOLUME	PRIOR OI	EASE	NO CHANGE	HIKE
18 Mar 2026	ZQH6	31 Mar 2026	96.3675	27,298	225,764	5.9 %	94.1 %	0.0 %

Target Rate Probabilities for 18 Mar 2026 Fed Meeting



TARGET RATE (BPS)	PROBABILITY(%)			
	NOW *	1 DAY 10 FEB 2026	1 WEEK 4 FEB 2026	1 MONTH 9 JAN 2026
300-325	0.0%	0.0%	0.0%	1.1%
325-350	5.9%	20.1%	9.4%	27.6%
350-375 (Current)	94.1%	79.9%	90.6%	71.3%

* Data as of 11 Feb 2026 00:16:56 CT

1/1/2026 and forward are projected meeting dates

https://sites.google.com/view/macro-current-issues/monetary-policy

QE And Long-term, Risky Rates

- Financial investors require a higher interest rate on risky bonds, than on safe short-term Treasuries.
- The lower the supply of risky bonds, the lower the required risk premia needed to get enough private investors to buy them.
- QE lowers the supply of long-term bonds held by private investors and thereby lowers the required risk premia and the interest rate on these bonds.

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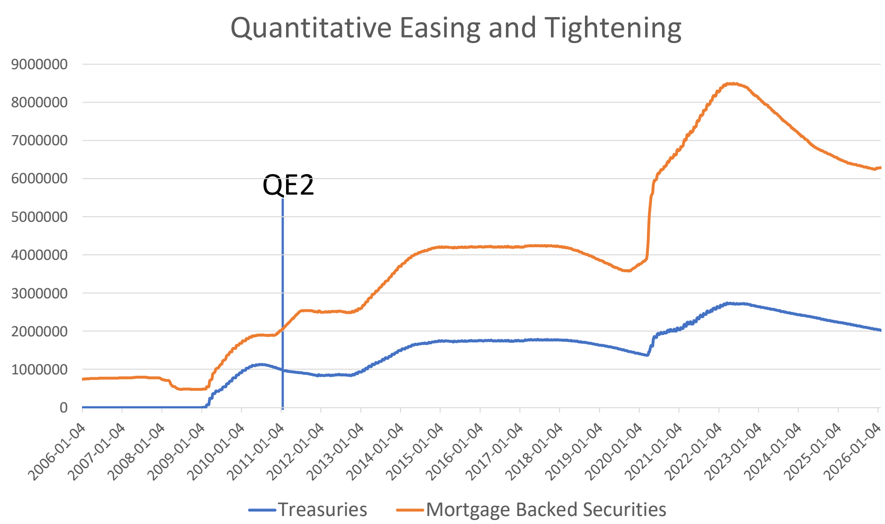
QE Had Been a Big Deal



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Source: Federal Reserve Board

A Policy Strategy: Stabilize Expectations of Inflation

- **Monetary Policy is much easier if the people believe that the Fed will achieve its inflation target.**

Ben Bernanke (2007):

"…if inflation expectations respond less than previously to variations in economic activity, then inflation itself will become relatively more insensitive to the level of activity…"

- **In central bank jargon, stable expectations are "well anchored."**

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Anchoring Requires Credibility

Credibility, the public believes that the Fed will achieve its goals.

- **Requirements for Credibility**
  1. Transparency (Communication)
  2. Accountability (Performance) BOE Letter?
  3. Political Independence

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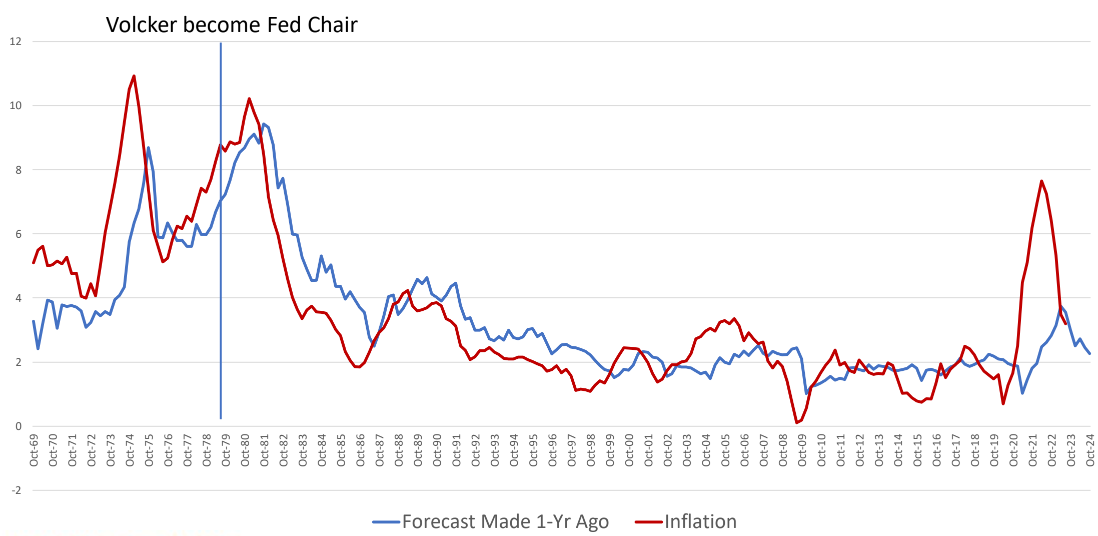
Theoretical Case for Independent and Conservative Central Banks

Keneth Rogoff's Conservative Central Banker paper (1985):

"Society can sometimes make itself better off by appointing a central banker who does not share the social objective function, but instead places "too large" a weight on inflation-rate stabilization relative to employment stabilization."

Independent "conservative" central bank leads to "well-anchored" and lower inflationary expectations.

Paul Volcker: Rogoff's Muse (?)



The Great Moderation

- Volcker paid a price in the early 1980s, but the price paid dividends from 1985 through 2008.
- During that period the performance of the US economy was extraordinary and even Milton Friedman gave kudos to the Alan Greenspan.
- Economist in the 1980s and 90s patted themselves on the back for identifying the importance of central bank independence for anchoring inflationary expectations leading to the Great Moderation

Evidence: The Low-Inflation Free Lunch

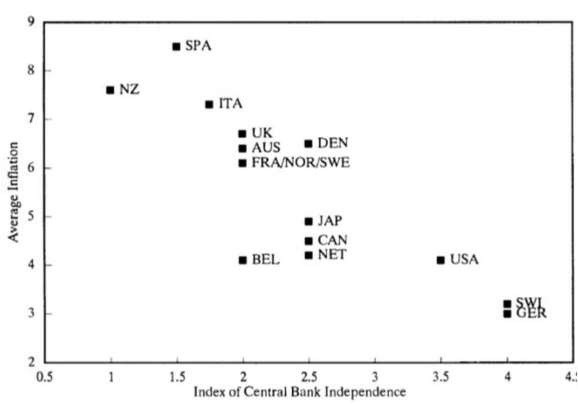


FIG. 1a. Average Inflation

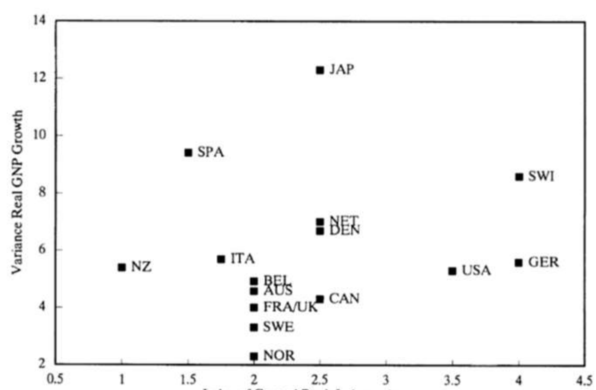


Fig. 2b Variability of Real GNP

Alesina, A., and L. Summers. "Central Bank Independence and Macroeconomic Performance : Some Comparative Evidence." *Journal of Money, Credit and Banking* 25, no. 2 (1993): 151–62. https://doi.org/10.2307/2077833.

Practical Effects of this Research

- Countries adopt strict inflation targeting: New Zealand (1989), Canada (1991), UK (1992), Australia and Sweden (1993)
- Tony Blair's first action as UK Prime Minister in 1997 is to remove Chancellor of the Exchequer from the Bank of England.
- Eurozone created 2002 which places monetary policy out of the hands of nations' central banks and into the hands of The European Central Bank (ECB).
- Where is the ECB located?

Frankfurt Germany!

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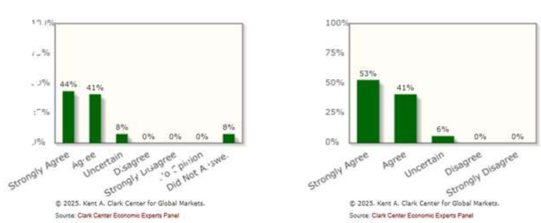
Who Says Economist Always Disagree?

Question A:

A substantial loss of Federal Reserve independence would substantially increase the overall nominal cost of U.S. government borrowing.

Responses

Responses weighted by each expert's confidence

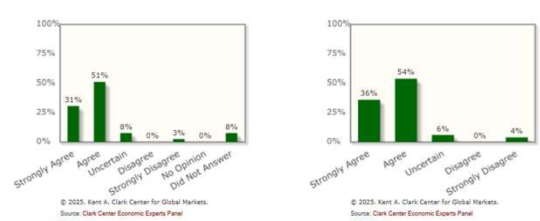


Question B:

A substantial loss of Federal Reserve independence would substantially raise risk premia on long-term U.S. government debt.

Responses

Responses weighted by each expert's confidence



https://kentclarkcenter.org/surveys/fed-independence/

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Central Bank Independence & the Fed

- **Monetary Policy interest rate decisions are made by the Fed (FOMC) and cannot be reversed by other branches of government.**
- **Federal Reserve Governors have 14-year terms.**
- **The Chair (Jerome Powell) serves a 4-year term (which will be up next spring).**
- **The Fed's expenses are financed from operations; it doesn't have to go to Congress for appropriation**
- **The Fed is accountable to Congress and the public by:**
  - Congress Sets the "Dual Mandate" (but not numerical targets).
  - Chair testifies to Congress.
  - Policy Statement issued and Chair Press Conference after Policy meeting
  - Current Policy deliberations are made available with a 6-week lag.
  - All policy discussions are released with a 5-year lag.
- **But, as opposed to the Supreme Court, the Fed can be eliminated by a majority vote in Congress**

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This Doesn't Help

- **The irony is that the Fed would be able to lower interest rates more aggressively with no attacks.**
- **If it appears the Fed is caving to political pressure, it will lose credibility and increase inflationary expectations.**

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An Unresolved Issue

- Is Central Bank Independence Consistent with Democracy?
- Things to think about: The Fed through monetary policy has the most influence on the short-run behavior of the economy. These governmental decisions are made "technocratically" and not democratically.
- In the current situation should the democratic process have input in how the Fed deals with the dilemma of stagflation?

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Questions Raised by Warsh Nomination

1. Will Warsh, who was an inflation "hawk," push Trump's agenda for lower rates?
2. If yes to 1., will he be able to push policy through the FOMC?
3. If Warsh succeeds will inflationary expectations become unanchored?
4. Will Powell stay on as a Governor after his term as Chair expires?
5. Warsh was a major critic of second round of QE in 2010. How quickly will he pursue quantitative tightening, and what will this due to long-term interest rates and the deficit?

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My Google Site

- https://sites.google.com/view/macro-current-issues/economic-update

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Next Week: US Govt. Budget Look

2024 Budget Summary (in Trillions)

Revenue			Outlays	
Income Taxes	$2.4		Mandatory	$4.1
Payroll Taxes	$1.7		Discretionary	$1.8
Corporate Taxes	$0.5		Interest	$0.9
Other	$0.3			
Total	$4.9		Total	$6.8

Budget Deficit: $1.8 Trillion

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Source: https://www.cbo.gov/publication/60053

Let's Hear from You!

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Contact NEED: Info@NEEDEcon.org

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