Fed Communication

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Post-Meeting Statements

- February 1994: First post-meeting statement
- May 1999: Statement after every regularly scheduled meeting

- Watershed moments for transparency
- But also transformed the nature of monetary policy

“I have learned to mumble with great incoherence”

-- Alan Greenspan, 1987

“Monetary policy is 98% talk and 2% action”

-- Ben Bernanke, 2015

The Importance of Forward Guidance

- Monetary policy is 98% forward guidance!

- Many people think of forward guidance as "unconventional policy" used mainly at the ELB
- Has in fact been a critical element of virtually every FOMC statement since 1999

May 1999 Statement

While the FOMC did not take action today to alter the stance of monetary policy, the Committee was concerned about the potential for a buildup of inflationary imbalances that could undermine the favorable performance of the economy and therefore adopted a directive that is tilted toward the possibility of a firming in the stance of monetary policy. Trend increases in costs and core prices have generally remained quite subdued. But domestic financial markets have recovered and foreign economic prospects have improved since the easing of monetary policy last fall. Against the background of already-tight domestic labor markets and ongoing strength in demand in excess of productivity gains, the Committee recognizes the need to be alert to developments over coming months that might indicate that financial conditions may no longer be consistent with containing inflation.

June 2005 Statement

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 3-1/4 percent.

The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity. Although energy prices have risen further, the expansion remains firm and labor market conditions continue to improve gradually. Pressures on inflation have stayed elevated, but longer-term inflation expectations remain well contained.

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Roger W. Ferguson, Jr.; Richard W. Fisher; Edward M. Gramlich; Donald L. Kohn; Michael H. Moskow; Mark W. Olson; Anthony M. Santomero; and Gary H. Stern.

In a related action, the Board of Governors unanimously approved a 25-basis-point increase in the discount rate to 4-1/4 percent. In taking this action, the Board approved the requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

March 2019 Statement

Information received since the Federal Open Market Committee met in January indicates that the labor market remains strong but that growth of economic activity has slowed from its solid rate in the fourth quarter. Payroll employment was little changed in February, but job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Recent indicators point to slower growth of household spending and business fixed investment in the first quarter. On a 12-month basis, overall inflation has declined, largely as a result of lower energy prices; inflation for items other than food and energy remains near 2 percent. On balance, market-based measures of inflation compensation have remained low in recent months, and survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chairman; John C. Williams, Vice Chairman; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.

Information Effects

- Recent research indicates:
  - Fed actions and statements affect private sector views about the state and trajectory of the economy (Romer-Romer 01, Campbell et al. 12, Campbell et al. 16, Nakamura-Steinsson 18, Lunsford 19)

Two Opposing Effects of Policy

- Suppose FOMC eases policy
- Traditional Effect:
  - Lower rates boost growth
- Information Effect:
  - Greater private sector pessimism lowers growth

Potential Dilemma

- How should the FOMC handle situations where its own assessment of state of the economy is more pessimistic than private sector’s?
- Should it ever refrain from easing policy for fear of Information Effect?
- Not well understood
  (see, Tang 15 and Jia 19)

Two Situations

1. Fed has enough policy room to counteract weakness
   - Information effect should not be a worry.
   - Policy easing should prevent pessimism
2. Fed may not have enough policy room
   - Revealing outlook truthfully may make economic situations worse

New Credibility Issue

- If the Fed starts to systematically withhold bad news in certain situations, the private sector will eventually catch on to this
- Undermines credibility of Fed's communications
- Private sector will adjust for bias
  … which may defeat the purpose

Summary of Economic Projections

- SEP critical in communicating FOMC’s views on economic outlook
- Decentralized nature of SEP important strength
- Release a SEP after each FOMC meeting
- Release the matrix

Nature of Fed Language Important

Two types of forward guidance:

1. Easing because economy is doing worse than private sector thinks
2. Economy no worse but more accommodation warranted than private sector thinks

- Important to distinguish between forward guidance that provides information about
  1. How economy is doing
  2. Fed’s reaction function

Lunsford (2019)

- February 2000 to June 2003:
  - Forward guidance solely about economic outlook (e.g., “risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future”)
  - Strong information effects
- August 2003 to May 2006:
  - Forward guidance about policy rate (“considerable period” and “measured pace”)
  - Much weaker information effects

Policy Reaction Function

- FOMC should communicate its policy reaction function as clearly as possible
- Forward guidance most effective when it affects private sector views about Fed’s reaction function
- Communicating Fed’s current views about its policy reaction function is not equivalent to committing to a particular reaction function or policy rule

Our Imperfect Understanding

- A fundamental constraint on Fed communication:
  - Our imperfect understanding of how economy works
- If understanding was perfect:
  - Optimal to commit to a particular policy rule
- With imperfect understanding:
  - Not wise to commit to a particular policy rule

Policy Rules and Evolving Understanding of Economy

- New information will alter our understanding of how economy works. (Think 2008.)
- Choice between two bad options:
  - Stick with policy rule that is now sub-optimal (perhaps seriously sub-optimal)
  - Ditch policy rule and suffer blow to credibility

Commitment to Objective

Alternative approach:

- Focus on communicating commitment to a medium and long-run run objective
- Arguably approach Fed has followed for last 40 years

Commitment to Low and Stable Inflation

- Fed has gradually convinced public that it will not tolerate substantial deviations from inflation target of 2%
- Has anchored inflationary expectations
- Has brought enormous benefits for stabilizing actual inflation
- Signature achievement
- Commitment to an outcome not policy rule