Federal Reserve Communications and Transparency

Celebration in Honor of Michael H. Moskow
January 23, 2018

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Goals of Better Communications

- **Central banks in a democracy have an obligation to transparently explain their policy decisions**
- **Reduce uncertainty about policy to allow for better private-sector decision making**
- **Communications as an "unconventional" policy tool in the presence of the zero lower bound on the federal funds rate**

Central Bank Communications; the Old Days

- **Bank of England under Montagu Norman in the 1930s:**
  - **Never explain, never apologize.[1]**
  - **I think it has been our practice to leave our actions to explain our policy. It is a dangerous thing to start to give reasons.[2]**
  - **To the first professional economist at the Bank: You are not here to tell us what to do, but to explain to us why we have done it.[3]**

1. "Within the City, it had always been said the motto of the Bank of England was "Never explain, Never Apologize." Liaquat Ahmed, Lords of Finance, pp 318. 2. Ahmed, op. cit., p 319. 3. Norma to Henry Clay, first BoE economist. Robert Skildelsky review of "Till Time's Last Stand" by David Kynaston, 2017.

Memorable Moment in Fed Communications

- **Federal Reserve 1987, Chair Greenspan:**
  - **"Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said."***

*Wikiquote; speaking to a Senate Committee, sourced to Guardian Weekly, Nov. 4, 2005

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  - **"Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said."***
- **Funny, but not really fair!**

*Wikiquote; speaking to a Senate Committee, sourced to Guardian Weekly, Nov. 4, 2005

One of Michael's Contributions to Transparency

- **July 1997 Policy Directive**
  - **In the implementation of policy for the immediate future, the Committee seeks <u>to maintain the existing degree of pressure on reserve positions</u>. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, <u>somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period</u>.**

One of Michael's Contributions to Transparency

- **August 1997 Policy Directive**
  - **In the implementation of policy for the immediate future, the Committee <u>seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5-1/2 percent</u>. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, <u>a somewhat higher federal funds rate would or a slightly lower federal funds rate might be acceptable in the intermeeting period</u>.**

A Great Moment in Fed Communications

- **December 1993 post meeting "statement":**
  - **The FOMC meeting has ended.**
- **February 1994: First post-meeting policy statement:**
  - **Chairman Alan Greenspan announced today that the Federal Open Market Committee decided to increase slightly the degree of pressure on reserve positions. The action is expected to be associated with a small increase in short-term money market interest rates.**

A Great Moment in Fed Communications

- **February 1994, cont.**
  - **The decision was taken to move toward a less accommodative stance in monetary policy in order to sustain and enhance the economic expansion.**
  - **Chairman Greenspan decided to announce this action immediately so as to avoid any misunderstanding of the Committee's purposes, given the fact that this is the first firming of reserve market conditions by the Committee since early 1989.**

Evolution of the Policy Statement

- **July 1995: First explicit mention of target for the federal funds rate**

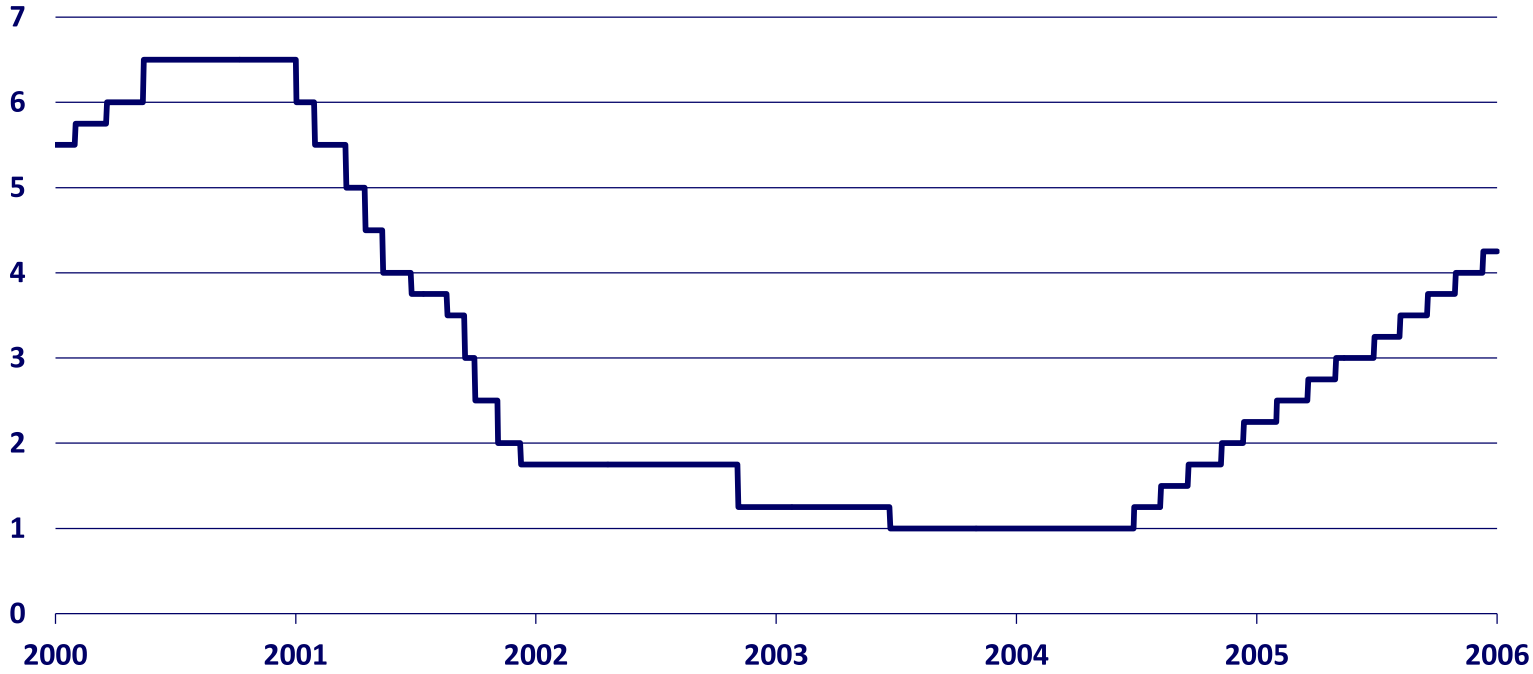
- **May 1999: Announcements after no-change meetings; include policy “tilt” in policy statement**

  - **Prior to May 1999 policy tilt was in minutes, which were made public after the subsequent meeting**

Forward Guidance About Policy Path

- **In 2003 Fed reached a perceived limit on its ability to cut rates**

Federal Funds Target Rate
(percent)



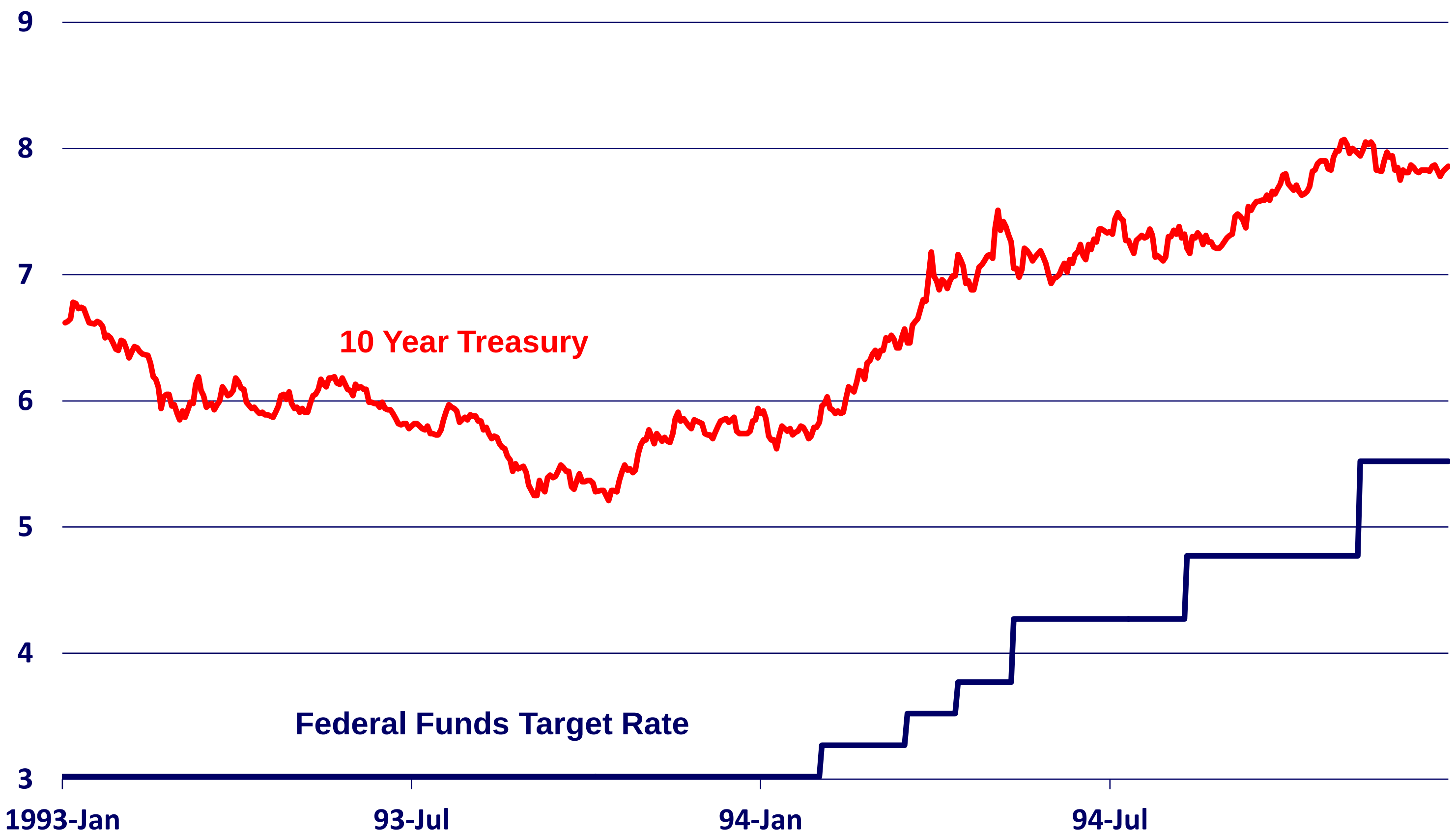
Source: Board of Governors of the Federal Reserve System from Haver Analytics

Forward Guidance About Policy Path

- **2003-04: Forward guidance with regard to policy accommodation for some time:**
  - **August 2003: …accommodation can be maintained for a <u>considerable period</u>.**
  - **January 2004: …can be <u>patient</u> in removing its policy accommodation.**
  - **June 2004 : …can be removed <u>at a pace that is likely to be measured</u>.**

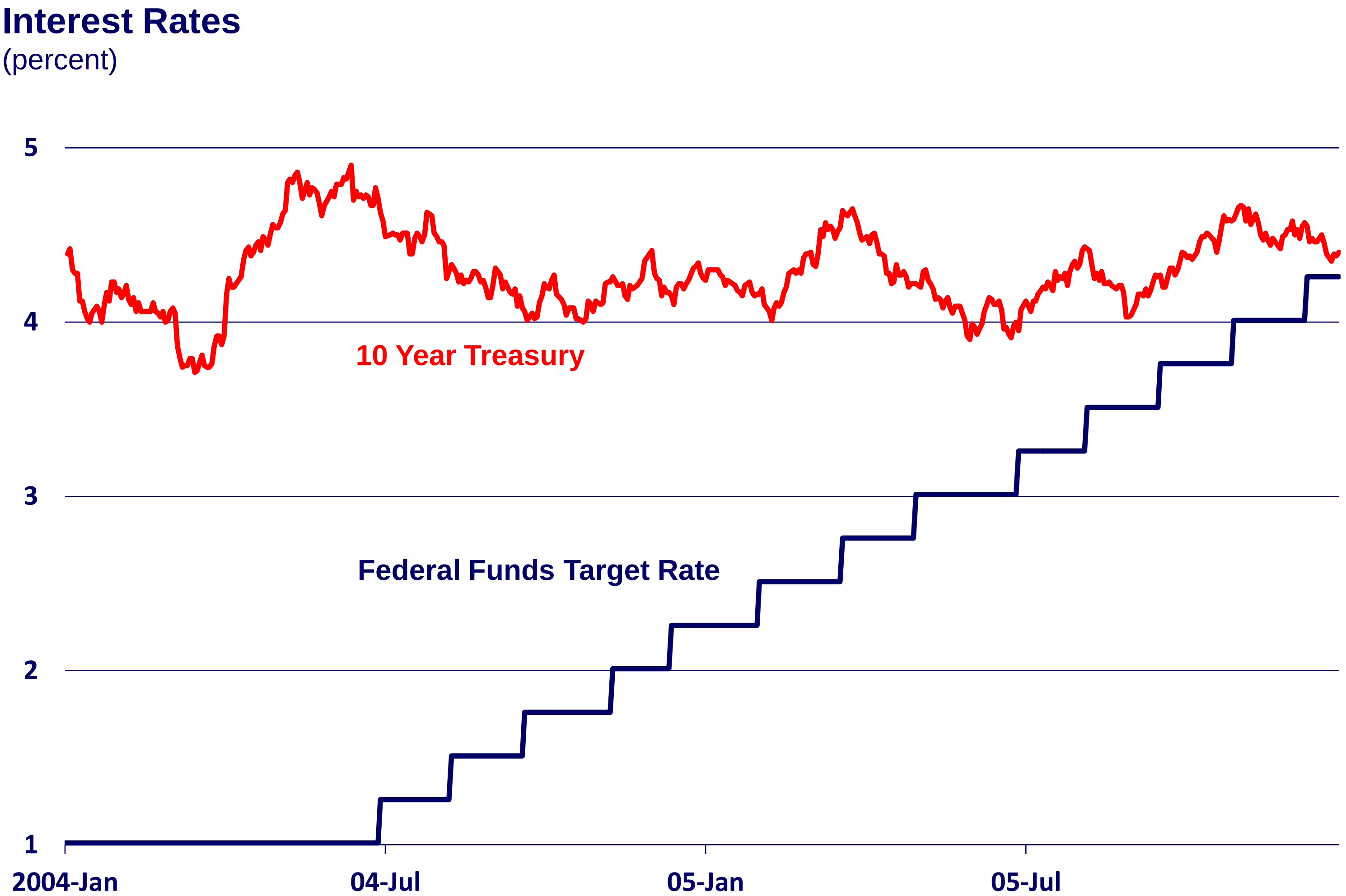
1994: "Blood in the Bond Market"

Interest Rates
(percent)



Source: Board of Governors of the Federal Reserve System from Haver Analytics

2004: No Crash in Bond Prices



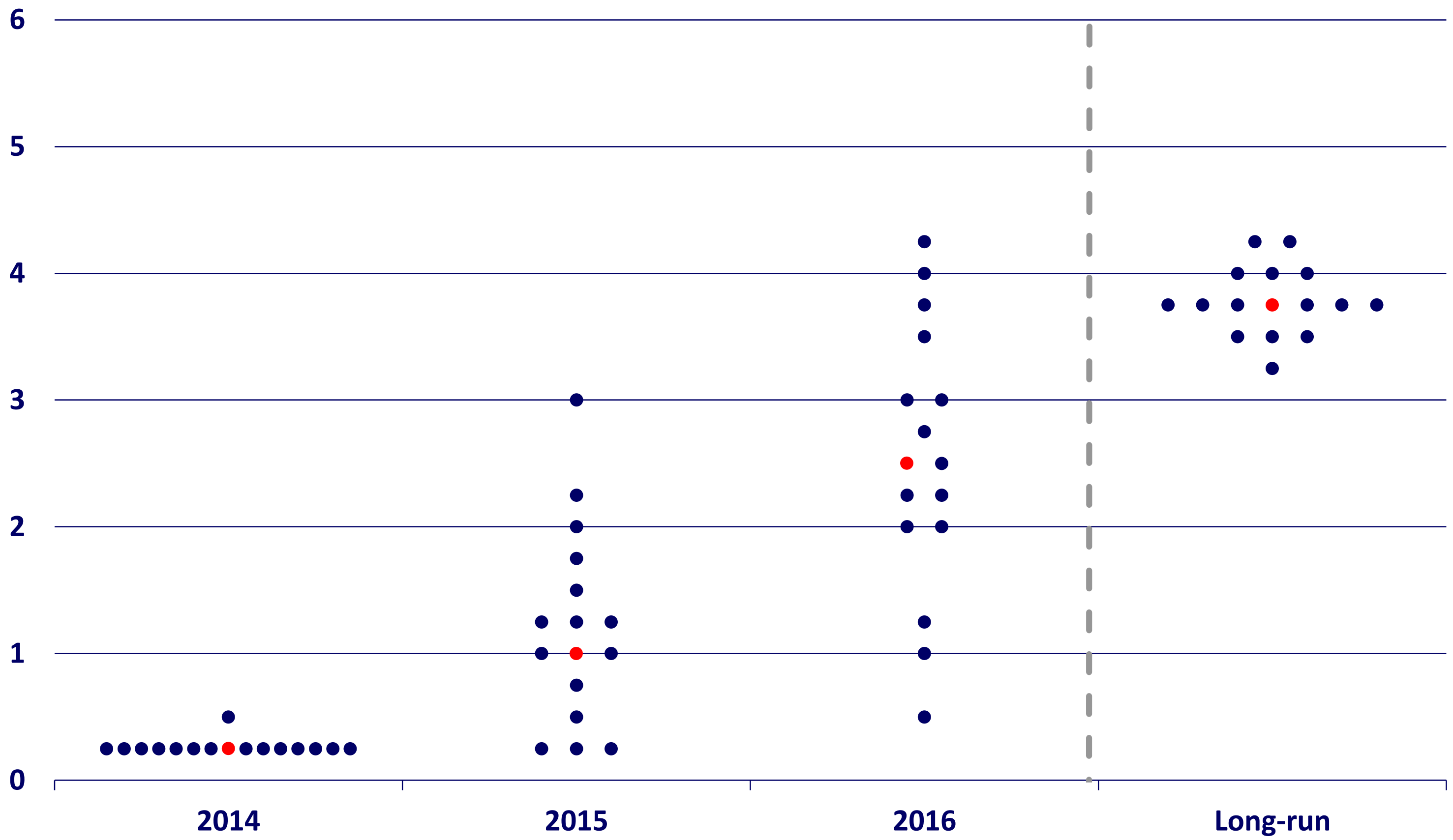
Source: Board of Governors of the Federal Reserve System from Haver Analytics

Other Communications Enhancements

- **December 2004: Expedited release of the minutes**
- **November 2007: Quarterly projections**
- **April 2011: Press conference**
- **January 2012:**
  - **Long-run policy strategy with explicit 2 percent inflation target**
  - **Fed funds rate projections**

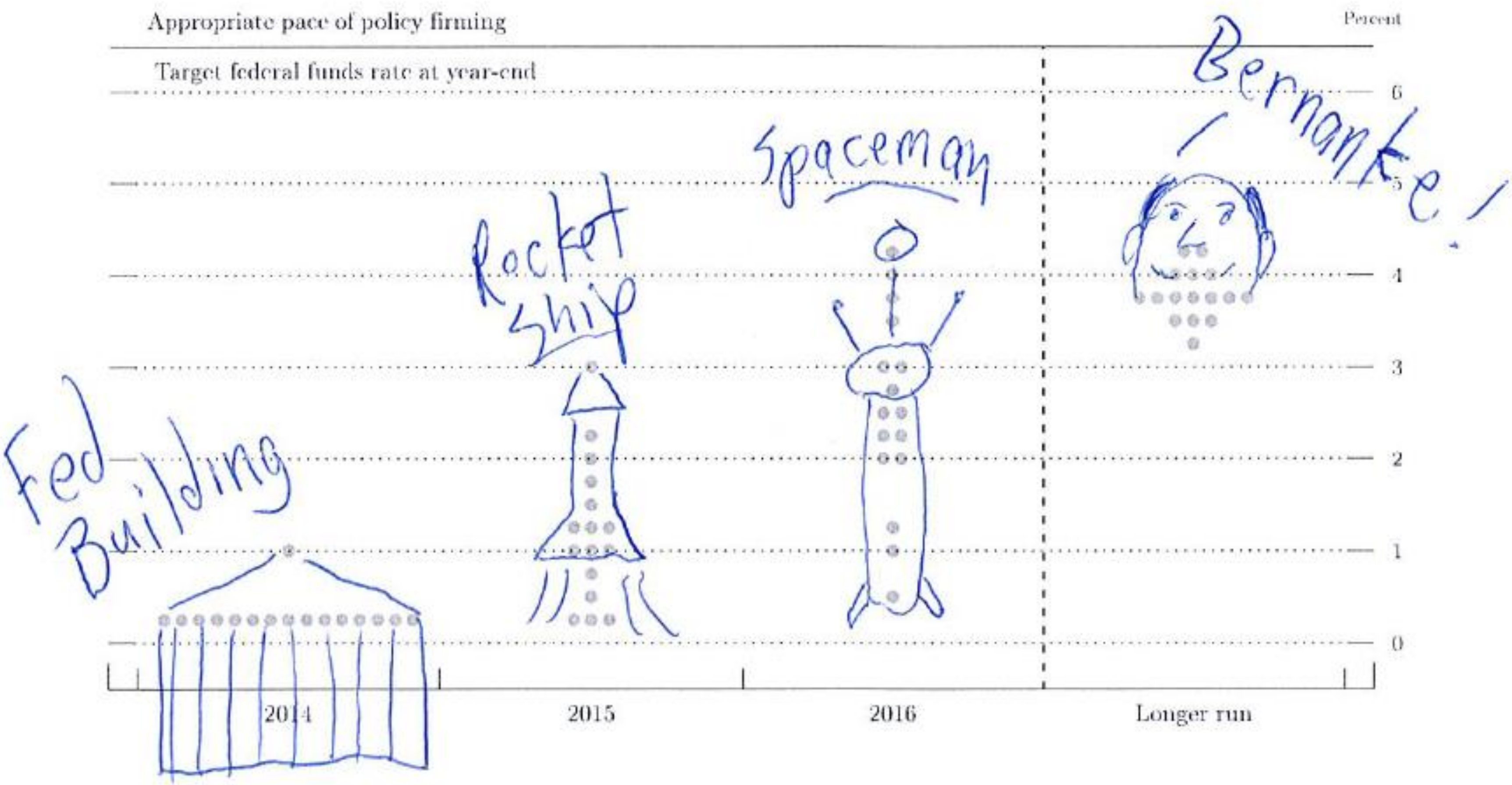
The Dot Plot: Federal Reserve Interest Rate Forecasts

June 18, 2014 Dotplot: Target Federal Funds Rate at Year End
(percent)



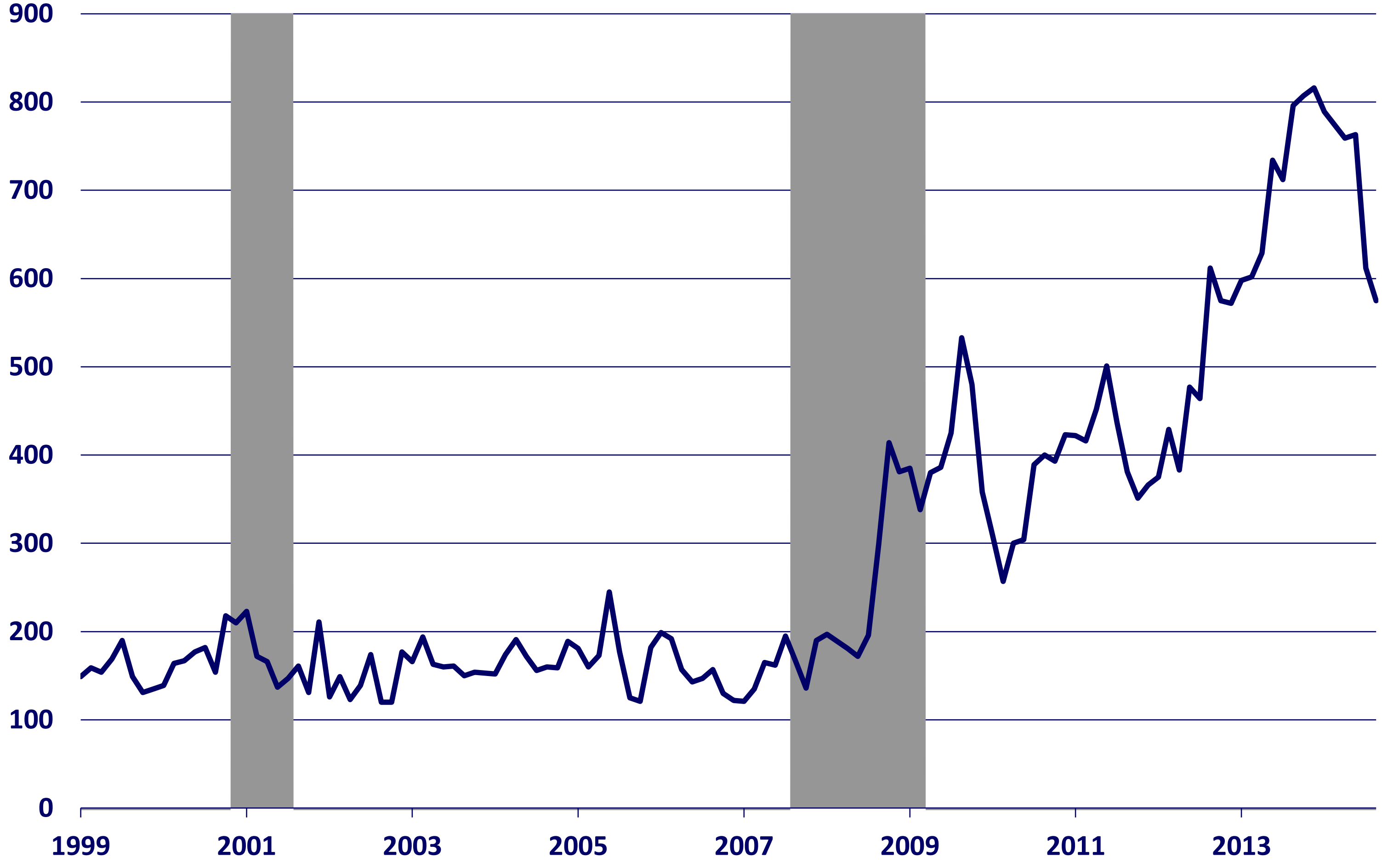
Source: June 14, 2014 Summary of Economic Projections. Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run. Red dots indicate the median projection.

Analyzing the Dots



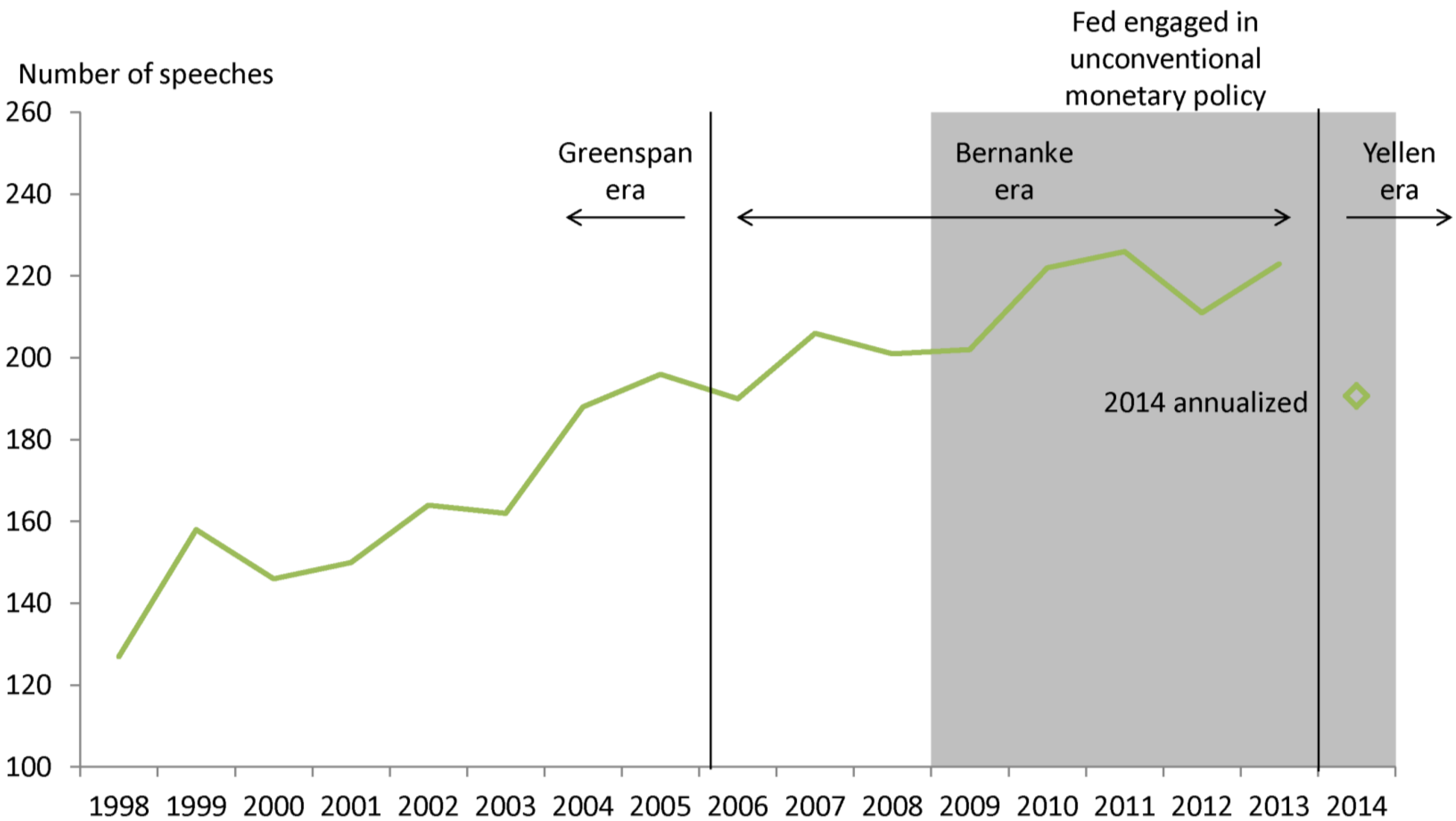
Source: This is What Happens if You Stare at the Fed's Dots for Too Long
Jared Bernstein blog, June 18th, 2014

Words in FOMC Statement



Source: "Hanging on Every Word: Semantic Analysis of the FOMC's Postmeeting Statement," Miguel Acosta and Ellen Meade, FEDS Notes, September 2015.

Total FOMC Member Speeches



Source: "How the FOMC Talks," Mark A. Wynne, Federal Reserve Bank of Dallas, October 29, 2014

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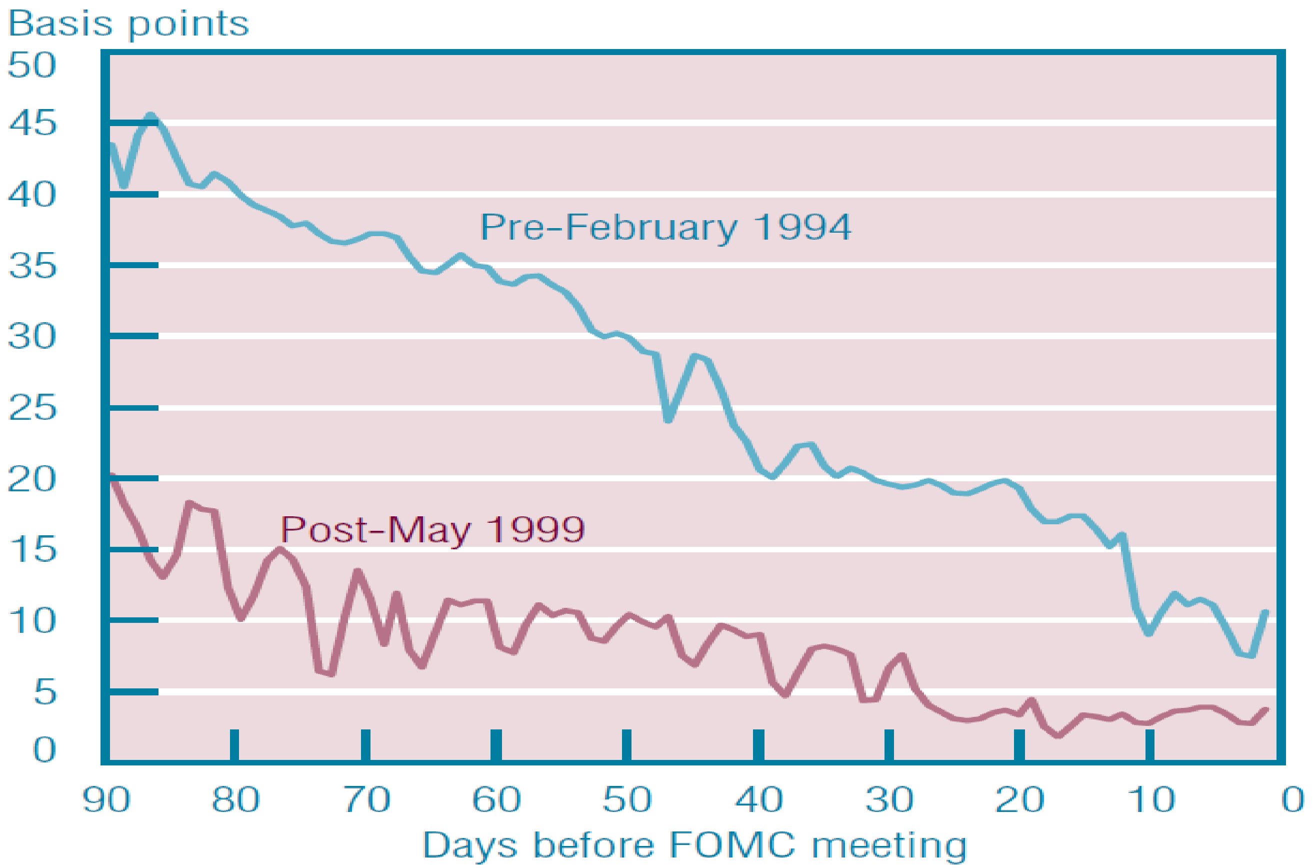
Reducing Uncertainty

FIGURE 3 AVERAGE ABSOLUTE ERROR



Source: "FOMC Communications and the Predictability of Near-Term Policy Decisions," John Carlson, Ben Craig, Patrick Higgins, William Melick, Federal Reserve Bank of Cleveland, June 2006

Communications as a Policy Tool

- **Longer-term interest rates equal expected average future short-term rates plus a term premia (tp)**

$$\boldsymbol{r_t^{10} \approx \frac{1}{10} E_t\left[r_t^1 + r_{t+1}^1 + r_{t+2}^1 + \cdots r_{t+10}^1\right] + tp_t^{10}}$$

- **Long rates matter more for aggregate demand. How can we lower them if can't change near-term $\boldsymbol{r_{t+j}^1}$?**
  - **Option 1: Communications -- Lower expectations of average <u>future</u> short-term rates through "forward guidance" on future policy rates**
  - **Option 2: Buy long-term bonds to**
    - **Reduce term premium**
    - **Reinforce option 1**

2008-12 Forward Guidance

- **Economic conditions likely to warrant exceptionally low level of the funds rate:**
  - **December 2008: “for some time”**
  - **March 2009: “for an extended period”**
  - **August 2011: “at least through mid 2013”**
  - **January 2012: “at least through late 2014”; interest rate “dot plot” added to projections**

2008-12 Forward Guidance

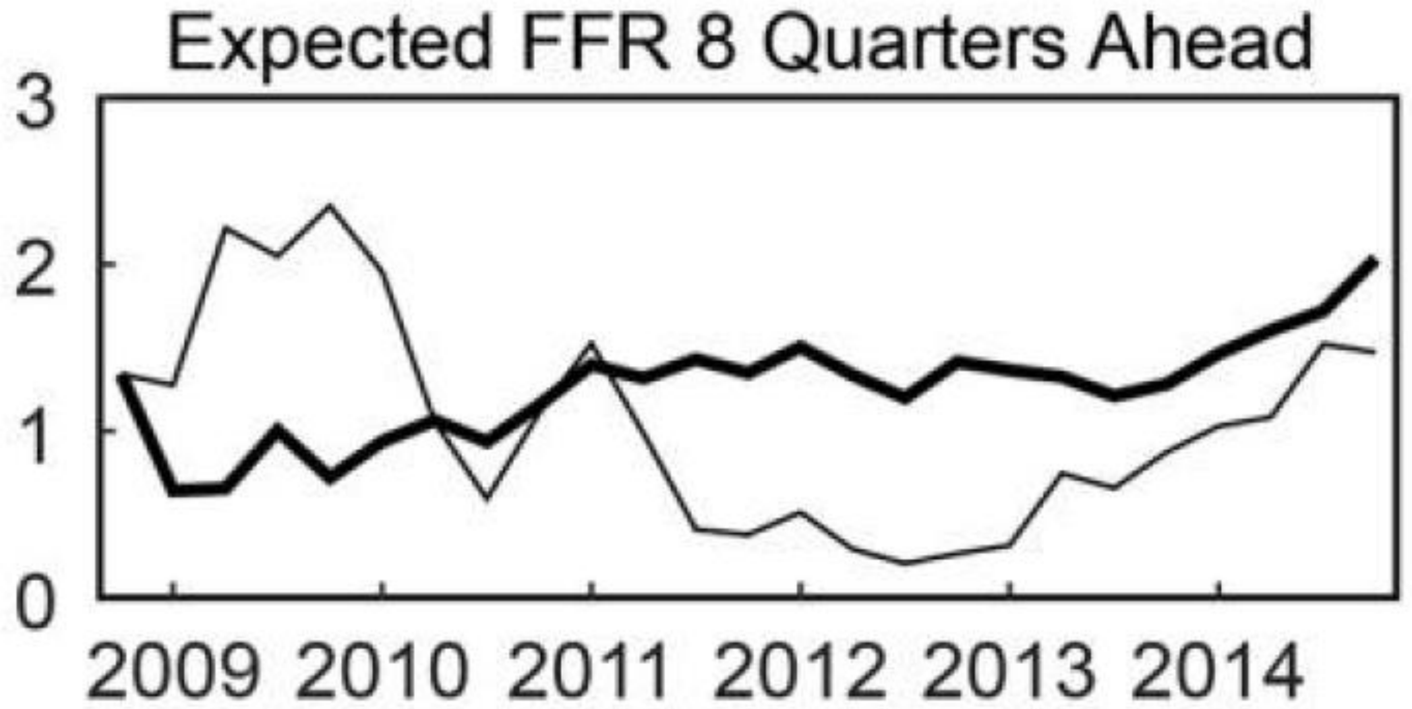
- **September 2012: "…the Committee expects that a highly accommodative stance of monetary policy will remain appropriate <u>for a considerable time after the economic recovery strengthens</u>….at least through mid-2015."**

- **Make up for period of constraint by ZLB by committing to a lower rate path for rates in the future then you would "normally" do.**

2008-12 Forward Guidance

- **December 2012: "Economic conditions likely to warrant exceptionally low level of the funds rate at least as long as <u>the unemployment rate remains above 6-1/2 percent</u>, <u>inflation</u> between one and two years ahead is projected to be <u>no more than a half of a percentage point above</u> the Committee's <u>2 percent</u> long-run goal, and longer-term <u>inflation expectations</u> continue to be <u>well-anchored</u>."**

2008-12 Forward Guidance



Thick line: Model's Taylor Rule federal funds rate prescription
Thin line: Market expectations for the federal funds rate

Source: Jeffrey Campbell, Jonas Fisher, Alejandro Justiniano, and Leonardo Melosi, "Forward Guidance and Macroeconomic Outcomes Since the Financial Crisis," NBER Macroeconomics Annual, 2016

Summary

- **Communications is important, and not easy**
- **Much progress has been made since “Never explain, never apologize.”**
- **Communications is an evolving story – stay tuned**