FEDERAL RESERVE BANK of NEW YORK

Changes in FOMC Communications

Krishna Guha, Executive Vice President Communications Group
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Outline

- Why central banks communicate
- Increase in transparency of FOMC communications from 1994 to present
- Use of forward rate guidance as a policy tool at the ZLB
- Recent changes to FOMC communications

Important disclaimer

- Only the FOMC in its collective statements and the chairman of the FOMC in his speeches and testimony can speak for the FOMC
- My presentation today is intended to be a factual account of evolutions in Fed communications
- I will not attempt to interpret the thinking of the FOMC beyond its published comments
- Any opinions expressed are my own

Why do central banks communicate?

- Communications enhances accountability and effectiveness of monetary policy (*Blinder et al)*
- Accountability = responsibility of central bank in a democratic society
- Effectiveness = establish nominal anchor *and* influence market expectations of future policy rate
- Benefits of predictability
- Communication is also key for financial stability policy

What do central banks communicate about?

The policy framework, which includes:

- Objectives
- The economic outlook
- Changes to the economic outlook and balance of risks
- How decisions regarding the use of tools such as the federal funds rate advance the objectives
- The outlook for policy and the policy “reaction function” ie how policy would respond to changes in the outlook or balance of risks

Evolution of FOMC communications 1994 to present

- Prior to 1994 FOMC did not even announce its decisions
- 1994 Greenspan issued first post FOMC statement
- Since then Federal Reserve has become progressively more transparent in describing its policy framework, including its outlook and policy reaction function
- Now includes quarterly press conferences by chairman Bernanke following FOMC meetings in which the committee releases the Summary of Economic Projections

Types of FOMC communication

- FOMC statement
- Minutes published three weeks after the FOMC meeting
- Quarterly Summary of Economic Projections
- Twice-yearly Monetary Policy Report and other testimony to Congress
- Speeches by the chairman and other Fed policymakers
- Transcripts of meetings published after five years

How to Read an FOMC Statement

- Current statement has a five paragraph structure
- First par describes current economic conditions, both real and nominal (prices)
- Second paragraph provides a qualitative description of the economic outlook and compares the outlook for employment and inflation with the committee's mandate objectives of full employment and price stability
- Third paragraph gives the stance of policy with respect to the target federal funds rate and guidance as to the future path of the federal funds rate
- Fourth paragraph provides the stance of policy with respect to the balance sheet
- Fifth paragraph records the vote on the statement and briefly explains any dissent

FOMC Statement, Paragraph 1

- Information received since the Federal Open Market Committee met in January suggests that the economy has been expanding moderately. Labor market conditions have improved further; the unemployment rate has declined notably in recent months but remains elevated. Household spending and business fixed investment have continued to advance. The housing sector remains depressed. Inflation has been subdued in recent months, although prices of crude oil and gasoline have increased lately. Longer-term inflation expectations have remained stable.

FOMC Statement, Paragraph 2

- Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects moderate economic growth over coming quarters and consequently anticipates that the unemployment rate will decline gradually toward levels that the Committee judges to be consistent with its dual mandate. Strains in global financial markets have eased, though they continue to pose significant downside risks to the economic outlook. The recent increase in oil and gasoline prices will push up inflation temporarily, but the Committee anticipates that subsequently inflation will run at or below the rate that it judges most consistent with its dual mandate.

FOMC Statement, Paragraph 3

- To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee expects to maintain a highly accommodative stance for monetary policy. In particular, the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.

FOMC Statement, Paragraph 4

- The Committee also decided to continue its program to extend the average maturity of its holdings of securities as announced in September. The Committee is maintaining its existing policies of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. The Committee will regularly review the size and composition of its securities holdings and is prepared to adjust those holdings as appropriate to promote a stronger economic recovery in a context of price stability.

FOMC Statement, Paragraph 5

- Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; Elizabeth A. Duke; Dennis P. Lockhart; Sandra Pianalto; Sarah Bloom Raskin; Daniel K. Tarullo; John C. Williams; and Janet L. Yellen. Voting against the action was Jeffrey M. Lacker, who does not anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate through late 2014.

Evolution of rate guidance as a policy tool

- Pre-December 2008: implicit guidance via the discussion of economic forecasts, heightened uncertainty and downside risk
- December 2008: “committee anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate *for some time*”
- March 2009: committee “anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate *for an extended period*”
- August 2011: committee “currently anticipates that economic conditions – including low rates of resource utilization and a subdued outlook for inflation over the medium run – are likely to warrant exceptionally low levels for the federal funds rate *at least through mid-2013*”

Recent Changes in FOMC Communication

There were three changes in FOMC Communication at the January FOMC – one on the stance of policy and two relating to the framework for communications:

1. Change in forward guidance in the FOMC statement from “at least through **mid-2013**” → “at least through **late 2014.**” Retained at March FOMC meeting.

2. Inclusion of FOMC participants **federal funds rate** (FFR) projections in the Summary of Economic Projections (SEP)

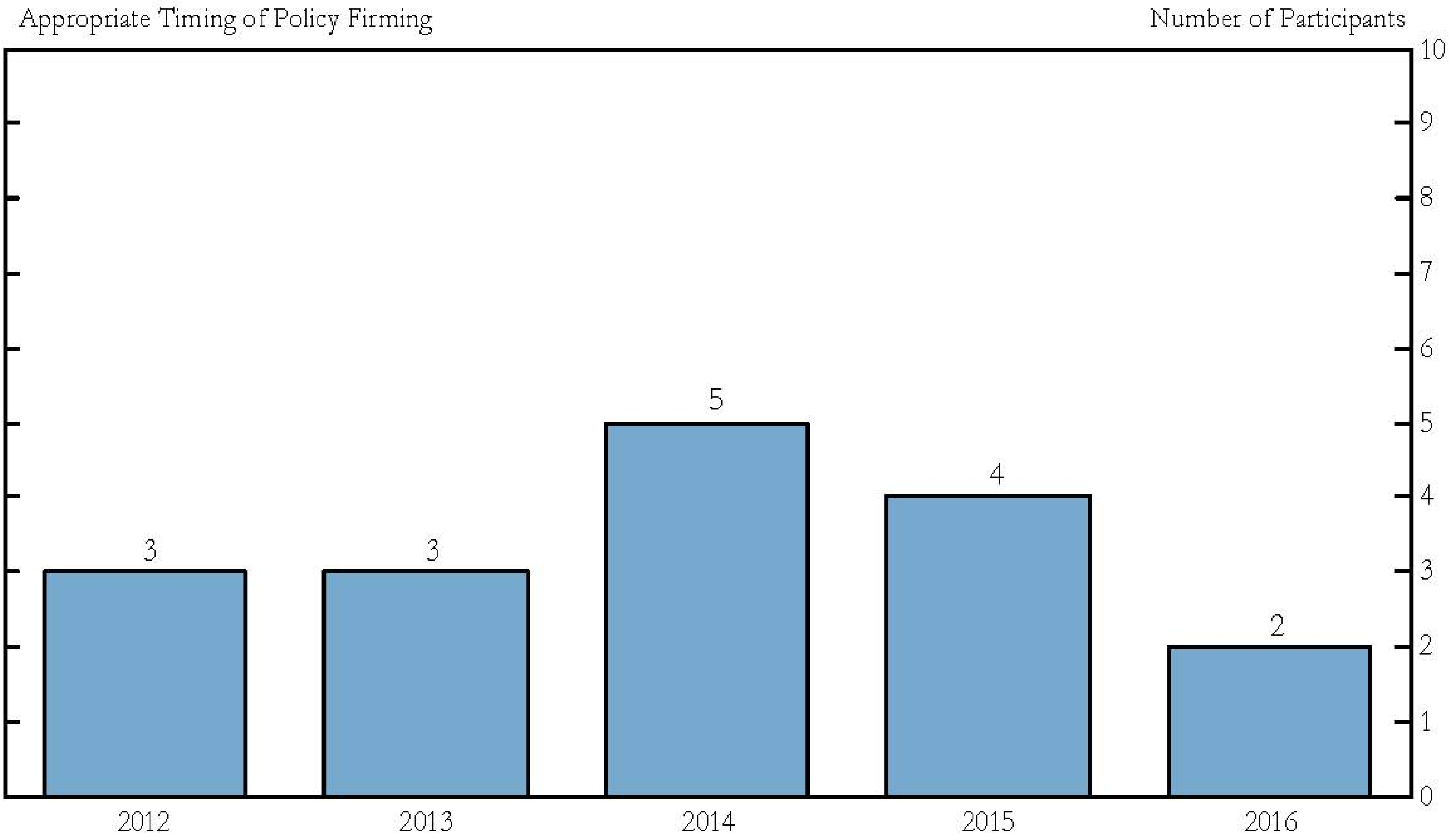
3. FOMC statement of **longer-run goals and policy strategy**

At least through “mid-2013” → “late 2014”

- “… the Committee … currently anticipates that economic conditions … are likely to warrant exceptionally low levels for the federal funds rate **at least** through **late 2014**.”
- Change consistent with most forecasts for speed of recovery and inflation when evaluated using standard policy rules
- Size of change partly produced by lack of updating for three meetings
  - No previous updating partly because of the “at least through…” condition -- explained by Chairman at November press conference
- Provides additional stimulus by moving market expectations
  - Expectations about balance sheet also affected
- Guidance as to current expectations, not a commitment
- Minutes show the date is derived from economic conditions expected to prevail at the time

Inclusion of Participants' FFR Forecasts in SEP

- FOMC participants' projections of the **appropriate timing** of **lift-off** from near-zero interest rates



Benefits of providing participants FFR projections

- Inform public on the range of views as to the future policy path
- Allow for a richer discussion in SEP of underlying reasons for the differing views on policy path particularly the contingent nature of the projections
- Supplement the contingent information in the FOMC statement ("economic conditions, including low rates of resource utilization and a subdued outlook for inflation over the medium run")
- Note that these are point estimates, and the range measures disagreement not uncertainty around each projection
- Individual projections of the future policy path are not linked to the individual projections for unemployment and inflation so it is not clear whether differences arise from differences in forecast, the loss function or some other cause

Statement of Longer-Run Goals and Policy Strategy – Part 1

Place numbers on Committee's interpretation of the dual mandate:

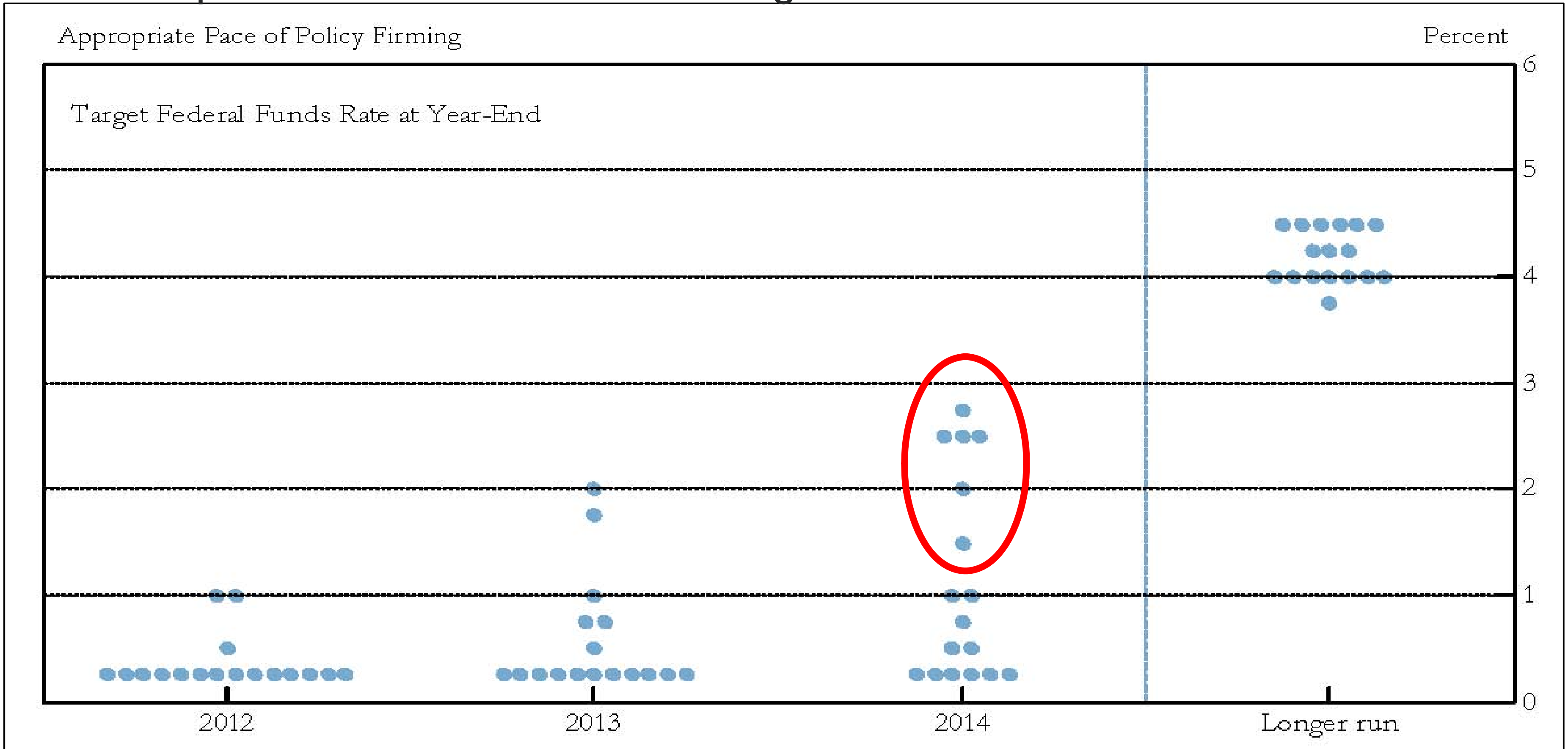
- Numerical inflation goal consistent with dual mandate:
  - "The Committee judges that inflation at the rate of **2 percent**, as measured by the annual change in the price index for personal consumption expenditures, is **most consistent over the longer run with the Federal Reserve's statutory mandate**."
- Maximum Employment goal cannot be specified in same way:
  - "The Committee's policy decisions must be informed by assessments of the **maximum level of employment**, recognizing that such assessments are necessarily uncertain and subject to revision…. For example, in the most recent projections, FOMC participants' estimates of the **longer-run normal rate of unemployment** had a central tendency of **5.2 percent to 6.0 percent** …"

Statement of Longer-Run Goals and Policy Strategy – Part 2

- Clarifies how the Committee pursues mandate in setting policy
  - "In setting monetary policy, the Committee seeks to **mitigate deviations of inflation from its longer-run goal** and deviations of **employment from** the Committee's assessments of **its maximum level**."
  - "These objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it follows a **balanced approach** in promoting them, taking into account the magnitude of the deviations and the potentially different **time horizons** over which employment and inflation are projected to return to levels judged consistent with its mandate."

Difference between statement and SEP

1. "Range of views" versus the Committee's decision
   - Markets need to know what the FOMC intends to do **as a committee**
   - Not what individual participants think is appropriate
   - Projections do not distinguish between members/participants or permanent voters and rotating voters



Why they might differ

- The statement and associated policy actions are the consensus view of the members of the committee, the SEP projections represent the individual views of both members and non-voting participants
- The forward guidance in the statement represents the collective judgment of the Committee as to what it expects the Committee to do in the future, the SEP projections represent individual perspectives as to what that individual would do
- Members may view a statement as a good compromise even if it does not exactly mirror their personal view
- Academics note that the Committee could in theory collectively chose to set out a policy path that anticipates the Committee will deviate from behavior relative to standard predictions to provide more stimulus/constraint today – though it has not done so – a so-called “time-inconsistent” policy

Other models for communication

- European Central Bank has a stated inflation objective but does not view itself as an inflation forecast targeting central bank
- Bank of England and the Bank of Canada operate explicit operate inflation forecast targeting regimes with regular monetary policy reports that provide a *collective quantitative* forecast of the economic outlook, a discussion of uncertainty around the forecast and how policy would react to changes in the outlook, and *collective implicit* guidance on the policy rate path consistent with their objective
- Norway's Norgesbank and Sweden's Riksbank also publish *collective explicit* forecasts for the policy rate path even in normal times (above ZLB). Riksbank "it's a forecast not a promise"