Toward a More Transparent FOMC

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Introduction

Thank you for that generous introduction, and thank you especially for the invitation to join you here today at the 2012 Business Law Institute. I often tell people when I give a talk that I look forward to taking their questions at the end of my speech. As a policymaker, I think that it's a great way for me to find out what people have on their minds. But today, I'm not so sure. A room full of lawyers—all trained in the fine art of cross-examination—is a bit more intimidating. But lawyer jokes aside—I do look forward to your questions, both on what I have to say today and whatever else is on your mind regarding the Federal Reserve.

I became president of the Federal Reserve Bank of Minneapolis in October 2009. One of my main objectives since then has been to make both the Minneapolis Fed and the Federal Reserve System more open and transparent. And I've been delighted to learn that I'm not at all alone in this pursuit. I see many positive developments along these lines throughout the System.

I'll spend the first part of my remarks providing some background about the functioning of the Federal Open Market Committee—the monetary policymaking arm of the Federal Reserve. Then I will talk about three recent and significant improvements in the FOMC's communication about monetary policy. I'll wrap up with a brief discussion of why these improvements have occurred recently and then open the floor for your questions.

Let me give you a quick preview of those recent changes in communication, which I'll describe in greater depth in a few minutes. The first change is that, after four of the regularly scheduled eight meetings it holds each year, the FOMC now releases the meeting participants' assessments of the evolution of future policy. The second is that after those same four meetings, the chairman of the FOMC now gives a press conference. And the third improvement in FOMC communication is that, in January 2012, the Committee released a consensus statement describing its long-run framework.[1]

The first two changes have received considerable attention from the media and the public. However, I'll spend most of my time today discussing the third item—the framework statement. Press reports on the FOMC often highlight apparent *differences* of opinion on policy among meeting participants. In contrast, the framework statement that we released in January is important because it details the *common* principles regarding goals and strategy that shape FOMC decision-making.

Before proceeding further, I'll remind you that my remarks today reflect my thoughts, and not necessarily those of others in the Federal Reserve System.

FOMC basics

To help you understand the significance of these changes, I'll start by providing some basic background on the structure and operation of the Federal Reserve System. I like to tell people that the Fed is a uniquely American institution. What do I mean by that? Well, relative to its counterparts around the world, the U.S. central bank is highly decentralized. The Federal Reserve Bank of Minneapolis is one of 12 regional Reserve banks that, along with the Board of Governors in Washington, D.C., make up the Federal Reserve System. Our bank represents the

[1] http://www.federalreserve.gov/newsevents/press/monetary/20120125c.htm

ninth of the 12 Federal Reserve districts and includes Montana, the Dakotas, Minnesota, northwestern Wisconsin, and the Upper Peninsula of Michigan.

Eight times per year, the Federal Open Market Committee—the FOMC—meets to set the course of monetary policy. All 12 presidents of the various regional Federal Reserve banks—including me—and the seven governors of the Federal Reserve Board contribute to these deliberations. (Actually, right now, there are only five governors—two positions are unfilled.) However, the Committee itself consists only of the governors, the president of the Federal Reserve Bank of New York, and a rotating group of four other presidents (currently Cleveland, Richmond, Atlanta, and San Francisco). I was on the Committee in 2011, and I'll be on it again in 2014. In this way, the structure of the FOMC mirrors the federalist structure of our government, because representatives from different regions of the country—the various presidents—have input into FOMC deliberations.

I consider this federalist structure important because it fosters valuable two-way communication between Americans and their central bank—exactly the kind of two-way communication that we're engaging in right here. Of course, one direction of communication is from regional Fed presidents to the residents of their districts. But the other direction matters a lot too, because the input from the presidents to the FOMC relies critically on information we receive from our districts about local economic performance.

Background on FOMC communication

I now want to turn to the recent changes in FOMC communications. I'll begin with some historical context. Over the past 30 years, central banks all over the world have become much more transparent about their objectives and how their current actions allow them to achieve those objectives. This transparency is widely viewed—by both policymakers and scholars—as an important means of enhancing the effectiveness of monetary policy.

Most central banks aim to keep medium-term inflation low and stable—at around 2 percent annually. They have been quite successful in achieving that goal over the past 20 or 25 years. They view that success as being due in part to their communicating on an ongoing basis how their current policy actions are consistent with that goal.

There are at least two benefits of transparency. The first is broadly appreciated: By being clear about their objectives, central banks are better able to achieve those objectives. For example, if the central bank's announced inflation target is 2 percent per year, firms and employees know that wages need to grow by 2 percent to keep up with the cost of living. That knowledge helps prevent wages from growing so fast that firms have to raise prices by more than 2 percent to cover their costs—and that in turn contributes to keeping inflation under control. In brief, then, transparency helps anchor inflation expectations.

The second benefit of transparency is less appreciated, but no less important. A transparent central bank is more accountable to the public because it is forced to be more disciplined in ensuring that its policy actions are in fact consistent with its policy objectives. The central bank knows the public will be able to track its performance. When performance matches words, the public will have an even stronger belief in the central bank, which serves to anchor inflation expectations more solidly.

So, there has been a trend toward central bank transparency internationally. What about here in the United States? I think we can all take pride in the fact that under Chairman

Bernanke and his predecessor, Chairman Greenspan, the Fed has made enormous strides in transparency. It is easy to forget that, as recently as 1993, the FOMC would act and not tell anyone for 90 days! It was not until 2000 that the FOMC began issuing the statement that many of us now take for granted. And it was a decade ago that the roll call vote of FOMC members was added to the statement. Thus, there has been substantial progress in monetary policy transparency over the past 15 or so years.

As of the beginning of 2011, the Committee had arrived at three main forms of communication. First, immediately after every meeting, the Committee issues a carefully worded, but brief, statement intended to describe the current state of the economy and to describe the current stance of monetary policy. Second, three weeks after each meeting, the Committee issues a carefully worded set of minutes that provide a longer, but still relatively high-level, description of interactions within the meeting. Third, after the January, April, June, and October/November meetings, the FOMC releases a summary of economic projections. Among other things, these quarterly releases contain information about FOMC meeting participants' goals for medium-run inflation and unemployment (roughly, over the next five to six years).

Communication changes

With that backdrop, let me turn to the communication changes that have taken place over the past year. I'll start with the release of information about FOMC meeting participants' assessments of future policy. To appreciate this change, it is important to recall that the current stimulative impact of monetary policy relies critically on people's expectations of future monetary policy actions. Monetary policy operates by affecting interest rates. If people expect short-term interest rates to stay low for a long period of time, longer-term interest rates—like those on three-year car loans—also will tend to be low, other things equal. People will borrow more to finance consumption, and firms will borrow more to undertake investment.

So, the impact of current policy depends not just on how low interest rates currently are, but also on how long interest rates are expected to remain low. To help shape those expectations, the Committee decided in January to release, on a quarterly basis, a summary of meeting participants' evaluations of the appropriate evolution of future policy. In particular, the release includes the participants' current assessments about the appropriate setting for the year-end fed funds rate in 2012, 2013, and 2014, as well as their judgments about the appropriate year of the first increase in the fed funds rate.

Here, I should stress that these assessments are *not* forecasts of what policy *will* be. They are judgments about what appropriate policy *should* be. Different meeting participants might well have different views about the evolution of economic conditions, and about how monetary policy should respond to those conditions. Those differences in viewpoints will be incorporated into their assessments of when interest rates should be raised or lowered. Thus, the recent release of these policy assessments in April showed that some participants anticipated that it would be appropriate to raise rates by the end of this year. Others anticipated that it would be appropriate to wait until at least 2015 to do so.

The policy assessments represent individual views, and so this creates the possibility of a conflict between the information in the policy assessments and the Committee's policy statement issued at the end of each meeting. As Chairman Bernanke has pointed out, the policy assessments are but one of many inputs into the policy process. In his words, the FOMC statement "trumps" whatever information is in the policy assessments themselves.

These releases about FOMC meeting participants' policy assessments will be part of the Committee's quarterly releases of its economic projections that take place after the January, April, June, and October/November meetings.

Let me turn to the second of the three recent communication innovations. Beginning last April, the FOMC made a major step toward transparency by deciding to have the chairman hold a press conference after each of these quarterly meetings. These press conferences allow the chairman to explain the Committee's actions in ways that a short written document cannot. He has more time and more words at his disposal. He can respond directly to concerns or questions about the Committee's actions. Overall, the press conferences allow the Committee to be more effective by explaining its actions more clearly and, of course, to be more accountable to the public for those actions.

There have now been five press conferences, and I think that they have been remarkably successful. In no small part, I see that success as being directly attributable to Chairman Bernanke's particular gift for exposition.

The framework statement

Finally, I want to discuss the third and most important change in communication that has taken place in the past year or so: the FOMC's release in January 2012 of a five-paragraph statement describing its long-run framework. The statement does not represent any change in the Committee's approach to policy, but it does represent a major step forward in the Committee's *communication* of that approach to the public. In particular, I think of this statement as providing the basic principles of how the Committee implements its statutory dual mandate that monetary policy should promote price stability and maximum employment. I won't go through the statement in any detail. Frankly, there is no need for me to do so: It is short and remarkably well-worded, and it deliberately shies away from technical language. I encourage all of you—indeed, all Americans—to read it when you have the opportunity.[2]

What I will do instead is describe four aspects of the framework statement that I view as especially important. The first key aspect of the framework is that it specifically translates the term "price stability" into a 2 percent target for inflation. The American public need guess no longer about the Federal Reserve's inflation intentions—either on the upside or on the downside: 2 percent is our goal.

Second, the framework describes how the Committee weighs the two mandates—promoting maximum employment and promoting price stability—against one another. Importantly, it stresses that the two mandates are typically complementary, in the sense that keeping unemployment from rising too high also keeps inflation from falling too low. I think that this point is often underemphasized in popular discussions of monetary policy.

Third, the framework enjoyed broad consensus support among meeting participants. Hence, this suggests that any changes in the framework will require the same level of broad consensus support. In this sense, one can think of the framework as being like a constitution.

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[2] For convenience, here again is a link to the statement: http://www.federalreserve.gov/newsevents/press/monetary/20120125c.htm

The fourth key feature is that while the statement provides a numerical target for inflation, it does not provide a similar explicit quantitative interpretation of the second mandate: “maximum employment.” As the statement itself says, “The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the job market.” What are these nonmonetary factors? There are many, including population trends, the incentives built into the tax system, the incentives built into social insurance safety nets, the returns to human capital accumulation for young people, and simply social norms.

All of these nonmonetary factors are hard to assess on a real-time basis, and they also change over time. Nonetheless, as the framework statement goes on to say, “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.” Different assessments will inevitably lead to differences in thinking about policy. If one monetary policymaker sees the level of “maximum employment” as being higher than another, then the first policymaker will typically favor more accommodative monetary policy than the latter.

Conclusions

Let me wrap up. We have seen three major changes in FOMC communication in less than one year’s time. Why have there been so many changes in such a short period? I think there are two reasons. One is that as an intellectual and as a policymaker, Chairman Bernanke has long been dedicated to the proposition that transparency and clarity are essential to the making of good monetary policy. His central vision has been an essential force behind these recent steps.

The other reason has to do with the current state of policy. Right now, the FOMC is targeting a fed funds rate of between 0 and 25 basis points—that is, 0 to 0.25 percentage points. The rate can't get any lower. But one way to vary monetary stimulus *today* is to influence the public's expectations of how long the fed funds rate will stay so low—and how fast the fed funds rate will rise when it does start to rise. Thus, communication, while always important, is especially so today.

While I think that we should all take great pride in the recent improvements in FOMC communication, there is still more that can be done (of course!). In prior speeches, I have spoken about the need for a public contingency plan on the part of the FOMC. Such a plan would provide clarity in two important ways. First, it would allow the public to know the kind of scenarios—both surprisingly positive and surprisingly negative—under consideration by the Committee. Second, it would inform the public about how the Committee plans to react to those scenarios.

Thanks for listening to my remarks. I'll be happy to take your questions now on these or any other topic that might occur to you.