Statement on Dissenting Vote at March 19, 2014, Meeting of the Federal Open Market Committee*

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I view the March 19 Federal Open Market Committee (FOMC) statement as an unusually significant one. In that statement, the FOMC adopted new forward guidance about the evolution of its target for the federal funds rate. I see that new guidance as being intended to describe the Committee's decisions for some time to come.

I dissented from the new guidance for two reasons. The first reason is that the new guidance weakens the credibility of the Committee's commitment to target 2 percent inflation. The second reason is that the new guidance fosters policy uncertainty and thereby suppresses economic activity. In what follows, I'll elaborate on these reasons, discuss an alternative form of forward guidance, and conclude by strongly endorsing one aspect of the FOMC's new forward guidance.

In terms of credibility: the Personal Consumption Expenditure (PCE) inflation rate has drifted downward over the past few years and is currently near 1 percent. The FOMC's new forward guidance does not communicate purposeful steps being taken to facilitate a more rapid increase of inflation back to the 2 percent target. The absence of this kind of communication weakens the credibility of the Committee's inflation target, by suggesting that the Committee views persistently sub-2-percent inflation as an acceptable outcome.

In terms of uncertainty: Currently, most labor market metrics imply that the economy is still well short of maximum employment. In its forward guidance, the Committee provides little information about its desired rate of progress toward maximum employment. Indeed, the guidance provides little quantitative information about what would characterize maximum employment. These omissions create uncertainty about the extent to which the Committee is willing to use monetary stimulus to foster faster growth, and this uncertainty is a drag on economic activity.

How could the FOMC have done better? I believe that, over the past 15 months, the Committee's forward guidance about the fed funds rate has been highly effective at shaping market expectations. That guidance has relied on an unemployment rate threshold of 6.5 percent and an inflation outlook guardrail of 2.5 percent. Given the effectiveness of this quantitative approach, I would have favored adopting a similar approach going forward.

For example, the Committee could have adopted language of the following form: "**the Committee anticipates keeping the fed funds rate in its current range at least until the unemployment rate has fallen below 5.5 percent, as long as the one-to-two-year-ahead outlook for PCE inflation remains below 2¼ percent, longer-term inflation expectations remain well-anchored, and possible risks to financial stability remain well-contained.**" This alternative guidance communicates the Committee's willingness to use monetary policy tools to push inflation back up to 2 percent. It reduces macroeconomic uncertainty by being clearer about the kinds of labor market and inflation conditions that are likely to be associated with an increase in the fed funds rate. Finally, it deals with the unlikely possibility of risks to financial stability through an explicit escape clause.

There is one key aspect of the Committee's new forward guidance that I strongly endorse. The guidance provides information about the Committee's intentions for the behavior of the fed funds rate once employment and inflation are near mandate-consistent levels. Those intentions are appropriate, and communicating them should help stimulate economic activity by reducing uncertainty about the likely path of the fed funds rate once the Committee's goals are reached.