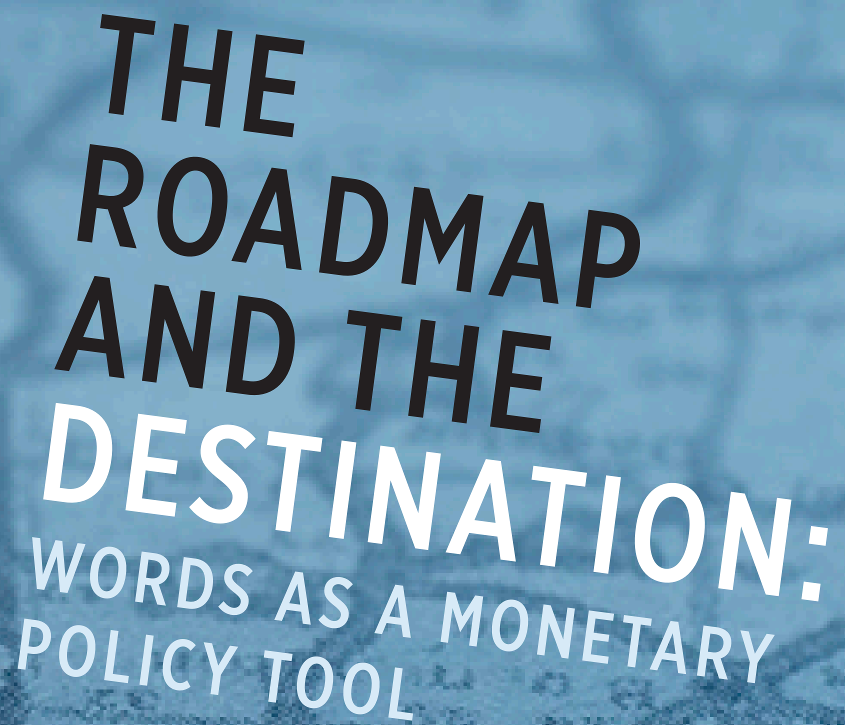

THE ROADMAP AND THE DESTINATION: WORDS AS A MONETARY POLICY TOOL

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PUBLIC UNCERTAINTY ABOUT THE ULTIMATE ECONOMIC DESTINATION CAN HINDER POLICYMAKERS' EFFORTS TO ACHIEVE THEIR GOALS. COMMUNICATING THE DESTINATION, THEREFORE, IS JUST AS IMPORTANT AS COMMUNICATING THE ROADMAP.

INTRODUCTION

The traditional monetary policy tool of central banks is interest rates. Central bankers move short-term interest rates up and down to influence the economy. But with the federal funds rate—the Federal Reserve System's main policy rate—stuck at its effective lower bound since late 2008, the Fed has relied on two less traditional tools: communication and asset purchases.

The Federal Reserve is no longer actively adding to its assets, but communication remains an active component of monetary policy (see Box 1 on page 8). Communications in recent years from the Federal Open Market Committee (FOMC), the Fed's primary policymaking body, have focused largely, though not entirely, on the Committee's expectations for the future course of interest rates and asset purchases.

I argue in this essay that this communications approach has been useful, but is incomplete. Describing the likely future path of policy—the roadmap, if you will—is clearly helpful in steering the economy. If families and businesses have a clear idea how interest rates will evolve, for example, they will find it easier to make long-term decisions. But unless policymakers also communicate clearly about the economic *goals* they aim to achieve—the destination—communications about the likely policy path alone leave the public more uncertain than it needs to be.

How much employment should people expect at different dates in the future? How much inflation? The answers to these questions are crucial information for consumers deciding how much to spend and for businesses deciding how much to invest and how many workers to hire. But a roadmap for policy tools does not provide these answers. In turn, public uncertainty about the ultimate economic destination can hinder policymakers' efforts to achieve their goals. Communicating the destination, therefore, is just as important as communicating the roadmap.[1]

Of course, policymakers cannot perfectly forecast the future, so they cannot promise that a certain inflation rate or level of unemployment will be achieved in a particular year. Nonetheless, they can say what they are trying to accomplish. If all goes according to plan, in what year do they intend to bring inflation back to the FOMC's 2 percent target? What labor market conditions do they expect will prevail at that time?

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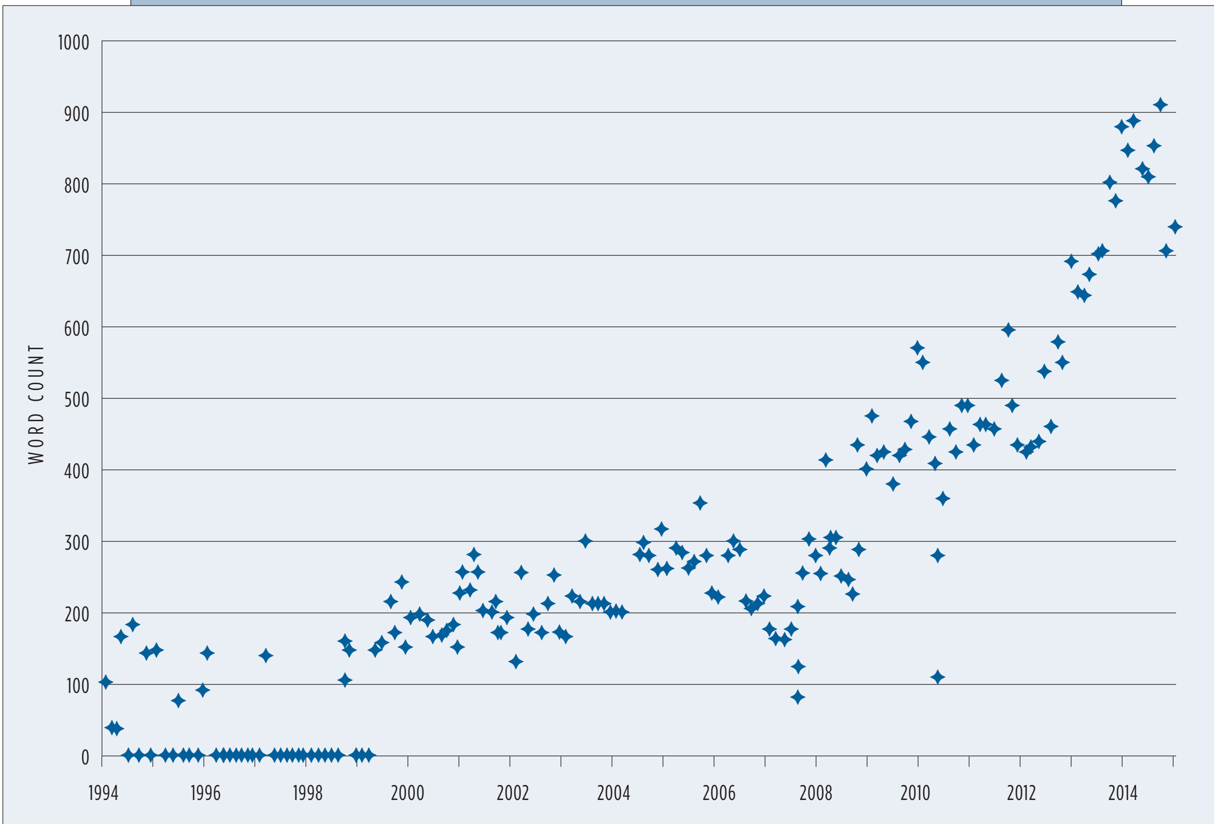
JOE PACZKOWSKI PHOTOGRAPHY

BOX 1

MORE TO SAY

Words are a more intensively used monetary policy tool than ever before. As this figure shows, the FOMC's post-meeting policy statements are longer than at any time since the first statement was issued in 1994.



Source: Author's calculations; FOMC statements from federalreserve.gov

The situation is like that of a bus company issuing a schedule for trips from Minneapolis to Chicago. The company must provide at least a basic roadmap—we'll stop in Rochester and Madison—so passengers know where they can board the bus. But the company cannot commit to an exact map—to drive through downtown on a particular avenue—because traffic jams or construction projects might force the driver to choose a somewhat different route.

What passengers really want to know, though, is that the bus is heading to Chicago and will arrive there at roughly such-and-such a time. And although this, too, is something the company can't forecast perfectly, it can say something simple that answers the passengers' question: We aim to get this bus to Chicago by 9 p.m.

Similarly, central bank policymakers will be most effective if they communicate clearly not only what they intend to do, but what they intend to achieve—the destination as well as the path.

The essay proceeds as follows. I begin by reviewing the basics of how communication about roadmaps and destinations can help achieve monetary policy goals. I then discuss how the FOMC has communicated in recent years. Next, I show how lessons learned from research and from the Fed's recent experience demonstrate the importance of communicating about a policy destination. I conclude by describing ways that Federal Reserve communications might be improved. Views expressed here are my own, and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

An underlying assumption of this essay is that clear communication is a basic obligation of democratic policymakers. From this perspective, the question is not whether to communicate transparently, but rather how best to be transparent.[2] I therefore do not explore whether non-transparent communications strategies might achieve better outcomes.[3]

HOW MONETARY POLICY COMMUNICATIONS INFLUENCE THE ECONOMY

The purpose of monetary policy communications is to explain the central bank's actions to households and businesses, so that they can understand the policy choices being made on their behalf and can therefore form accurate, fully informed expectations about these choices. In fact, as Federal Reserve Board Chair Janet Yellen has emphasized, all monetary policy tools work in large part by influencing expectations.[4] For example, a change in the federal funds rate, which is an interest rate on overnight loans, has an impact mainly because a change in today's rate alters household and business expectations about the path of rates well into the future. Even if the Fed did not communicate at all, its actions alone might influence expectations because the public could learn from patterns in the Fed's historical behavior. But communication enhances policymakers' ability to move expectations—especially, though not only, in unusual times that have little historical precedent.[5]

Monetary policy tools must operate by influencing expectations because most economic decisions are medium- and long-term ones. The goals of monetary policy in the United States,

THE PURPOSE OF MONETARY POLICY COMMUNICATIONS IS TO EXPLAIN THE CENTRAL BANK'S ACTIONS TO HOUSEHOLDS AND BUSINESSES, SO THAT THEY CAN UNDERSTAND THE POLICY CHOICES BEING MADE ON THEIR BEHALF AND CAN THEREFORE FORM ACCURATE, FULLY INFORMED EXPECTATIONS ABOUT THESE CHOICES.

established by Congress, are the Federal Reserve's "dual mandate": maximum employment and stable prices. Monetary policy helps achieve these goals by affecting people's demand for goods and services and by influencing how businesses set prices and wages, hire workers, and make capital investments. But decisions about buying goods and services, setting prices and wages, and making capital investments have long-term impacts, so households and businesses tend to base these decisions on their expectations for the future. A family that expects its income to grow may buy a larger house. A company will give its workers a larger annual raise if it expects demand for its products to rise at a healthy clip in the next year. Likewise, if the company is considering whether to expand, it will be more confident in doing so if it expects persistently high demand for its products.

Expectations about the future are subject to uncertainty, because many different shocks can hit the economy. Monetary policy communications must account in some way for this uncertainty. In particular, policymakers cannot give a complete roadmap for their future actions—a fixed time path of interest rates, for example—because they will need to make adjustments in response to shocks. If inflationary shocks hit, the Committee may need to raise the path of interest rates. If demand falls, the Committee may need to lower the path of interest rates. A policy path that will achieve good results in one possible future will be undesirable in other possible futures.

At the same time, because so many shocks are possible, there is no way for policymakers to lay out a contingent plan for responding to every conceivable shock. At its Aug. 21, 2001, meeting, the FOMC could not have contemplated that the United States would come under terrorist attack within three weeks—let alone developed and announced a contingent plan for a monetary policy response to such an attack. But a terrorist attack did come, and on Sept. 17, the Committee responded by reducing the federal funds rate. Should that monetary policy action be interpreted as an entirely random event? Or was there a way for the public to anticipate it—to know, even before the tragedy of Sept. 11, that the Federal Reserve would respond appropriately if an unanticipated bad shock were to arrive?

In many theoretical economic models, monetary policymakers have no need to communicate to solve this problem. The public is assumed to know policymakers' goals and rationally expects policymakers to act as appropriate to achieve those goals—whatever shocks may come. Thus, in these models, families and firms can put themselves in the shoes of policymakers, work out what choices the policymakers will make in any conceivable future, and thereby know the entire contingent plan, even though policymakers never announce it.

In practice, however, making policymakers' goals sufficiently clear so that the public *can* anticipate how the Fed would respond to shocks is exactly the difficulty. The Federal Reserve Act lays out a dual mandate for monetary policy, but does not define maximum employment or stable prices. It was not until 2012, some 35 years after Congress passed the dual mandate, that the FOMC, in a "Statement on Longer-Run Goals and Monetary Policy Strategy," gave a quantitative interpretation to price stability: a 2 percent inflation rate. But even then, the

POLICY NEEDS TO REACT APPROPRIATELY TO SHOCKS, AND THE CERTAINTY THAT POLICYMAKERS SHOULD PROVIDE IS ABOUT THE NATURE OF THAT REACTION. GIVEN THE VAST VARIETY OF POSSIBLE SHOCKS, COMMUNICATING ABOUT THE DESIRED DESTINATION IS AN EFFICIENT WAY TO EXPLAIN HOW POLICY WILL REACT.

FOMC did not say how far or how long it would allow the economy to deviate from that target, and it added that it could not provide a fixed quantitative goal for employment. So the public must work hard to infer what policymakers are trying to achieve and, hence, how they are likely to act.

The public's lack of complete information about policymakers' goals means that if policymakers communicate only about their planned actions, about their roadmap, they force the public to guess how they will react to shocks that the plan does not contemplate. By contrast, if policymakers also make clear the destination they are trying to reach—acknowledging, of course, that some shocks may prevent reaching it—then the public can better infer how policy will respond to any shock.

Why care whether the public knows how policy will respond to shocks? First, conveying this knowledge is how policymakers move expectations and hence influence the economy. Second, if the FOMC is to achieve the goal of maximum employment, it must avoid creating unnecessary drags on economic activity. Uncertainty about how the FOMC itself will behave is one such drag, because households and firms will typically act more cautiously—saving more and spending and investing less—if they have more doubts about the future. Importantly, the best way to provide certainty about policy is not to establish a fixed policy that will not respond to shocks. Such a policy would be certain, but it would be certainly inappropriate. Policy needs to react appropriately to shocks, and the certainty that policymakers should provide is about the nature of that reaction. Given the vast variety of possible shocks, communicating about the desired destination is an efficient way to explain how policy will react.

THE FEDERAL RESERVE ROADMAPS AND THEIR PITFALLS

The FOMC continually emphasizes in its statements and its members' other communications that its policies depend on how the economy evolves. This data dependence, though crucial for effective policymaking, can be challenging to communicate: How can the FOMC concisely explain its potential reaction to each of the many shocks that might hit? The FOMC's recent response to that challenge has been to focus instead on the likely path of its policy instruments. This communications strategy is clearly helpful for financial market participants, who can have billions of dollars riding on whether interest rates will change in June or September. But it is of limited benefit in helping ordinary households and businesses understand where the economy is headed.

Box 2 highlights the FOMC's recent communications about its plans, often referred to as "forward guidance." Some examples are "calendar-based"; they talk about deploying interest rates or asset purchases for a particular period of time. Other examples are "state-based"; they talk about deploying interest rates or asset purchases until a particular state of the economy occurs, such as a 6.5 percent unemployment rate. Relative to calendar-based guidance, state-based guidance can give a better sense of the data-dependence of the Fed's policies—at least to the extent that the Fed clearly communicates this guidance, and the public correctly interprets it.

BOX 2

THE FOMC'S FORWARD GUIDANCE SINCE THE CRISIS

- **DECEMBER 2008:** The FOMC establishes a federal funds rate target of 0 to 25 basis points and says it "anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time." Later statements extend that horizon to "an extended period" and then to specified dates of mid-2013, late 2014, and ultimately mid-2015.

- **MARCH 2009, NOVEMBER 2010, SEPTEMBER 2011, AND JUNE 2012:** The FOMC announces programs to buy specified quantities of assets over specified time periods.

- **SEPTEMBER 2012:** The FOMC says it will buy $40 billion per month of mortgage-backed securities until the outlook for the labor market improves substantially "in a context of price stability."

- **DECEMBER 2012:** The FOMC stops forecasting a time period when exceptionally low interest rates will remain appropriate. Instead, it says it will keep the funds rate target at 0 to 25 basis points at least as long as unemployment exceeds 6.5 percent, assuming inflation remains under control.

- **DECEMBER 2013:** The FOMC slows asset purchases and says it will likely reduce them in "further measured steps" if incoming data match expectations.

- **MARCH 2014:** As unemployment nears the 6.5 percent threshold, the FOMC describes a "wide range of information" that will influence its decisions and says it anticipates that low interest rates will likely remain appropriate for a "considerable time" after the end of asset purchases.

For economists and financial analysts well-versed in Fed-speak, it may even be possible to read between the lines and infer how the FOMC will behave in different scenarios. But these forecasts do not really tell families and businesses what to expect for the variables that matter most to their decisions—variables like prices, wages, the chance of finding a job, the likely demand for their products. In other words, both calendar-based and state-based forward guidance emphasize the roadmap for policy tools—not the economic destination.

One pitfall of providing a policy map without a clear destination is that the public may misinterpret a midway stop as the ultimate destination. In December 2012, when the FOMC said it would keep interest rates effectively at 0 percent at least until the unemployment rate reached 6.5 percent, this unemployment number was intended merely as a *threshold*—a line that had to be crossed before the Committee would even consider raising rates.[6] But some FOMC participants voiced concerns that the public would mistakenly view the 6.5 percent number as a *trigger* that would result in automatic rate increases.[7] The two interpretations, threshold or trigger, imply significantly different economic destinations: If 6.5 percent unemployment is a trigger for rate increases, the FOMC must not be aiming for unemployment much below 6.5 percent, while if 6.5 percent unemployment is just a threshold for considering rate increases, the goal could be a much lower unemployment rate. The difference between those destinations could matter greatly for households and businesses. Should they plan to live in an economy with a long-run unemployment rate of 6.5 percent, or an economy with much less unemployment? By making the 6.5 percent number prominent in its communications without saying anything in its policy statements about its actual goal, the FOMC ran the risk that the public would mistake 6.5 percent for the goal and form expectations predicated on that mistake.

Another pitfall of omitting the destination is that the public can come to question what the destination is. That uncertainty, in turn, could lead to bad economic outcomes. Consider, for example, a situation in which inflation has run below the FOMC's 2 percent goal for several years. What will happen if the FOMC reacts to this situation by announcing that it will keep nominal interest rates low for a long time?[8] The conventional prediction is that this policy roadmap for low interest rates will cause households and businesses to borrow and spend, stimulating the economy and raising inflation back to the 2 percent goal.

But another outcome is also possible. In the long run, nominal interest rates tend to be lower when inflation is lower. The public could interpret the policy roadmap for low interest rates as an admission by the FOMC that inflation is *not* going to rise back to the 2 percent target. If households and businesses interpret the FOMC's announcement that way, they will expect lower inflation in the future—and those low expectations, in themselves, will lead to further downward pressure on inflation, fulfilling the expectation that inflation will remain below target. So although the low-rates policy can lead to a destination of 2 percent inflation, it can also lead to a destination of much lower inflation.[9] Making clear which destination is desired can help coordinate the public's expectations and avoid an unintended outcome.

THE IMPORTANCE OF THE DESTINATION

There are two major exceptions to the FOMC's recent focus on roadmaps. These exceptions—as well as the research literature—show both the benefits of providing a destination and the importance of explaining that destination clearly.

The first exception is the January 2012 announcement that price stability means a 2 percent inflation rate. This announcement freed the public from the need to guess what inflation rate the FOMC is aiming for. It plays a crucial role in anchoring inflation expectations at 2 percent even as realized inflation data continue to run below that target. But at the same time, it is far from being a complete destination. As the Federal Reserve Bank of Minneapolis' president, Narayana Kocherlakota, has said, the public needs to know not only what inflation rate the Fed is aiming for, but how quickly the Fed aims to get there—the benchmark time horizon for achieving this goal.[10] Households and businesses will make different decisions if they expect inflation to creep back to 2 percent over a decade than if they expect the target to be attained next year. What price increases should firms plan on this year? How good a deal is a five-year car loan at a 3 percent interest rate? The answers depend on how quickly inflation returns to the FOMC's target.

The second exception is the expanded asset purchase program that the FOMC began in September 2012. In launching that program, the Committee said: "If the outlook for the labor market does not improve substantially, the Committee will continue its purchases … and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability." The program thus involved not only a roadmap, buying assets at a pace of $85 billion per month, but also a destination: a substantially improved outlook for the labor market.

Still, this destination was not very precise. What indicators would represent substantial improvement in the labor market outlook? How rapidly does the FOMC intend to reach that goal? When the FOMC began to give more specifics, financial markets reacted sharply. In a June 19, 2013, press conference, then-Chairman Ben Bernanke said the Committee anticipated it would be appropriate to slow its asset purchases later that year if the labor market, economic growth, and inflation continued to improve in line with the FOMC's expectations. Over that and the next four trading days, the yield on 10-year Treasury bonds jumped by four-tenths of a percentage point, one of a series of financial market jolts in spring 2013 that have come to be known as the "taper tantrum." Market participants appeared to view the rising long-term interest rates as likely to reduce economic growth. In other words, markets viewed the announcement as revealing that the FOMC had changed the economic destination. But policymakers evidently did not intend this negative reaction—Governor Jerome Powell said that "market expectations began to lose touch with Committee intentions"[11]—and subsequently sought to persuade the country that they had not changed plans.

Some have viewed the taper tantrum episode as demonstrating that state-dependent for-

ward guidance and communications about the destination of monetary policy lead to undesirable volatility in interest rates and, by extension, the economy as a whole. I take the opposite lesson. The mismatch between public and FOMC expectations happened because the Committee described the destination only vaguely; markets became volatile when the Committee surprised the public with its choice of a more precise destination.

It is as if a bus left New York with an announcement that it was headed for the West Coast, the passengers expected to go to San Francisco, but when the bus got to Salt Lake City, the driver turned a bit south and drove to Los Angeles. Of course the passengers would be surprised. If the destination had been clear from the outset—for example, if the FOMC had said in September 2012 that it would use its tools as appropriate to bring unemployment down to 7 percent within a year while moving inflation closer to the 2 percent target—much confusion could have been avoided.

Academic research on central bank communications, while not entirely agreed on all points, largely supports the importance of credible signaling about goals as well as strategies, and the high costs of not communicating about goals.

• THE VALUE OF COMMUNICATING A GOAL

Orphanides and Williams (2004) investigate what happens if people do not know the central bank's inflation target. They find that this imperfect knowledge causes the central bank to respond more sharply to deviations from the target; in essence, pushing inflation closer to the target than the central bank would normally desire helps the private sector learn the target. But this policy approach is costly, because the central bank must focus more on inflation stabilization, and less on output stabilization, than it ideally would. If the central bank could communicate its target to the private sector, outcomes would be better.

• THE IMPORTANCE OF CREDIBILITY

In a recent paper, Hachem and Wu (2014) offer a stark example of the importance of credibility. They model a central bank whose *only* tool is its ability to talk about its destination—in particular, an inflation target. They find that the central bank cannot announce an inflation target that is too far from the current inflation rate: If it does so, the target will be badly missed, which will cause the public to stop paying attention to the target announcements and ignore the central bank forevermore.

• Much research on policy communications focuses on whether policymakers can credibly promise to follow policies they may later wish to change.[12] Campbell et al. (2012) distinguish between two types of forward guidance: Delphic guidance, in which the central bank predicts how the economy will evolve and how policy will

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likely respond to that evolution, and Odyssean guidance, which commits the central bank to some future action that it may later wish it did not have to take.[13] They argue that Odyssean forward guidance is powerful because a central bank that can commit to providing future stimulus can thereby stimulate the economy today. But the question of commitment is distinct from the focus of this essay. Even if a central bank cannot hold itself to promises of future actions, it can still explain its goals.

STRENGTHENING THE FEDERAL RESERVE'S COMMUNICATIONS

How might the FOMC convey its destination and not just its roadmap? One approach would be to add more details to the statement on longer-run goals, as Kocherlakota has suggested. I see expanding the longer-run goals statement as a potentially useful step forward. However, this statement is generally viewed as quasi-constitutional, a foundational document for the Committee's activities rather than a description of what it is doing at any point in time. So, in addition, it is important for the FOMC to talk directly about its destination in its routine post-meeting communications.

Staff at the Federal Reserve Bank of Minneapolis have experimented with alternative ways of writing the FOMC's post-meeting statement to communicate more effectively. Box 3 (on page 21) shows an example based on the statement from January 2015. I emphasize that this example is intended to illustrate a different communications approach for the same policy decision—not any difference in the policy decision itself.

The FOMC's actual January 2015 statement begins with two paragraphs describing recent economic developments and the Committee's economic outlook. The Committee then lays out a roadmap for the federal funds rate and states that the rate will be data dependent. The statement indicates that the Committee expects to be "patient" in normalizing policy, a word that the FOMC also used in its previous statement and that Yellen translated in a December 2014 press conference as indicating that the Committee was not likely to raise interest rates for at least the next two meetings. Thus, by repeating the word "patient" in January 2015, the Committee decided to extend by one meeting the period when it was not likely to raise interest rates. The statement also describes plans for asset holdings and concludes with a long-run roadmap for the funds rate.

The experimental alternative statement shows that the original can easily be modified to emphasize the economic destination, without any change in the policy decision that the statement conveys.[14] The alternative statement begins by stating the day's policy action and what destination it is expected to achieve. (The description of the destination draws on Committee participants' forecasts, published in the December 2014 Summary of Economic Projections, of likely economic outcomes under appropriate monetary policy.) The experimental alternative then gives details on the current policy roadmap. For interest rates, the roadmap avoids using "patient" as a code word and simply states that the Committee is unlikely to raise rates at its next two meetings. For asset holdings, the roadmap draws on the Committee's September 2014

statement on policy normalization principles. Finally, to help make the destination credible, the experimental alternative explains why the FOMC believes the roadmap will lead to the destination.

Monetary policymakers in other places and times have also communicated effectively about their destinations. In July 2012, as a sovereign debt crisis threatened the stability of the single European currency, the euro, European Central Bank (ECB) President Mario Draghi said, “Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”[15] Draghi did not say anything about what “it” would involve. Still, this clear statement about the outcomes the ECB sought to achieve increased confidence that those outcomes would, in fact, be achieved, and the euro rose 1.2 percent against the dollar on the day of Draghi’s speech.[16]

In 2013, Kocherlakota called for “goal-oriented monetary policy,” in which the FOMC would articulate a clear goal and do “whatever it took” to achieve that goal.[17] He argued that U.S. policymakers successfully used such an approach to bring down rampant inflation in the early 1980s and ought to use it again to fight severe employment shortfalls in the present day.

More broadly, though, communication about the destination need not be a tool deployed only in extraordinary circumstances. It may be tempting to think that because the Federal Reserve achieved good results for the two decades before the financial crisis without communicating about its destination, such communication will again be superfluous now that the crisis has passed and the recovery is well under way. But if the FOMC does not communicate its goals, the public must infer those goals from the FOMC’s actions. In the stable economic environment that existed before the crisis, such inferences were relatively easy. Today, by contrast, policymakers and the public face an unusual degree of uncertainty about economic fundamentals.[18]

Even in good economic times—which, after many years of recovery, 2015 may finally bring—explaining both the policy roadmap and the destination can help better align public expectations with policymakers’ goals.

BOX 3, PART 1

REWRITING THE FOMC STATEMENT TO BETTER COMMUNICATE POLICY

Minneapolis Fed staff have experimented with alternative wording for the FOMC's post-meeting statements to better communicate policy actions and rationales. On this page is the original text of the FOMC's Jan. 28, 2015, statement. On the next page is a possible alternative wording of that same statement.

ORIGINAL STATEMENT FOR JAN. 28, 2015

Information received since the Federal Open Market Committee met in December suggests that economic activity has been expanding at a solid pace. Labor market conditions have improved further, with strong job gains and a lower unemployment rate. On balance, a range of labor market indicators suggests that underutilization of labor resources continues to diminish. Household spending is rising moderately; recent declines in energy prices have boosted household purchasing power. Business fixed investment is advancing, while the recovery in the housing sector remains slow. Inflation has declined further below the Committee's longer-run objective, largely reflecting declines in energy prices. Market-based measures of inflation compensation have declined substantially in recent months; survey-based measures of longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators continuing to move toward levels the Committee judges consistent with its dual mandate. The Committee continues to see the risks to the outlook for economic activity and the labor market as nearly balanced. Inflation is anticipated to decline further in the near term, but the Committee expects inflation to rise gradually toward 2 percent over the medium term as the labor market improves further and the transitory effects of lower energy prices and other factors dissipate. The Committee continues to monitor inflation developments closely.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress—both realized and expected—toward its objectives of maximum employment and 2 percent inflation. 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. Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy. However, if incoming information indicates faster progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.

The Committee is maintaining its existing policy 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. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

BOX 3, PART 2

REWRITING THE FOMC STATEMENT TO BETTER COMMUNICATE POLICY

Minneapolis Fed staff have experimented with alternative wording for the FOMC's post-meeting statements to better communicate policy actions and rationales. On the previous page is the original text of the FOMC's Jan. 28, 2015, statement. On this page is a possible alternative wording of that same statement.

A REWRITTEN STATEMENT FOR JAN. 28, 2015

SUMMARY

On Jan. 28, 2015, the Federal Open Market Committee decided to maintain the current levels of its monetary policy instruments. The Committee extended by one meeting the period when it is not likely to increase the federal funds rate target. The Committee expects that its plan for the federal funds rate and asset holdings will return the economy to maximum employment this year and to an inflation rate near 2 percent within two to three years.

POLICY STANCE

FEDERAL FUNDS RATE

• CURRENT LEVEL: The target range remains 0 to 1/4 percent.

• FUTURE PLAN: The Committee is not likely to increase the target range at either of its next two meetings. The Committee will continue to set the target range based on realized and expected progress toward its inflation and employment objectives. The Committee will use a wide range of information to assess this progress and will take a balanced approach to the two goals. Even after employment and inflation are near the objectives, the Committee may temporarily need to keep the target federal funds rate below normal levels in order to achieve the dual mandate.

ASSET HOLDINGS

• CURRENT ACTIVITY: The Committee will continue reinvesting principal payments from agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The Committee will continue rolling over maturing Treasury securities at auction.

• FUTURE PLAN: At some time after it begins increasing the federal funds rate target, the Committee will reduce its asset holdings by stopping reinvestment of principal payments. In the long run, the Committee will hold primarily Treasury securities.

RATIONALE

The Committee determines how to attain its statutory mandate of maximum employment and price stability by reviewing information on resource utilization and inflation.

RESOURCE UTILIZATION

The labor market has improved further, with strong job gains and a lower unemployment rate. Risks to the outlook for resource utilization appear nearly balanced.

INFLATION

Falling energy prices have pushed inflation further below the Committee's longer-run objective of 2 percent. Market-based measures of inflation compensation have declined substantially in recent months. However, survey-based measures of longer-term inflation expectations have remained stable. Inflation will probably fall more in coming months before rebounding as the labor market improves and transitory influences dissipate.

POLICY DECISION

The Committee determined that its outlook for employment and inflation over the medium term, coupled with stable survey-based measures of longer-run inflation expectations, justifies maintaining the current stance of monetary policy.

ENDNOTES

[1] The metaphor of roadmaps and destinations is inspired by Andrew Levin's use of global positioning system-based devices for generating driving directions as a metaphor for monetary policy communications in remarks at the 2014 Bank of Canada Annual Research Conference. But where Levin called for more attention to turn-by-turn directions, this essay emphasizes ultimate outcomes.

[2] See Stein (2014).

[3] For a contrasting perspective, see Stein (1989).

[4] See, for example, Yellen (2013).

[5] See Yellen (2013) for more on this point.

[6] The Committee did leave open the possibility that it would raise interest rates before unemployment fell to 6.5 percent if inflation was projected to be unduly high or inflation expectations became unanchored.

[7] See Bullard (2012) and Federal Open Market Committee (2012). One participant, Federal Reserve Bank of Philadelphia President Charles Plosser, later called for the threshold to be converted to a trigger; see Plosser (2013).

[8] The nominal interest rate is the rate a borrower pays a lender; it is not adjusted for inflation.

[9] See Benhabib, Schmitt-Grohé, and Uribe (2002) and Cochrane (2015).

[10] See Kocherlakota (2014).

[11] See Powell (2013).

[12] See Kydland and Prescott (1977).

[13] The terms refer to the Oracle of Delphi, a priestess renowned for her prophesies, and to the Greek king Odysseus, who had himself tied to the mast of his ship so he could resist the temptation of the sirens' song.

[14] Because the experimental statement is designed to reflect the FOMC's actual policy decision in January 2015, it does not necessarily reflect the views of Kocherlakota, who is not a voting member of the FOMC in 2015.

[15] See Draghi (2012).

[16] But the ECB's recent experience also shows the limits of communicating about the destination. ECB officials have said repeatedly that they are aiming for inflation close to 2 percent. Nonetheless, both the inflation rate and market-based measures of inflation expectations slid significantly in the eurozone in 2014. Communication about a destination will persuade the public to expect that destination only if the central bank also shows by its other actions that it will indeed do what it takes to get there.

[17] See Kocherlakota (2013).

[18] Witness the current academic debate about "secular stagnation," the possibility that the economy's long-run growth rate will be much lower than in the past. (See Teulings and Baldwin 2014.) Such stagnation, to the extent it occurs, will tend to require lower interest rates for any given level of inflation and employment. But with little agreement among leading experts about whether secular stagnation is occurring, it will be challenging for the public to infer the meaning of any particular interest rate choice by the FOMC: Does it signal a change in the Committee's assessment of the risks of secular stagnation, a change in the Committee's desired paths for inflation and employment, or some other change?

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