BROOKINGS

Improving Fed Communications: A Proposal

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The FOMC's communications toolbox

The Fed has tended to lag best practice but today its communications toolbox is broadly similar to those used by other advanced economy central banks

- Post-meeting statement (1994), press conference (2011), minutes
- Inflation target (2012), use of forward guidance, public outreach
- Speeches and testimony
- Regular reports like the Beige Book and SLOOS

- A nonstandard Fed tool is the release of **FOMC participants' projections of macro variables and policy rates.** Will return to this.

The FOMC communications toolbox lacks a key element

- **However, the Fed differs from virtually all peer central banks in offering limited context and explanation of the policy decision *at the time of the policy announcement*, when attention to monetary policy is greatest.**
- In contrast, other central banks release quarterly **Monetary Policy Reports** or similar documents with or shortly after the policy decision
- **Monetary Policy Reports at other central banks typically include**:
  - Review and analysis of **recent economic and financial developments**
  - **Special topics and deep dives** on relevant issues
  - **A macro forecast**, including a transparent discussion and explicit assumptions

Advantages of a timely MPR

- **Transparency.** MPRs provide the public valuable insight into the rationale for the policy decision and the factors likely to determine future policy choices, building public understanding, credibility, and confidence
- **Insight into the outlook.** A comprehensive, internally consistent forecast can be used to identify the key factors driving the outlook (and changes in the outlook)
- **Better communication.** A fully articulated forecast allows for **more quantitative communication** while providing a baseline for creating *alternative scenarios*. **Alternative scenarios** facilitate communication that emphasizes the **inherent uncertainty about the outlook** and provides important information about the central bank's **policy reaction function**

How (with hindsight) the Fed might have communicated with alternative scenarios in periods of uncertainty

- Example 1. (2021) "…Based on current information, the most likely scenario is that the increase in inflation will be transitory. **But if inflation proves higher and more persistent than expected, we will do this (e.g., suspend QE, prepare to raise rates). If inflation is transitory but growth is weaker than expected, we will….**" Alternative scenarios to illustrate reaction function quantitatively or qualitatively. Helps prepare public and markets for changes in policy.
- Example 2: (2012) "…QE3 will continue until labor markets show substantial improvement, **meaning a decline in unemployment of xxx percentage points or more. If substantial improvement has not occurred in the next yyy months, or if financial stability concerns become severe, asset purchases will be phased out over a period of approximately…..**"
- Recently we've seen more use of the multiple scenario approach at the Fed (Powell, Waller). See also Bank of Canada, IMF World Economic Outlook

The Proposal: A Scaled-Down MPR with a Staff Forecast

- With the policy decision, release an (abbreviated) quarterly **Monetary Policy Report** led by Board staff with FRB contributions
- Besides a review of recent developments, deep dives, and various special features, the MPR would include **staff forecasts of key macro variables, with discussion of key driving factors and underlying economic assumptions. Selected alternative scenarios** would be presented, with FOMC input into the choice of scenarios to release
- **An FOMC consensus forecast would be preferable**, but 2012 experiment showed difficulty of achieving agreement in available time.

Why aren't the Summary of Economic Projections (SEP) and the dot plot alone good enough?

Participants' projections of macro variables and rates provide some insight and should be retained with modifications (see below). But they have significant drawbacks relative to a transparent, internally consistent forecast

- Projections made before the meeting **may not reflect post-meeting consensus**
- The dot plot forces **de facto forward guidance**, cannot accommodate state-contingent guidance (or no guidance)
- Projections are **not transparent** and offer no rationale or analysis
- Median projections **focus market and media attention on one central scenario**, de-emphasizing uncertainty and alternative scenarios

Possible objections to releasing a staff forecast

- **Demands on staff.** Not a serious concern. Much smaller central banks do MPRs with forecasts. The report would largely be based on FOMC briefing materials, with contributions from Reserve Banks. Distributed with Tealbook.

- **It would inhibit staff's ability to be frank with FOMC, e.g., about projected effects of nonmonetary policies.** Assumptions underlying public forecasts could stick closely to current and announced government policies. Unlikely but possible scenarios discussed internally only. Brexit example

Why a staff-led MPR and forecast would get attention

- **Observers know that briefing materials are influential.** At a minimum, releasing some of these materials increases transparency
- **It works for the ECB.** The staff forecast is influential because policymakers talk about it and reference it in the press conference and statement
- **The MPR, including the forecast, would be influenced by FOMC views through various channels.** The paper describes various opportunities for FOMC input, including in pre-meeting calls and in determining which alt sims to release
- **Releasing summaries of participants' SEP commentary (already collected!) on staff forecast and rate projections** would identify areas where FOMC participants might disagree with the staff

Mock MPR-style document (Appendix)

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Possible improvements to the SEP, if retained

- Leave time in the meeting for participants to update projections.
- In communication, emphasize that the dot plot is not always forward guidance, not a plan, and not a promise
- **Release summaries of participants' written commentary** (already collected)
  - Why does the projection take the shape it does?
  - Why did the outlook change?
  - What are the most likely alternative scenarios and their implications?
  - What are participant views on the staff forecast and policy assumptions?
- **De-emphasize the median projections in favor of greater attention to uncertainty and alternative scenarios in communication**.

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