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Communications Challenges and Quantitative Easing

Remarks by

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It is an honor to be here today with such distinguished panelists to discuss the communications challenges associated with quantitative easing. I should say at the outset that the views I express here today are my own and may not reflect those of other Federal Open Market Committee (FOMC) members.

I'll start with the FOMC's commitment, when the current asset purchase program was launched in September 2012, to continue purchases until the Committee sees a substantial improvement in the outlook for the labor market, a term the Committee left undefined.<sup>1</sup> This commitment was powerful precisely because it was open ended. But "open ended" does not mean unending. As time passed and labor market conditions improved, it would be important for the Committee to clarify the meaning of the term substantial improvement. And given the lack of precedent, it was likely that this transition to more-specific guidance would involve some short-run volatility.

Economic conditions have improved since the program was launched. Consumer and business confidence moved higher, and sectors such as housing and autos have performed well. Despite strong, ongoing headwinds from fiscal policy, there has been significant progress in the labor market. From September 2012 through August of this year, the private sector created 2.3 million new jobs. The unemployment rate declined from 8.1 percent to 7.3 percent. It's unclear how much of this improvement was due to the program, but I think there is evidence that it played a role, lowering long-term interest

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<sup>1</sup> The Committee also noted: "In determining the size, pace, and composition of its asset purchases, the Committee will, as always, take appropriate account of the likely efficacy and costs of such purchases." See Board of Governors of the Federal Reserve System (2012), "Federal Reserve Issues FOMC Statement," press release, September 13, [www.federalreserve.gov/newsevents/press/monetary/20120913a.htm](http://www.federalreserve.gov/newsevents/press/monetary/20120913a.htm).

rates and raising equity prices and home prices, effects that have supported household and business spending.

In March 2013, the Committee began noting in its postmeeting statement that it would consider “the extent of progress toward its economic objectives” in judging “the size, pace, and composition of its asset purchases.”<sup>2</sup> In late May, the Chairman stated, in response to a question during a congressional hearing, that the Committee might begin to reduce the pace of asset purchases “over the next few meetings.”<sup>3</sup> A few weeks later, at his press conference after the June 2013 FOMC meeting, the Chairman noted that the substantial improvement test might well be met over the coming year, and he therefore set forth a framework designed to clarify the path of purchases.<sup>4</sup>

Under the most recent articulation of that framework, in considering when to reduce purchases, the Committee will “assess whether incoming information continues to support [its] expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective.”<sup>5</sup> The path of purchases is entirely data dependent, as numerous FOMC participants have emphasized in public remarks.

The market reaction to the Chairman’s May testimony and the June FOMC press conference was significant, particularly given the modest character of the news: that the Committee might bring purchases to a gradual halt over the course of a full year, but only

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<sup>2</sup> See Board of Governors of the Federal Reserve System (2013), “Federal Reserve Issues FOMC Statement,” press release, March 20, [www.federalreserve.gov/newsevents/press/monetary/20130320a.htm](http://www.federalreserve.gov/newsevents/press/monetary/20130320a.htm).

<sup>3</sup> The Chairman delivered a statement before the Joint Economic Committee, U.S. Congress, on May 22, 2013.

<sup>4</sup> Information on the Chairman’s June 19, 2013, press conference is available on the Board’s website at [www.federalreserve.gov/monetarypolicy/fomcpresconf20130619.htm](http://www.federalreserve.gov/monetarypolicy/fomcpresconf20130619.htm).

<sup>5</sup> See Board of Governors of the Federal Reserve System (2013), “Federal Reserve Issues FOMC Statement,” press release, September 18, [www.federalreserve.gov/newsevents/press/monetary/20130918a.htm](http://www.federalreserve.gov/newsevents/press/monetary/20130918a.htm).

if the economy performs broadly in line with the Committee's expectations--which is to say, pretty well.

Many factors may have contributed to this market reaction. Among them, I would argue that market expectations began to lose touch with Committee intentions in two ways. First, while the Committee sees policy as data dependent, markets seem to fix on dates. The decision to reduce purchases now or to hold off for a meeting or two does not carry great macroeconomic significance. But, to a fixed-income trader, the timing of the decision is everything. It appears that many market participants concluded after the June press conference that the Committee was eager to reduce purchases and committed to doing so at the September meeting, independent of incoming data.

Second, the expected path of the federal funds rate, as reflected in various market prices, increased significantly, implying an earlier liftoff from the zero lower bound than suggested by the Committee's forward guidance.<sup>6</sup> Many FOMC members had said publicly that the decision to reduce purchases did not reflect any change in the Committee's plans for holding the federal funds rate at its current level.

The September decision not to reduce purchases clearly took some market participants by surprise. For me, the decision was a close call, and I would have been comfortable with a small reduction in purchases. However, as the minutes of the September FOMC meeting reflect, there were legitimate concerns about the strength of incoming economic data, the economic effects of tighter financial conditions and of

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<sup>6</sup> Decomposing federal funds futures into components representing the true expected path of the federal funds rate and term premiums is difficult. Staff models suggest that a portion of the upward revision in the federal funds futures curve over this period was associated with a pulling forward in the expected date of liftoff in the federal funds rate.

tighter fiscal policy, and the prospect for disruptive events on the fiscal front.<sup>7</sup> I supported the decision as a reasonable exercise in risk management. Events since the September meeting suggest that the concerns regarding fiscal matters were well founded.

I would like to push back against the narrative that the decision at the September meeting has damaged the Committee's communications strategy. In its communications, the Committee seeks to influence market conditions over the medium term in a way that is consistent with its policy intentions. As I suggested earlier, as we navigate this unprecedented transition back to more normal policy, there may be volatility in the short run. And we will continually strive to improve our communications and avoid surprises. But, at the end of the day, my own judgment is that market expectations are now better aligned with Committee assessments and intentions.

The September decision underscored the Committee's intention to determine the pace of purchases in a data-dependent way based on progress toward our objectives. Moreover, the modest net tightening in financial conditions since the June meeting has likely reduced the prevalence of highly leveraged, speculative positions. I believe that the market is now prepared for a reduction in purchases when the economic outlook and the broader situation support it.

Short term rates have fallen back since the September meeting, and are now better aligned with the Committee's forward rate guidance. This is particularly important because, as the Chairman stressed in September, the Committee views rate policy as its stronger and more reliable tool.

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<sup>7</sup> See Board of Governors of the Federal Reserve System (2013), "Minutes of the Federal Open Market Committee, September 17-18, 2013," press release, October 9, [www.federalreserve.gov/newsevents/press/monetary/20131009a.htm](http://www.federalreserve.gov/newsevents/press/monetary/20131009a.htm).

To wrap up, let me emphasize that what matters is the overall stance of policy, not the pace of asset purchases. In all likelihood, policy will remain highly accommodative for quite a while longer--as long as needed to support an economy that still struggles to shake off the lingering effects of the financial crisis.

Thank you.