MONETARY POLICY PANEL

Luncheon Meeting, February 17, 2012

AGENDA

Changes in the FOMC Communication

At its January meeting the FOMC introduced two innovations to its public communication. In addition, it modified the forward guidance language in the post-meeting statement.

New Communication Tools

1. The FOMC issued a statement on Long-Run Goals and Policy Strategy. There are two important elements in this statement:
    a. The FOMC provided an interpretation of its statutory mandate by defining a longer-run objective for inflation and providing information about its assessment of the longer-run normal rate of unemployment:

        "The Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate."

        and

        "FOMC participants' estimates of the longer-run normal rate of unemployment had a central tendency of 5.2 percent to 6.0 percent, roughly unchanged from last January but substantially higher than the corresponding interval several years earlier."

    b. The FOMC stated the *principles* that will guide its policy in attaining these objectives:

        "In setting monetary policy, the Committee seeks to mitigate deviations of inflation from its longer-run goal and deviations of employment from the Committee's assessments of its maximum level. These objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it follows a balanced approach in promoting them, taking into account the magnitude of the deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate."

2. The FOMC elicited the participants' projections, based on their individual assessments of appropriate monetary policy and compatible with their economic forecasts, of the path of the federal funds rate over a three-year horizon and over the long-run. Chairman Bernanke discussed these projections at the post-meeting press conference on January 25 (available at http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20120125.pdf.) These projections will be routinely included in the Summary of Economic Projections (SEP) that is released 4 times a year with the minutes of the FOMC meetings. The minutes of the January meeting will be published on February 15 (they will be available at http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20120125.pdf.)

Modified forward guidance

In the statement the FOMC extended to late 2014 the period of time for which it expects that the federal funds rate will remain "exceptionally low":

> "…the Committee decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014."

At this meeting we will discuss the implications of these three aspects of the enhanced Fed's communication and their impact on the conduct of monetary policy going forward.

Discussion items

- To what extent does the statement of long-run goals improve the effectiveness of monetary policy?
- Does the communication about the "policy strategy" provide useful information on the FOMC reaction function?
- How could potential conflicts between participants' policy rate projections and FOMC policy guidance be resolved?
- Is the adjustment of the calendar time for an exceptionally low federal funds rate effective in communicating a more accommodative stance? Or does it obscure the message that the target range is contingent on the state of the economy?