



The FOMC: Transparency Achieved?

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During the past two decades, central banks have increasingly adopted inflation targeting because theoretical and empirical analyses suggest that its use promises improved economic performance.¹ Simultaneously, central banks have sought to improve the transparency of their policymaking because macroeconomists argue that the full potential gains of inflation targeting will be realized only when such greater transparency is achieved.²

The Federal Open Market Committee (FOMC) formally adopted inflation targeting at its January 24-25, 2012, meeting, setting as its goal a medium-term increase of 2 percent annually in the chain-price index for personal consumption expenditures. With this action, the Federal Reserve (specifically, the FOMC) became the only inflation targeting central bank among the G-7 countries that does not release in a timely fashion the staff analyses, models, and projections that underlie its policy actions.³ These FOMC staff materials, compiled in the Greenbook and the Bluebook and now recently combined into the Tealbook, are released with a 5-year lag. Absent publication of such materials, is the FOMC sufficiently transparent to realize the full promised gains of inflation targeting?

Modern definitions of transparency emphasize the extent to which the public clearly understands how policymakers respond to incoming economic data—that is, their implicit or explicit economic models—and their related monetary policy rules and preferences. Geraats (2009, p. 237) defines monetary policy transparency “as a situation in which there is no asymmetric information about monetary policy-making,” that is, the public fully understands how policymakers will react to incoming economic data. Poole (2001, 2005) defines transparency as existing when information provided by policymakers is sufficiently complete that market participants can replicate the central bank’s analysis and forecasts.

The FOMC’s modern track record is one of increasing transparency.⁴ From the FOMC’s first meeting in 1936 through early 1967, each year’s policy actions were announced the *following* year. Beginning in mid-1967, policy decisions were announced 90 days after each meeting. That delay was later shortened: Starting in early 1994,

decisions were announced at the conclusion of each meeting if the target federal funds rate had been changed. In addition, minutes of each meeting were released after the subsequent meeting. Beginning with the July 6, 1995, meeting, a numerical target for the federal funds rate was announced at the end of each meeting. In 2000, the FOMC began issuing a statement at the end of every meeting (regardless of whether the target federal funds rate had been changed) accompanied by a “balance of risks” proviso. In 2005, expanded FOMC minutes began to be released three weeks after each meeting.

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The release of forecasts by FOMC participants also has become more frequent. Beginning in 1979, 2-year-ahead forecasts began to be released twice each year. Beginning in October 2007, 4-year-ahead forecasts began to be released quarterly. On January 25, 2012, the FOMC for the first time published participants’ forecasts of future levels of the federal funds rate. Additional economic information is provided in other venues as well. In April 2011, Fed Chairman Bernanke began post-FOMC meeting press conferences, holding four per year. Further, individual FOMC participants frequently speak to the public regarding economic conditions and FOMC actions.

Are these actions sufficient? One way to assess sufficiency is to ask if the public, armed with these announcements and forecasts, might infer correctly the underlying macroeconomic models and policy rules being used by FOMC meeting participants. Modern macroeconomic analysis emphasizes that few, if any, important decisions depend on the *announced* level of the central bank’s overnight target interest rate. Rather, what *is* important is the complete expected future path of the overnight rate because

the *set* of expected future interest rates affects the relative intertemporal planning of consumption, saving, production, employment, leisure, investment, and so on. Further, that set of expected future rates depends on expectations of how the FOMC will react to future values of economic variables that differ from their published forecasts—that is, the *mechanism* of policymaking, not just the forecasts alone. Hence, transparency requires revealing, to the maximum extent possible, the underlying *processes* used to form these projections.

Macroeconomic theory suggests that it is difficult to infer policymakers' models and policy rules (or preferences) based on policymakers' forecasts of inflation, output, unemployment, and the policy rate. Necessary conditions include that (i) the economy is well described by a small number of equations that do not change over time, (ii) the central bank is credibly committed to an unchanging policy rule, and (iii) the public uses the correct model of the economy to form its forecasts.⁵ But in the real world, these conditions are unlikely to be satisfied. Former Fed Chairman Alan Greenspan, for example, (often) reminded us that monetary policymaking is an exercise in risk management, not in optimal control, because the world is constantly changing. And Chairman Bernanke (2004) noted that “specifying a complete and explicit policy rule, from which the central bank would never deviate under any circumstances, is impractical... The number of contingencies to which policy might respond is effectively infinite.” Geraats (2009) notes that although central banks have become more transparent since 1998 (at least, in her database of 98 banks), they remain opaque in the disclosure of information about policy deliberations and policy inclinations—essential information needed by the public to assess and understand the process of policymaking.

What is the risk to the economy if the public cannot accurately infer policymakers' models and rules from published forecasts and FOMC minutes? Consider the academic literature on adaptive learning, as discussed by Chairman Bernanke (2004). When the public does not know but must infer policymakers' models and rules, there is no guarantee that the economy will converge to a desirable equilibrium. Errors by the public in inferring policymakers' models and rules are errors also in understanding the relationships among current and future values of economic variables, including short- and long-term interest rates. To the extent that such errors affect household and firm decisions, they affect the behavior of the overall economy. In turn, those economic outcomes feed back into the learning

process, creating further errors in forecasting future values.⁶ Macroeconomic theory suggests that such an economy, riddled with erroneous beliefs, risks becoming trapped in a high-unemployment, low-growth equilibrium if the erroneous economic outcomes come to be accepted as reality by the public. As former St. Louis Fed President William Poole emphasized, greater transparency is a means to better synchronize the public with policymakers and minimize the risks of undesirable economic outcomes. ■

Notes

¹ Walsh (2009) and Svensson (2010, 2011).

² Blinder et al. (2008) and Geraats (2002, 2009).

³ The G-7 includes the United States, United Kingdom, Canada, France, Germany, Italy, and Japan.

⁴ The FOMC's journey toward transparency is chronicled by Lindsey (2003) and Bernanke (2007).

⁵ Blinder et al. (2008), Woodford (2005), and Geraats (2009).

⁶ Bernanke (2004).

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