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Improving FOMC Communication

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The last thing the world needs right now is more uncertainty. That is why President George W. Bush's vote of confidence in Alan Greenspan is so welcome. Now it is the turn of Mr. Greenspan and his colleagues to minimize the uncertainty created by their own actions.

Since beginning his tenure in 1987, the Federal Reserve chairman and his colleagues have worked diligently to remove an additional uncertainty in the economy - the one they themselves create. But they can and should do better. They should publish the minutes of their meetings as soon as practically possible.

As everyone in financial markets around the world knows, the Federal Open Market Committee now makes a public statement immediately following each of its scheduled meetings. It has been issuing such statements regularly since 2000.

We have come a long way from the days when central bankers relied primarily on obfuscation and mystique, claiming that even accurate information could be misinterpreted and result in undesirable financial market volatility.

Nevertheless, there are still faults with the current system. They centre on the tail end of the FOMC's statement, describing what is known as the "balance of risks". The purpose of the balance of risks is to clarify the committee's collective assessment of the likely path of the economy and hence its policy response beyond the next FOMC meeting.

The language of the public statement has presented everyone with a challenge. The single sentence on the balance of risks gives the committee only three choices. Risks can be balanced, so the next move is as likely to be up as down, or risks can be skewed towards either increasing inflation or slower growth, suggesting it is probable that the next move is more likely to be either up or down. The difficulty arises from the fact that there is no natural mechanism for adapting the balance of risks to current events or adding nuance.

The deficiencies of the current scheme have now become painfully apparent. At the end of its last meeting on March 18, the FOMC did not use a stock phrase. Instead it said: "In light of the unusually large uncertainties clouding the geopolitical situation in the short run and their apparent effects on economic decision-making, the committee does not believe it can usefully characterize the current balance of risks with respect to the prospects for its long-run goals of price stability and sustainable economic growth."

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The result was confusion. Central bankers are conservative in every way and especially careful with their words - that is one of the primary qualifications for the job. So why would they refuse to follow the protocol? Was it a signal of a higher probability of an interest rate change before the next meeting, scheduled for tomorrow? How could things be so unclear that even the experts, with hundreds of Fed staff, did not know whether interest rates were more likely to go up, or down, or stay the same in the next few months? And there were those who concluded that the statement was disingenuous. Surely, when uncertainty increases to this extent, there is no basis for claiming that the risks are anything other than balanced.

When everyone is anxious, it is the job of our leaders to restore confidence. The FOMC's statement surely failed to reassure people. When it mattered most, the FOMC's communication strategy faltered. Something has to change. We need more information about what goes on at the meeting.

The essence of good monetary policy is that the economy and the markets respond to the data, not to the policymakers. Policy needs to be transparent. But transparency is not nudity. Understanding policymakers' contingency plans does not mean laying the policymaking process bare for all to see. Monetary policymakers should not put cameras in the meeting room. But they do need to find a mechanism for giving us a better sense of how they are likely to react to unfolding events.

The best solution to this problem is to eliminate the statement of the balance of risks and accelerate publication of the minutes of the meeting. Minutes are anonymous summaries of the arguments made by participants, providing a detailed window into the deliberations. Current practice is to publish them after the following meeting. The minutes of the 18 March meeting will be published on 8 May, after we have read the next FOMC statement.

The Bank of England's monetary policy committee publishes minutes two weeks after the meeting, when they can still inform observers about what is likely to occur at the next meeting. Why can the FOMC not do the same?