Transcript

Cleveland Fed Conversations on Central Banking: Challenges and Opportunities for Central Bank Communications
Federal Reserve Bank of Cleveland, May 13, 2024

Welcome:
Edward S. Knotek II, Senior Vice President and Director of Research, Federal Reserve Bank of Cleveland

Moderator:
Nick Timiraos, Reporter, *Wall Street Journal*

Panelists:
Charles Evans, Former President, Federal Reserve Bank of Chicago
Esther George, Former President, Federal Reserve Bank of Kansas City
Randall S. Kroszner, Norman R. Bobins Professor of Economics, University of Chicago Booth School of Business
Athanasios Orphanides, Professor of Practice, Global Economics and Management, MIT Sloan School of Management

Edward S Knotek II (00:01):

We're very delighted to have Nick Timiraos moderating our final panel of the day on challenges and opportunities for Central Bank Communications. This is also part of our conversations on central banking series. So please Nick, the floor is yours.

Nick Timiraos (00:16):

Great, thank you so much. Without further ado, I'll introduce the panelists and the order that they'll speak. We'll hear from each of them for about five minutes. Then I'll ask questions and then I'll turn it over to you all for questions. So to start, we will have Charlie Evans, who was President of the Chicago Fed for 15 ish years. Then we will have Esther George, who was President of the Kansas City Fed for 12 ish years. And then we will have Randy Kroszner, who is at the University of Chicago, is a former governor of the Fed and is now a member of the Financial Policy Committee at the Bank of England. And then finally we will hear from Athanasios who began his career as an economist at the Fed Governor of the Central Bank of Cyprus, and as a professor at MIT. So Charlie, over to you.

Charles Evans (01:11):

You've got some slides.

(01:16):

What am I doing with the slides? Okay, do I advance them or? Yeah, good luck. Okay. Alright. I just want to introduce a couple of ideas, really not answer any questions really with this, but I wanted to, oh, there's no fed disclaimer. I'm not with the Fed. Okay. I wanted to mention two challenges for communication. Well, one challenge and one observation. And the first one is that we don't really talk about inflation targeting versus price level targeting because everybody gave up on price level targeting a long time ago because it's so hard. You'd have to try to correct for overshooting inflation. Think about that now in the current environment and what you would've to do to economic activity. But we've certainly learned and been reminded that households really detest unexpected high inflation. And just

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because you declare victory and kind of go, I got inflation back to 2% and going forward doesn't change the fact that the price level is not exactly where they want it for a whole bunch of goods.

(02:20):

And what's the process that gets them back to the right cost of living. Second, central bankers really don't like forward guidance that much. I do, but many don't. It involves a particular type of commitment that at the wrong time really embarrasses you, but the DOT plot and the SEPs offer a soft type of forward guidance, which I think has been very useful. So lemme just show a couple of charts. Okay. This is a conference honoring, well, I mean this is a conference that's been put together in the spirit of things that President Mester has really cared a lot about transparency and monetary policy and communication. And so here's my full transparency picture of me as fed President for 15 years where I argue for a long time, you go back to December, 2007, we should be trying to get on that 2% line and we were undershooting for a lot.

(03:20):

You could say, well we didn't really do this until 2012 and that's a dash line and we undershot that a lot. So I talked about let's get inflation up. Of course bygones are bygones and that would be a lot of inflation if we've been able to do it. And then all of a sudden we've seen a lot of inflation, right? This is a chart that I showed embarrassingly at the Booth Monetary Policy Conference in February, 2022, and all of a sudden you could kind of say, well maybe we're going to get back to that 2% line, all for the wrong reasons. I don't have the research staff to help me do simple. I just did the dash line there and it looks like we're almost back. We're slightly above that 2% line. But I think getting at what's feasible, what people like and monetary policy is really important.

(04:03):

Okay, second one, how do you communicate as a monetary policy maker when you do a big pivot on monetary policy like happened after that episode and the Fed Jay Powell Fed starts raising rates a lot. This is just a reminder that around the world, central banks were surprised by the inflation persistence. This is from the IMF World Economic Report and it just shows different vintages of how everybody was sort of changing their guesses as to what inflation would be. And it took a while to get kind of stabilized at a higher rate. And in this case there was a delay in policy liftoff, and you can see this from central banks around the world. And the US was later than the Bank of England, but the ECB was later still. So when you do decide to lift off, what do you actually do? And so I just want to sort of point out backend, somebody mentioned this earlier today in January, like 94, the Fed started lifting off after having the funds rate at low level for quite some time.

(05:15):

And at that time they introduced an announcement for the first time. They hadn't been doing that before. Imagine if Jay Powell had done that. That dot down at the bottom is the first 25 basis points. And what if Jay had gone to the press conference and say the FOMC just met March of 2022, we decided to raise the funds rate, we did it for 25 basis points. I'll be back in six weeks and tell you what we're going to do after that. That's all they said. So if you're not willing to talk about it, the dot plot showed what every participant is thinking they were likely to need to do. And I put the median in the red crosshairs and at least it sort of said, well, they expect to increase the funds rate by a couple hundred basis points. This year wasn't enough. Everybody revisited what they needed. That was the inflation surprises. But in the moment it's a very good and useful communications tool and at other times the Chair doesn't want anybody to look at it. That's part of what you get with that. So just wanted to put that on the table for us to talk about.

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Esther George (06:26):

Well thank you to the Cleveland Fed folks. This is a lot of food for thought today and to all the presenters really, it made me flashback to some of my times around the table to think how might I have incorporated that or thought about that different. And Loretta, I want to just say to you what a remarkable career you have had. Loretta and I were at the Board of Governors in 2009 in different places doing a special assignment, but hers was working on communication. And so this is such a fitting way to commemorate and let me just say what a terrific colleague you have been to work with. So I'm going to just take a couple of minutes because I think this is so interesting. As I listened to the papers this morning, thinking about my time as a policymaker, how much we paid attention to communication, thinking about every word, how we'd craft the statement, trying to guess how the market would receive that information.

(07:24):

And we were trying to again, build accountability, credibility, make sure that the transmission of policy was along the lines we intended. But when I would come back home then as a Reserve Bank President and try to think about how to talk about these policies in my region, that was also a tall order. And that's what I want to make a few comments about today because trying to communicate to an audience that has technical acumen has some sense of what the central bank is trying to do as one thing. When you try to talk to the public that is experiencing the economy in a different way, it's quite another, and I'm going to make a slight twist on this communication angle for central banks because I think a lot today about the low level of trust, the public reports that they have in the government generally and true in the Federal Reserve.

(08:20):

And frankly, a lot of that goes back to the 2008 and 09 experience. I remember Ben Bernanke, he had come out to Kansas City trying to explain to the public why saving Wall Street was going to benefit Main Street. And in an interview, Bernanke said this himself. He said, I tried, but evidently I should have been doing more because some of the political reaction we're still seeing was related to that. I wish I had been better able to explain convincingly and to the public exactly what we were trying to do. And this was true of other central banks. I remember Andy Halane talking about the twin deficits that central banks had in terms of a deficit of public understanding and a deficit of trust. And so when I think about our communications to the public, I am going to take a narrow slice here and talk about how is it that you communicate with the general public from the perspective of a Reserve Bank President.

(09:25):

I think it is a lot of one-on-one contact. I mean that a little bit loosely, but there are two things that I found in my time at the Fed that I think were important on this. One was simple and understandable messages. One of my very first speeches as a Fed President in Kansas City, I had someone come up afterwards and thank me for speaking and said, I really appreciated your remarks. You really know how to dumb it down. Now I understand Midwestern nuances of compliments when I hear one, but I was really glad he followed up by saying, because I think I understood what you were saying and I mentioned that because it's hard. These are complex things. Most of the time monetary policy tools have gotten a little more complicated. So the ability to relate to a public that has regional dynamics that is basing their view of the economy on every time they put gas in their car or they pull a gallon of milk off the shelf at the store, really means relating what we do in central banks to people's lives.

(10:35):

The second thing that I would say is just inherent really in the structure of the Fed. I mean, you hear a lot of proposals to say, we could tighten that thing up. We don't need all the Feds and their branches

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like we did a hundred plus years ago. But if you think about the real underlying motivation for this structure, it had a lot to do with political support and this idea of trusting an institution that the previous two central banks were not able to achieve. And so when I think about the role of Fed Presidents getting out in that region, having a governance structure, Boards of directors where the American public actually sits at the table in those Reserve Banks, they introduce you to others in their communities. It is an aspect I think of how you engage with the general public that I think has been important. And the last thing I'll say when I think about Jay Powell getting up at the podium at every meeting, he always says this at the end of his opening remarks, which is we understand that our actions affect communities, families, and businesses across the country. Everything we do is in service to our public mission. And so I hope this afternoon, Nick, we'll talk a little bit about, it's difficult for sure, but I think it's probably never been more important that we think about that public trust today. Thank you.

Randall S. Kroszner (12:06):

Thanks very much. I don't know whether I'll actually use my slides, but you can see one of the things I want to talk about is faith-based monetary policy. The reason I say that is because I had started talking about this and Charlie knows this because as a member of his academic advisory council about five or six years ago, I said, there's too much faith in that the Fed can make statements that people will be listening, people will then understand them, people will then change their expectations and then change their behavior. And there was very, very little work that was done on this. I think today's conference shows that there is work that's being done on it. I think there should be even more work that is done on this. I think the marginal value of another paper on the zero lower bound I think is kind of low.

(12:52):

And the marginal value of trying to understand how people receive different statements from the Central Bank I think is extremely high. I'm so delighted to be here at this conference and be here with Loretta. She's been just a wonderful person. Both when I was an academic, when I was at the Board of Governors and since I left the Board of Governors in involving me in so many different conferences, engaging in so many different discussions and just being an incredibly warm and supportive person. And you usually don't hear that much about central bankers, but I think Loretta is really the exception on that. And she not only has an important impact on how I think about things, but she also has an important impact on my heart. So I really wanted to say that. And actually I think that's something that could be helpful in trying to get out to the markets because along the lines of what Esther was saying, it is very important that Jay say that.

(13:53):

But the challenge is I don't think it's perceived as being honest, not that in any way that he's not being honest, but I don't think it's perceived that way because it seems like, well, here's someone who is a central banker who is, that's not like you and me and they're different kind of people. So I think it's exactly the right sort of thing. But I think along the lines of what you were saying, how do you connect with people? How do you make them accept it and really understand what is what you're trying to convey? And we'll just quickly mention this. So some of the things are, and as we've heard today, and I think this is important for a research program, are people paying attention or not? What sort of statements do they pay attention to?

(14:47):

Can the information be presented in a reasonable way? One of the things that is a challenge for economists in general is we use words in very odd ways. The word rent, people think about that as paying their landlord. Of course economists have a very specialized meaning for that, even inflation. So that's a word that seems to be an easy word to understand. But most times, and as we've seen from

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some of the research that's been cited, when you hear about, when people talk about or when asked about inflation, they often report much higher numbers than is actually the case. And that was true before the recent inflation. And that may be because when you ask about price changes, they're focusing on which prices have changed. They're not carefully weighing out a Laspeyres versus a Paasche basket of different things and who knows what Laspeyres and Paasche are and the difference between the PCE and the CPI.

(15:44):

But thinking about it from the perspective of the individuals out there, when I was at the Fed, one of the things that we did is we were reforming the disclosure for credit cards. And what we did is we did mall intercepts, we went around the country and we asked people who were going to use their credit card that day, would you help us out a little bit? And we had some alternative model forms. What did they understand what they didn't understand? So we typically thought we as the PhDs and the lawyers who were doing this, well, you want something that's easily comparable like an average percentage rate the APR. Well, it turns out that that's useful in the normal range of business for people, but when you have these very high fees and suddenly you get an APR that's like 87%, it's not meaningful to people.

(16:31):

They want to know I was charged five bucks for that or 50 bucks for that. And now your credit card bill, the way it comes is your fees are separated out. They used to be just in throughout the month, so now it's very easy. They're separated out in a separate section, they're summed up for the month and for the year. And that was super helpful to people. And I think focusing on that kind of thing is extremely, extremely valuable. Another thing, and so one other thing that I wanted to mention that's related to kind connecting more broadly but also related to how central bankers think about these issues is what happened? Oops, well it doesn't really matter. I don't need the overhead with monetary policy versus financial stability. And so when the crisis struck with Covid, the Fed, I think quite rightly did massive purchase of securities to try to stabilize the markets, but D spreads had blown out, et cetera, but there wasn't a clear articulation of the action for monetary policy purposes versus financial stability purposes.

(17:46):

And then it became very difficult for the Fed to pull back on those asset purchases, and I think that was a problem that led the Fed to put more fuel on the inflation fire than they otherwise would've. The Bank of England. In contrast, by having a financial policy committee that's separate from the monetary policy committee can articulate this very clearly that we're looking after financial policy issues. And when there was the disruption in the gilts market in September of 22, the Bank of England was engaged in quantitative tightening. The challenge was that, well, they're suddenly massively buying assets. Same time they said they're reducing their balance sheet. How do we make sense of this? They were able to very clearly articulate, well, we're doing this for financial policy reasons, financial stability reasons, and this is temporary targeted and it will end on Friday. And that helped them to get out of that without losing credibility in that circumstance.

(18:41):

And I think this is something that I think is also very important to think about in the coming policy reviews of thinking about the role of financial stability policy related to monetary policy because in a crisis they're going to be mixed up and it's very important to pull them apart because otherwise the policymakers sometimes can get stuck in their own box and it became very difficult I think for the policymakers to pull out. So one message is try to understand from the bottom up, ask people first what they understand rather than try to get them to understand what we're saying, understand what they're

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thinking, what they're saying, and then in difficult situations, clearly separate financial policy from monetary policy. Thanks.

Athanasios Orphanides (19:36):

Okay, so it's an honor to be here and yeah, I will actually say it frankly, I see this as an event that is honoring Loretta Mester. I mean President Mester contributed to communications for a very, very long time, in my view, very, very important contributions from the way she was at the Philly Fed working with Charlie Plosser trying to convince the rest of the committee to adopt great ideas on how to improve Fed communications. Now I'm going to start with that and then say there is something that makes me different from everybody else on the panel. I have never completed any dots. I would not want to complete any dots. I left the Fed in 2007. I was working on the Humphrey Hawkins and then on preparing for the SEP later on, and I have to say that for all of the credit that we can be giving to Loretta for the communication, unfortunately the committee did not adopt all of Loretta's suggestions.

(20:46):

And this is what I want to talk about. How can we improve the SEP going forward and I will just focus on one thing. This is a sentence from a speech from 2018. Let's begin using simple monetary policy rules as benchmarks to explain our policy and decisions. One of the hardest things for central banks in general to communicate is how to describe their policy as being systematic. Some central banks rely too much on the faith approach. Just trust us. Trust us, we are systematic and that doesn't usually give you great results. The question is how to do better than this and there have been suggestions for decades about how central banks can do this with simple monetary policy rules. I'm not going to recount Loretta's speeches, but I'm going to say is that I think it would have useful if the Fed had listened to these suggestions like some other suggestions we may go to later on before the 2020 policy review and I hope that they're on the table for the next review that will be happening next year.

(21:55):

Lemme show you an example about how this works. I will actually show you here two policy rules that have been in the Tealbook and Bluebook. They were introduced in the Bluebook in 2004. They have been there, we actually have them. We can see them until 2018. Now at the Board from the 1990s, the staff was presenting rules memos to the Board of Governors and as of 2004, this became part of what the committee could do. I just want to show you with an example what these things are. We know that not everybody likes the same types of rules. There is an argument to be made for presenting alternative rules. Here are the numbers in red that were presented in Bluebooks and Tealbooks from 2004 until 2018 that we have the information for the Taylor Rule with standard coefficients and what is being called first difference rule in the Tealbook, which is a variation of the Taylor Rule that focuses on growth rates, growth rate of nominal GDP compared to normal.

(23:05):

That's it. Nothing complicated than that. Of course, we would have liked to know what these kinds of rules would have been suggesting more recently when unfortunately we did have this unfortunate, I'm going to say episode of converging too fast to Charlie's 2% line. Maybe this is one way to describe the high inflation episode. We can use something like the several professional forecasters projections are being published by the Philly Fed. Again, President Mester is very intimately familiar with these things. This is an example of what this particular rule would have suggested. And you can see this is an example of the rule that would have been suggesting that the Fed needed to start normalizing policy very, very quickly in 2021. If the Fed had been showing rules of this nature as part of the SEP as part of these communications, the Fed would have been more likely to want to explain major deviations from these rules.

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(24:16):

And in my view and the view of many others who have made this point, it would have been more likely that the Fed would have stuck with more systematic policy and we would've avoided what I call policy mistake of not adjusting policy early enough in 2021. And we would have avoided what we ended up with is the alternative, the forward guidance trap where trying to communicate that policy is going to be easy. The Fed funds rate is the solid line trying to communicate the accommodation that was indeed very important to put in place in 2020. There was no systematic policy rule in the background that would remind policy makers what you know as inflation. Inflation expectations are picking up. If you don't do anything, the real interest rates keep falling and falling and falling and falling and this is not what you want to be doing. And we see the one year example, real interest rate fell all the way to minus four in late 2021 and early 2022 when things would have been better if the adjustment can come early. So it's just one suggestion from the numerous suggestions that Loretta has made and maybe we can talk about some of the rest later on.

Nick Timiraos (25:46):

Great. Well thank you all. So the Chair has announced, Chair Powell has announced they're going to do another I guess in every five years framework review. The next one will start later this year. Should, I mean if you were brought out retirement and sent back to run a communication subcommittee, Charlie Esther, I'll start with you on this. Is there anything communications feels like it's always a work in progress? What would be at the top of your list? Is there any low hanging fruit for the next framework review? Not so much around, I mean maybe it's around changing the policy framework, but maybe keeping this focus just on communications. What's at the top of your list for if anything, in terms of improvements?

Charles Evans (26:42):

Well, yeah, no thanks for that question. So I think the Jay Powell FOMC thought long and hard about the experience after the great financial crisis, how the long run framework from 2012 had been proceeding and as you go into 2020, we'd had a long period where inflation had underrun the 2% objective and accumulated quite a lot in the spirit of trying to reserve as much monetary capacity as you could in order to cut rates when you really needed to hitting the 2% objective seemed important. And so they put in what's come to be known as flexible average inflation targeting, which said that if you go through a period where you have material underruns in inflation, then you would want to get inflation up to two and overshoot. There's a real question as to the September, 2020 implementation in the FOMC statement and whether or not there was an escape clause for the kind of rapid behavior that we saw in 2021.

(27:53):

I've written a little bit about that and I came to a conclusion that Loretta Mester had emphasized for quite a long time, and I think I frankly underappreciated and I think she was exactly right, the critical role of inflation expectations, which always I knew were important, but the fact that inflation expectations continued to be anchored during the high runup in inflation I think allowed inflation to come back down after the relative price changes from the supply shock sort of came back. So I think that sort of settled things down at three. So the lesson for the next review I think is take the best parts of what we have. There's nothing in the 2020 framework that prevented the Fed from raising the funds rate very rapidly in response to high inflation. The question was sort of how do you deal with underrun inflation and if your view is it never was a problem, I never had to worry about, it was just as good as it should have been,

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then okay fine. You could sort of try to take that out. But I think judiciously thinking about escape clauses and risk management about that is sort of the material improvement opportunity. Esther?

Esther George (29:08):

Yeah, I guess because I often get asked this question, you wish you'd have done something different with the framework and you might've raised interest rates sooner, and I don't think that I agree with Charlie. I think we had all the maneuvering room we needed for whatever lenses we were looking at this on. It wasn't the framework that said though the very fact that people raise this question I think reminds you this is used as a communication device. It is trying to tell people how we approach that dual mandate and it tells me there should be some serious looking at that and whether it is to revisit how we've weighted the language, whether we entertain a rule. I mean, if anything, Nick, I hope there will be a really willingness to roll up sleeves on this and not just be an incremental kind of review, but to say what fundamentally have we learned during this period, what would help us in terms of explaining to the public as best we can ahead of time, what that strategy is for the committee.

Nick Timiraos (30:16):

Randy, I guess I'd ask you, I mean is the SEP has now kind been through all seasons, it's been through low inflation, high inflation season, a low rate, a high rate season, so it's been stress tested. I guess do the benefits of having the SEP outweigh the well-publicized drawbacks in your view?

Randall S. Kroszner (30:39):

I think it should be reformed. So I think having some form of getting information out to the public about what the members of the FOMC think about where things are going, I think there's benefit of that, but the challenge is that, I forgot, maybe it was Charlie had mentioned her or Esther who had mentioned it, sometimes that's very useful to the Chair and sometimes it's not useful to the Chair. So Janet Yellen gets up as one of her first meetings, says basically pay no attention to the dots, listen to me. Which was I think accurate other times and I think early on it was very useful in helping to underscore what was meant by low for long because you can use words but you want to supplement words with something that's a little bit more concrete. The challenge is you want to turn it on and off at different points and you can't do that because it's not credible to turn it on and off.

(31:32):

And so I think thinking about, well, what is the essence of what that's trying to get at? Well, at certain times you need an additional boost to the words that you're using to convey what low for long means. Other times it can be more noise. And so in doing the review, what you want to do is step back and say what are we trying to achieve? And the dot plots as they are not achieving that, but is there a way to convey information that is going to be more salient in certain circumstances, which are the circumstances that you need that? And I also think that relates to Esther's point and the point that I was trying to make about think about what really connects with people trying to understand what they're paying attention to, what will really matter in different circumstances. I don't think they're paying attention in the same way all the time. I mean some of the research that we heard today says that, and I think that could be taken on Board to try to then make it more useful. I think you do want something that's forward looking, but you don't want to get into this situation where the Chairman to get up or the Chair has to get up and say, don't pay attention to the dot plots.

Athanasios Orphanides (32:45):

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Well, I'd say that it's very useful to provide policymaker information about the outlook of inflation in particular, and you could supplement that with objectives about growth. Now the committee has been doing that. The Board started producing Humphrey Hawkins projections I believe in 1978. For a couple of rounds, it was just Board of Governor's projections. By 1980, it was actually central tendencies arranges of the committees and that was very, very useful. The question is are all of the elements in the current SEP really useful? I agree that there are times at the zero or bound in 2012, it was useful to find a way to communicate that the Committee would keep interest rates low. This could have been done with a policy rule as I recall was being advocated by a number of people, but instead the decision was made to make it with dots that don't really explain very well in what sense policy systematic.

(33:50):

So they have that drawback. So in my view, it would be important to keep the good elements of the SEP but add elements that would help explain how the Fed is being systematic that is missing right now. That could be added with simple policy rules, some other elements that could be added. Again, benefiting from President Mester's speeches. There was a discussion in 2012 about the value of having a consensus forecast. Very difficult to have a consensus forecast on the committee. I think it would be useful for the committee to revisit that and see if they can come to agreement. If not, I think it would be useful to consider publishing the Greenbook forecast now Tealbook forecast so that there is a benchmark of what a consistent forecast is, especially for the next few quarters. I think we would all benefit from the wisdom and analysis of Fed staff that I think they have very good record of forecasting within quarter, quarter out where we actually need information from the data. So those are simple things that I think could be done.

Nick Timiraos (34:58):

Does the asymmetry of the lower bound create a complication? I mean I wonder the Chair's communicating now about a policy rule at every press conference and why if you're at the lower bound, why you're not following the rule? Is that a? Sure, Charlie?

Charles Evans (35:12):

No, I think that's important and if you want to go to a policy rule, you got to live by the policy rule and you're going to cry by the policy rule. I think your Taylor rule, you were truncated at zero. You didn't show the negative implications like minus 4% on the funds rate. So there's going to be all kinds of embarrassing things that you would have to show or explain and you've got to think about that in terms of what it means after that. But you do need to somehow come up with a mechanism to describe what policymakers think appropriate policy is going to be. The way I always described this was I would submit a forecast for GDP unemployment and inflation and my good colleague, Loretta knew very well, Charlie Plosser, would submit his. A year from now, we might have the exact same forecast, but we could very well have different funds rate assumptions, one, restricted one, accommodate 'em. Those numbers don't mean anything unless you provide that information how you do it in a way that's well articulated and people appreciate, that's a challenge and the papers here tried to get at that. I think.

Esther George (36:18):

I wonder if in the interest though of being systematic, I mean we often, and I worry about this too, you don't want to be bound to the rule, to the detriment of the economy, but it ought to provide a discipline to say when I deviate, and obviously you can't be fast and loose with that, but I think otherwise people don't perceive you have a discipline that is guiding or some kind of guide and then you can explain zero

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lower bounds a good opportunity say, why didn't we go negative? What were we thinking in that context? So I'd be more open to that I think than

Nick Timiraos (37:00):

Does the Fed communicate too much about a modal outlook right now, especially when we've learned the difficulties of inflation forecasting. Is there a danger of being too focused, which the SEP is kind of an amalgamation of a modal outlook. To what extent has that hindered policymaking? Has it helped policymaking over the last couple of years?

Athanasios Orphanides (37:25):

If I were to say word on that again, if you go back to Humphrey Hawkins projections, they had projections up to a year and a half out. I think this was extremely useful. You could actually put in that year and a half projections all of the current information that the policy makers and the staff had without the speculation that would be coming out of the models and the questions about are inflation expectations will anchored. Then I have this scenario, the other scenario, so think about the longer run projections that we have right now for some of the concepts that we don't really know. There are guesses, like what exactly is the long run concept of the federal funds rate? That's really a statement about R star in my view. It's not helpful for the Fed to be providing information about things it doesn't know like R star. I would have preferred to let the market participants, business, and households play that out and then use the information in financial markets to filter that and get information from that rather than have this hall of mirrors effect where the Fed is telling you what they think it is and then you expect people to go and then the Fed may be complaining, oh, our estimates are now different by a couple hundred basis points. Sorry they were wrong. So I think there is some information that relates to the horizon that could be a rethought as well.

Nick Timiraos (38:53):

Charlie, you're nodding your head Randy. Well,

Randall S. Kroszner (38:56):

Randy, I mean when there are things like, I mean with R Star, that's one of the challenges with the rules because you need some sort of anchor in those rules and we know how much R star our estimates of R STAR have varied over the last few years both in the US and globally. And so I think it just makes it very, very tough because even if you're using a market-based measure, if that's varying a lot, that's not going to be very useful for seeing where things are going to go if there can be very large movements in that. So I think it's really, really tough to use those structures in principle, yes, be great. Just like when I teach my class, I use the debate between John Taylor and Bernanke over whether interest rates were too low and causing the housing bubble. What's interesting is if you look at both of their papers, they don't have in the Taylor rule, they don't put in R Star, they put in two because it was just known to be two. It was a constant, there was no question about it. You wouldn't even bother to put in R Star, you'd just put in two now no one would do that. And I show how in class how much these things have moved around. I think it's better that we acknowledge that they move around, but I think that makes these things much more difficult to use as benchmarks.

Nick Timiraos (40:13):

We'll get to questions from the audience. I see one that's been submitted online from Julia Coronado. Where does balance sheet policy fit into this discussion? Esther, I'll throw that one to you first.

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Esther George (40:27):

Well, I'll start being the balance sheet skeptic here. Sometimes I think this has been a challenge when I talk about the complexity that I think has come with monetary policy settings, this is one of the elements which is not to say it shouldn't be used, it's to say this is difficult to explain and in our SEP the questions would often come up about where does that fit in here? If you're thinking about when is the balance sheet reached its peak, how fast are you going to run it off at some point? And so just as a policy tool trying to emphasize that the Fed funds rate is our primary tool, that's the one we're looking at. We have this other tool that it's a big push when we send it out on the backside, when we unwind it, it sort of disappears into the background. So I think more work around communication on that balance sheet policy is important and how they fit together if they do, because they kind of hobble along side by side sometimes in our communication,

Athanasios Orphanides (41:37):

And I make a small suggestion on this, one way to look at this is we need to have in the current formulation some assumption by each participant of appropriate monetary policy in order to construct the projections that are shown in the SEP. Now the Fed had been telling us that they now have two tools, so I think in the name of symmetry it would be useful for the committee to decide either they should provide projections about the appropriate policy for both tools or for neither one of them just symmetry would call for that. So right now we are in this in-between situation that I think does raise the questions about what exactly are the assumptions about balance sheet that different participants have

Randall S. Kroszner (42:24):

Just on that because that very much relates to what I was saying earlier, just clearly differentiating what is the balance sheet being used for? Is it just monetary policy purposes or is it some of the financial stability purposes? It's very valuable for financial stability purposes. I think the Fed should and does use its balance sheet that way, but it can be very difficult because once you start using it that way, and often you're using it that way when there's a stress situation, it's then difficult to get out unless you're really clear about what you're using it for. So I think thinking about what is the balance sheet being used for would be an extremely important part of that discussion.

Nick Timiraos (43:06):

Charlie, I want to ask you one thing about this and then you can make whatever point you were going to make on the back of it. The Fed has said that they want the primary tool to be the funds rate. And so I wonder to some extent does communicating more about the balance sheet interfere with that? Because now if you include something in the SEP about the balance sheet, if you get 19 different participants talking more about the balance sheet, does it actually interfere with that order of operations?

Charles Evans (43:33):

Sure. All right. I'm going to make a wildly speculative statement here. I've never asked my former colleagues this, but I'm going to guess that no one wants to do asset purchases except for the financial stability reasons that Randy mentioned that are well known. FOMC members, I believe would very much like to not have to do QE going forward. I know that after the Fed did QE one, QE two and we got to the summer of 2011 and we knew that we needed more accommodated policy that policymakers were going, please, let's not buy more assets. I'm getting killed by people up on the Hill about the size of our balance sheet. Can we do something else? So we did the maturity extension program. It accomplished

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the same thing by extending duration, but it did not lead to a larger balance sheet until 2012 when we still needed more.

(44:34):

So the question about QE and whether or not what we're going to do is why do we do it? We do it because we've run out of ammunition on the funds rate. Would the Fed would prefer to have a single instrument? The fed funds rate up until about 2003, nobody worried about that. Then we started worrying about it. And so I think when you start making conversations about R star off limits, you're saying you can't have a discussion about what the probability of hitting the effective lower bound is because when the effective lower bound is in sight and you hit it, if you've said, I don't want to do asset purchases, you're saying game over, we're just going to have to live with what this is. I don't see that as the Fed's mission. So I mean fundamentally it comes down to how close is the effective lower bound? Can you do it with a single interest rate? And oh, by the way, you don't want to talk about a higher inflation objective, but if you had a higher inflation objective, the probability of hitting the effective lower bound would be lower presumably, and you could do fewer asset purchases. That's a very,

Esther George (45:41):

I'll let you communicate that,

Charles Evans (45:43):

Isn't it?

Esther George (45:46):

I don't know. We still didn't hit 2%. Charlie, despite all that, and I think the other challenge with that balance sheet is that the balance sheet has not been able to normalize in a way that we had set out careful communication about how that would work. And again, we all agreed to we're going to a different operating framework, but I think not so much that you don't need more policy accommodation, you certainly need it for market functioning, but I think really understanding did it get us, did it get to the inflation goal we wanted? Was it,

Charles Evans (46:26):

And you think

Esther George (46:27):

So?

Charles Evans (46:27):

Well, I mean the economy is doing better with more accommodation. I think if you hadn't done that, then I think everybody would've read the FOMC is giving up and then that would've had a negative implication too. So I think the communication role of asset purchases was stronger than the portfolio balance myself.

Nick Timiraos (46:46):

Questions from the audience? We'll start with Bob in the back.

Speaker 7 (46:52):

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Thank you. I saw an article, an article by another economist, I can't remember who it was, but it was an international context and he was saying that the Federal Reserve is not an inflation targeting central Bank because the Federal Reserve has a dual mandate because of this. It's not an inflation targeting Central Bank. Of course I hear you talk about rules, but those rules are about inflation and they're presented as though there isn't an unemployment issue there. And of course it's easier to make this very simple when you only are going to target inflation. The final thing I'll just say is that, and the final problem with communication I think is that wasn't brought up in this conference is that policy is made by a committee and if anybody reads the FMC minutes as they come out, you just see that there's all of this controversy. And so I just wondered to what extent on any given meeting, the Fed really has a message it wants to communicate to us, and if they don't have a message, they want to communicate and it's not a surprise that they can't communicate it very well. So I think they're all on these really important issues about communication, but I think there's still a question about the objective, the complication of the dual mandate and the fact that a committee is making these decisions.

Nick Timiraos (48:20):

Anybody want to respond to that?

Esther George (48:24):

Again, I don't have to. I think the committee has taken into account, well this dual mandate factor, and frankly in the framework document it does talk about where over the long run the committee sees its impact around inflation and how for the employment mandate, there are other factors that are going to be present in that. So again, this large committee I think has generally come to some consensus around those things. It's put now we can talk about opportunities to reframe that and I think those will come up, but I think the committee's been clear for a while about how it handles the dual mandate.

Athanasios Orphanides (49:10):

So I could add something relating to the mandate on this by reminding us how I'm going to go back in the nineties. Then esteemed professors, Ben Bernanke and Rick Mishkin described inflation targeting before then became governors. And the idea of inflation targeting doesn't have to do with a single mandate. Most inflation targeting central banks actually care a lot about stabilizing employment and growth at a high level, much like the Fed does. The idea is to constrain discretion. The idea is to make policy more systematic so you can achieve better outcomes, both in terms of price stability and in terms of stabilizing the economy from business cycle fluctuations. Now, it is a little bit trickier for the Fed because of the formulation of the mandate, but there are other central banks that nobody else has as extreme mandate as saying, please deliver maximum employment and price stability at the same time. But there are a number of other central banks that also have to deliver maximum sustainable employment, for example, which is much better. So what I would argue is that for the Fed, it's more important to find ways to constrain its discretion and explain in what way policy is systematic because of the mandate, but it can be done and it can be done in the context of inflation targeting.

Nick Timiraos (50:46):

Any other questions from the audience? If none, I'll pose. I'll ask one of the two former Fed Presidents here a couple of weeks ago during the IMF spring meetings, I heard from central bankers on other continents who said, why does the Fed communicate so much? And part of it is that you have 19 participants. I think there's 21 business days between the end of the blackout of the last Fed meeting and the next one. So if everybody speaks just once, that's almost every single day. But is it a problem to

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some extent that you hear? Do you think that there's too much communication from the Fed at times? Esther, I'll start with you on that.

Esther George (51:31):

Yeah, I mean, I've heard this for a long time. There can be too many voices talking. I guess, and I saw this in some of the research today. I think the markets in particular can sort out who they're listening to, where the key points are. They look at the rest to try to figure out where might they be falling in the dots and other places. But I think if I had to err one way or the other, when you have a large committee, this committee has been emitted to transparency and accountability, and you have 12 Fed presidents, 11 of whom are rotating on their vote, I don't think you can really pick and choose to say, let's orchestrate it. So you're quiet and you do that. Part of it is your obligation, I think, to the region you serve. Part of it is just your accountability as a policymaker.

Nick Timiraos (52:24):

Charlie, anything to add?

Charles Evans (52:26):

Yeah, one a day would be restrictive for policymakers as I look at the schedule of events or often three or four people speaking on the same day. Yeah, no, I agree with Esther. It's a large committee. There are diverse views, there are real debates that periodically take place during these meetings. And the research this morning that was getting at how does the Fed meeting and what information content isn't revealed and it works its way out and eventually gets out there. I know I would put a lot of effort into going into the meeting and have some pretty distinctive messages, and I viewed it as important to sort of deliver those first at the FOMC meeting. And then I went out and a lot of times I was talking about the things that I had discussed there. I think that that's useful. I think that's how you get that Larry Meyer kind of idea that was mentioned, which is, well, you talk about ideas at one meeting and then the next meeting or the next meeting it takes on that trajectory. It just is in the nature of how a large committee shares information. If you don't do that, you're going to end up having more dissents where people feel like that's how they'll get their message across and all of that. So I think ultimately the committee finds a pretty good balance. Now I'm on the outside and I'm looking at this, and of course I can't imagine why people want to shut these people up. I want to know more.

Nick Timiraos (53:57):

Anybody else with a question? I'll keep going. Then. At the Hoover conference a couple of weeks ago, there were a couple of different ideas floated in terms of improving communications. And I'm curious to get the panel's response. One is the idea, I think Austin Goolsby who was here earlier had floated to some extent the SEP is designed to convey a reaction function more than a forecast. Is it a good idea? Would it make sense to put out a grid essentially that would allow the public to see the funds rate forecast associated with the GDP projection and the inflation projection behind it? Or does that provide maybe too much complexity, more than can be sufficiently digested by whoever the audience is that you're trying to reach?

Charles Evans (54:53):

You're a big Hoover guy.

Athanasios Orphanides (54:55):

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So as a person who has never had to do dots, I would say that it would be quite nice for researchers to have the matrix and be able to do work with it. You

Charles Evans (55:06):

Get that with a five-year

Athanasios Orphanides (55:06):

Lag? Yeah, you can do this with a five-year lag right now and not only have the matrix but also have it color coded. So who's voting and who's not voting. So that would be a first step, but in my view, it would be more useful to get a better sense of what the systematic policy in the background is. So if the whole point of doing all of this is to improve the communication of the policy reaction function, why don't we communicate the policy reaction function? Why do we do all of this, all of these additional elements there. I mentioned one additional element that came up in that you can also provide additional information with scenario analysis. And I believe this had come up as well at the Hoover. That's true. That can be useful. The staff is providing wonderful scenario analysis to the committee in the Tealbook right now. So another consideration is would you want some of that to be public? How much of that would you want to be public? If the staff projections are published as a benchmark, that would be a next step that could be added. But you have to ask the question, what is the policy reaction function in the background? You have to discuss the assumptions there. We know what the assumptions are and what the staff is doing. Maybe we don't want to do exactly the same thing in what the committee would want to communicate

Charles Evans (56:30):

The scenario. I guess Ben Bernanke really brought this to the fore when he mentioned this with the Bank of England review, and it's a very interesting idea and definitely worth, it's the thinking about, I will say, a concern that I have is as soon as you start throwing out scenarios, it's like, okay, how many are you going to have? Which ones are you going to emphasize? What do I learn when you mention this exercise over? I would've done something else. And oh, by the way, I have no idea what weights you put on this, right? So why don't you tell me 25% on this scenario and 40 on that you're going to move the discussion down the road to similarly uncomfortable questions I think that you're trying to avoid. So I think it's very complicated. I do think it's much more informative, but in terms of feasibility, gosh, I don't know if I'm speaking out of turn, but I want to take a little bit of credit for the fact that researchers who now have access to this information within five years, it used to be 10 years, but I contributed to the fact that during FOMC meetings, I would periodically go, oh, by the way, in the SEP submission that you're looking at, we've got a numerical rank one to 19, and I'm number three if you want to look at what my forecast is.

(57:57):

It was pointed out that since that was kind of in the public domain, that was uncomfortable, and then they switched it to the normal five years, policymakers have different appetites for being putting out a forecast, how much detail and all of that. And that's the nature of having a diverse group seems to me.

Esther George (58:16):

And I think if you're going to go that route, it leads you back to saying, should we talk about a consensus forecast then and try to do that versus the dots, which for me, we're always about, here are the range of views on this. It is to say, you've got 19 people and here's the range, and you can draw some central tendencies here and medians to whatever their reaction function is.

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