VOL. 8, NO. 8 • SEPTEMBER 2013

DALLASFED

Economic Letter

A Short History of FOMC Communication

by Mark A. Wynne

Federal Open Market Committee communications have changed radically over the past two decades.

Twenty years ago, when the Federal Open Market Committee (FOMC) decided to alter the stance of monetary policy by raising or lowering interest rates, it did not announce that fact to the general public. Rather, financial market participants were left to divine what the FOMC had decided by watching the behavior of the "open market desk" in securities markets.[1]

Today, when the FOMC decides to change the stance of monetary policy, it releases a detailed statement outlining the rationale for its decisions. The Chairman holds press conferences four times a year, and FOMC members give numerous speeches and press interviews to explain their thinking.[2]

FOMC communications have changed radically over the past two decades.[3] These changes have proven especially important in the current environment, where it is no longer feasible to adjust interest rates to provide monetary accommodation. By communicating its beliefs about the likely stance of monetary policy over the coming months and quarters, the FOMC can support the ongoing recovery.

FOMC Statements

The first time the FOMC issued a statement immediately after a meeting explaining what action had been decided was on Feb. 4, 1994.[4] That statement simply noted that the committee decided to "increase slightly the degree of pressure on reserve positions" and that this was "expected to be associated with a small increase in short-term money market interest rates." By way of explanation for why the committee was announcing its decision, the statement said that this was being done "to avoid any misunderstanding of the committee's purposes, given the fact that this is the first firming of reserve market conditions by the committee since early 1989."

In February 1995, the committee decided that all changes in the stance of monetary policy would be announced after the meeting. It was not until July 1995, when the committee had shifted to easing the stance of monetary policy, that mention was made of a specific level of the federal funds rate, when a decision to ease monetary policy was expected to "be reflected in a 25 basis point decline in the federal funds rate from about 6 percent to about 5¾ percent."

Through 1996, 1997 and 1998, the FOMC referred to target levels for the funds rate of "around" or "about" a particular value and only issued statements following decisions to change the funds rate. Starting with the May 1999 meeting, the FOMC announced that it had made no change in policy, and initiated the practice of releasing a statement after

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every meeting regardless of whether the stance of policy had changed. That same year it began to refer to specific "target" levels for the funds rate.

Also starting in 1999, the committee began to issue forward guidance of a sort in the form of an assessment of the perceived risks going forward. For example, after the August meeting, it announced that "the directive the Federal Open Market Committee adopted is symmetrical with regard to the outlook for policy over the near term." By October of the same year, the directive was "biased toward a possible firming of policy going forward." However, references to symmetric or asymmetric directives proved short-lived. Starting in February 2000, the committee instead referred to risks of "heightened inflation pressures" or "economic weakness" in the near term, that is, risks to the committee's mandate to deliver price stability and maximum sustainable employment.

By 2003, the committee was worried about inflation getting too low, and it reduced the federal funds rate to the then-unprecedented level of 1 percent. Starting with the August meeting, the committee again began issuing forward guidance about the stance of policy, noting that it believed that "policy accommodation can be maintained for a considerable period."

In January 2004, the committee changed this language to state that it believed that it could "be patient in removing its policy accommodation." The language was altered once again in May 2004 to state that "policy accommodation can be removed at a pace that is likely to be measured." Then the committee raised the federal funds rate by 25 basis points at its June meeting and at each of the subsequent 16 meetings.

The "likely to be measured" language was included in every statement until the December 2005 meeting, by which time the federal funds rate had been increased to 4.25 percent. Through 2006, the committee noted that the "extent and timing" of any additional firming of policy depended on the evolution of the economic outlook and specifically the outlook for both inflation and economic growth. The tightening cycle ended with the funds rate at 5.25 percent, where it remained until the first strains of the financial crisis began to manifest themselves in August 2007.

Financial Crisis Communications

In response to deteriorating economic conditions as a result of the financial crisis, on Dec. 16, 2008, the FOMC lowered the target for the federal funds rate to a range of 0 to 0.25 percent and noted that "weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time." Thus began the period of unconventional monetary policy.

The FOMC had previously announced plans to purchase "up to $100 billion" in government-sponsored enterprise (Fannie Mae and Freddie Mac) obligations and "up to $500 billion" in mortgage-backed securities. The December statement included the declaration that the FOMC "stands ready to expand its purchases of agency debt and mortgage-backed securities as conditions warrant." This program subsequently became known as QE1.[5]

The commitment to maintain the fed funds rate at an exceptionally low level for an extended period was included in every statement until August 2011, when the language was altered to "at least through mid-2013." Subsequently the dates were changed to "at least through late 2014," and to "at least through mid-2015."

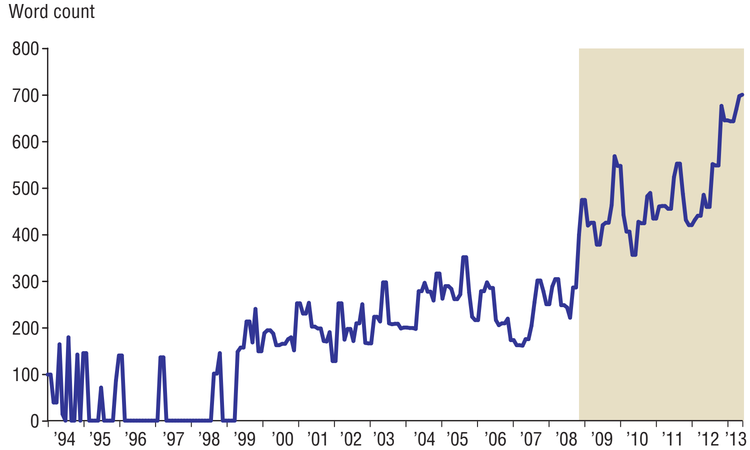
But at the December 2012 meeting, the committee made a radical change in how it communicated its intentions. The FOMC adopted language stating that it anticipated that "this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the committee's 2 percent longer-run goal and longer-term inflation expectations continue to be well anchored." Thus, over the course of two decades, the committee has gone from vague language about "pressure on reserve positions" to concrete statements about its target range for the federal funds rate and the specific economic developments that would prompt a change in that target in the future.

Evolving FOMC Statements

Chart 1 presents a simple measure of the evolution of the FOMC's communications over the past two decades as summarized by the word count in the post-meeting statement.

The first statement, issued on Feb. 4, 1994, was a mere 99 words. The statement issued after the April 30–May 1, 2013, meeting was 669 words and included—in addition to the committee's decision about the stance of monetary policy—information on the committee's assessment of economic conditions, the economic outlook, the factors that are likely to prompt a change in the stance of policy and the extent to which the committee's voting members agreed on the policy decision (one member dissented).

Chart 1
FOMC Statement Word Counts Increase, 1994–2013



NOTE: The shaded area is the period of the FOMC's unconventional monetary policy with interest rates at the effective lower bound of near zero.

SOURCE: Federal Reserve Board.

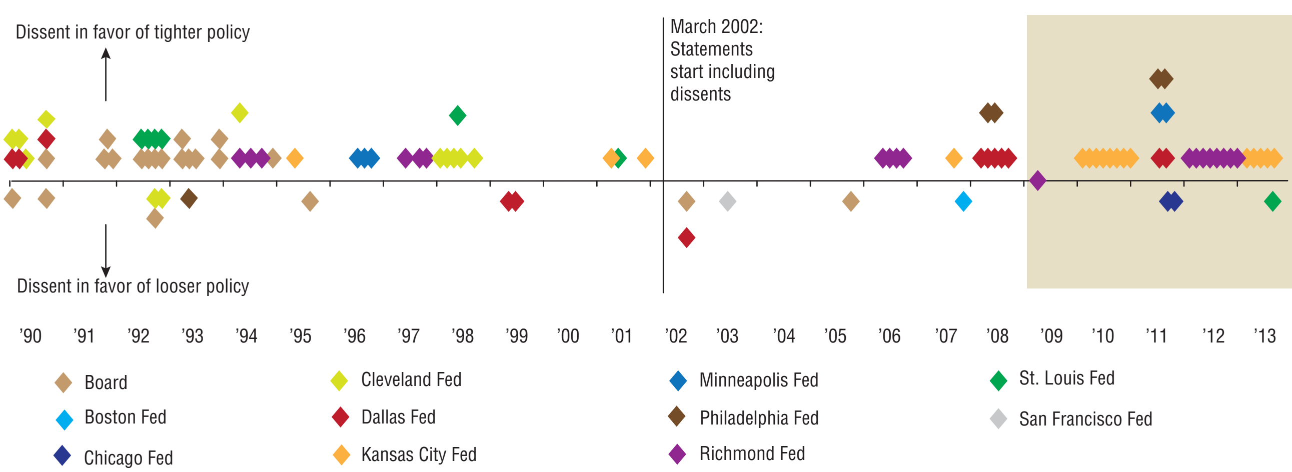
Dissent

FOMC members do not always agree about the appropriate stance of monetary policy, and since 2002, dissenting votes have been made public immediately after the meeting at which the vote is taken to enhance the transparency of the monetary policy process. (Prior to this, dissenting votes only became known when the Record of Policy Actions or the minutes were published after the subsequent meeting.) Sometimes a dissenting vote reflects a difference of opinion about the true state of the economy, something that is difficult to assess in real time; sometimes it reflects a difference of opinion about the appropriate policy response to given economic conditions.

The history of dissenting votes over the past two decades, shown in Chart 2, illustrates three things. First, dissenting votes are not uncommon, but in recent years it has been rare for more than one voter to dissent at any one time. The record is three dissenting votes at the August and September 2011 meetings. Dissent was a lot more frequent in the early 1990s, with as many as four dissents at one meeting in 1990 and at another meeting in 1992.

Second, between 2000 and the onset of the financial crisis, dissenting votes were particularly rare. This was the period during which the housing market boomed and some critics argued that the FOMC deviated from its previous rule-like behavior.[6] But the record on dissenting votes suggests that there was

Chart 2
FOMC Dissents Not Uncommon



NOTES: The Atlanta and New York Feds had no dissenting votes during 1990–2013. The shaded area is the period of the FOMC's unconventional monetary policy with interest rates at the effective lower bound of near zero.

SOURCE: Federal Reserve Board.

an unusual degree of consensus among policymakers on the appropriate stance of monetary policy during this period.

Finally, dissenting votes have become more persistent in recent years. That is, a voter who dissents at one meeting is more likely to dissent at the following meeting. There have been two instances in recent years where a voting member dissented at every single scheduled meeting over the course of a year.

This increased persistence in dissent is not too surprising. The situation that has confronted the FOMC since the onset of the financial crisis is unprecedented, with short-term interest rates as low as they can go since the end of 2008 and expected to remain there for some time. In such circumstances, one might expect a wider-than-usual range of opinions on the committee about the appropriate course of action. Also, as the committee has come to rely more on forward guidance to support economic activity, committing itself to a particular course of action for longer than was previously the case, dissents might be expected to be more persistent.

Tools of Communication

Of course, the post-meeting statement is just one of the ways the FOMC communicates with the public. It has always issued minutes after its meetings. Through 2004, the minutes were released two days after the subsequent meeting, which limited their usefulness in conveying the thinking behind the policy decision made at the meeting. In December 2004, the decision was made to bring forward the release of the minutes, and they now appear three weeks after the meeting to which they refer, providing additional insights into the thinking behind policy decisions.

Two other major innovations in communication have occurred in recent years. Following the long-standing practices of other major central banks, the Chairman now holds a press conference four times a year.[7] Second, the members of the Board of Governors and the individual Reserve Bank presidents now release their economic forecasts four times a year as part of a regular Survey of Economic Projections. Previously, these forecasts had only been reported twice a year as part of the regular Monetary Policy Report to Congress.[8]

Increased Transparency

Best practices in central banking call for transparency in policy deliberations and communicating the outcome in a timely manner. Over the past two decades, the FOMC has gone from being quite secretive in its deliberations to very transparent. As the committee has had to deal with the worst financial crisis since the Great Depression and exhausted conventional options, unconventional monetary policy has played a greater role. And within the class of unconventional monetary policies, forward guidance—that is, communication about the likely future course of policy conditional on economic developments—has taken on more importance. This move to increased transparency has been integral in helping the FOMC fulfill its mandate.

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Notes

[1] The FOMC is the main policymaking entity within the Federal Reserve System. The open market desk at the Federal Reserve Bank of New York implements the decisions of the FOMC by buying or selling securities in financial markets.

[2] The Chairman held three press conferences in 2011, five in 2012 and is scheduled to hold four in 2013.

[3] See "Revolution and Evolution in Central Bank Communications," speech by Janet L. Yellen at the University of California, Berkeley, Nov. 13, 2012.

[4] In 1975, the FOMC was sued under the Freedom of Information Act by a citizen requesting release of the committee's policy directive to the open market desk at the time of its adoption. The resolution of the case allowed the committee to defer release of the directive until after the subsequent meeting of the committee. The FOMC's case for secrecy is critically evaluated in "Monetary Mystique: Secrecy and Central Banking," by Marvin Goodfriend, *Journal of Monetary Economics*, vol. 17, January 1986, pp. 63–92.

[5] QE stands for quantitative easing, an approach to conducting monetary policy when interest rates have been cut to the lowest possible levels. It was pioneered by the Bank of Japan.

[6] See, for example, "Housing and Monetary Policy," by John B. Taylor, paper presented at the Federal Reserve Bank of Kansas City's Economic Symposium, Jackson Hole, Wyo., September 2007.

[7] For example, the president of the European Central Bank holds a press conference 11 times a year, following each meeting of the bank's Governing Council. The Bank of England holds a press conference four times a year, following the release of its quarterly *Inflation Report*.

[8] All the governors and Reserve Bank presidents give regular speeches and interviews, and the frequency of these speeches has also increased over time.

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