EVENT SUMMARY

Wither Federal Reserve Communication?

Governor Frederic S. Mishkin, Board of Governors of the Federal Reserve System

Peterson Institute for International Economics, Washington DC
July 28, 2008

Over the past thirty years, monetary policymaking in the United States has become more transparent. In 1979, the Federal Open Market Committee (FOMC) started including the economic projections of Committee participants in their semiannual *Monetary Report to Congress*. In 1994, the FOMC began announcing changes in its target for the federal funds rate. And in November of last year, the FOMC began publishing its projections for inflation, economic output, and unemployment for a longer horizon than before—three years instead of two—and doubled the frequency at which it releases these projections to four times a year.

On July 28th at the Peterson Institute for International Economics, Federal Reserve Governor Frederic Mishkin discussed the benefits of past efforts to increase monetary policy transparency, but also stressed that there was still room and reason for improvement. Specifically, Governor Mishkin outlined a policy for improving FOMC transparency beyond its current level. His proposal consists of three main parts: The FOMC should extend the horizons for its projections for output growth, unemployment, and inflation; FOMC members should try to reach a consensus on a specific inflation rate that will meet the Federal Reserve's dual mandates of price stability and full employment; And the FOMC should declare that it will only deviate from a monetary policy aimed at achieving the consensus inflation rate for sound economic reasons. After his prepared remarks, Governor Mishkin took questions regarding his proposal.

Benefits of Transparency

Governor Mishkin argued that one of the main responsibilities of central bankers is to manage inflation expectations, because these expectations can have a significant impact on actual inflation. Monetary policy transparency thus provides the public with the information needed to make accurate assessments of future inflation. Previous FOMC efforts to increase the transparency of US monetary policy have helped manage inflation expectations, but Governor Mishkin argued that more could be done. The experiences of other countries in setting a numerical inflation target have proved successful in managing inflation expectations and have contributed to sustained economic growth. In this regard, Governor Mishkin discussed the inflation targeting experiences of the Bank of England and the European Central Bank (ECB).

A Proposal to Increase Transparency

The first part of Governor Mishkin's proposal to increase the transparency of US monetary policy—extending the economic projections of the FOMC—need not be entirely fixed. He believes that it would be sufficient for FOMC members to be more explicit about their long-term expectations for the US economy. If a concrete time period should be desired, projections could be lengthened to a period of five or more years. The second and most controversial part of Governor Mishkin's proposal is that the FOMC should reach a consensus on a nominal anchor for inflation with the important caveat that the nominal anchor would only need to be reached in the long-run. Trying to reach this rate in the short-run would be difficult and could have adverse effects. The third part of his proposal reinforces the second: By assuring the public that the nominal inflation anchor would only be changed for sound economic reasons, inflation expectations would be managed more successfully than with a nominal anchor alone.

Possible Concerns

Governor Mishkin addressed a few possible concerns with his proposal. He explained that even with a nominal anchor, the Federal Reserve could fulfill its dual mandate of price stability and full employment. It may seem that a nominal anchor would place too much emphasis on price stability, but the proposal calls only for a long-term target. This would work to stabilize fluctuations that could disrupt the economy and full employment. Governor Mishkin also explored the idea of an inflation range as opposed to a specific rate, but dismissed the idea because the international experience with ranges has proved less successful than experiences with specific rates. A number of other concerns are addressed in the written version of his prepared remarks, available here.

Q&A

During the question and answer session, Governor Mishkin expressed his desire to avoid the term "inflation targeting." This term suggests that the Federal Reserve would have to maintain a strict inflation rate in the short-run; Governor Mishkin stressed that this is not the intent of his proposal.

Bill Cline of the Peterson Institute asked whether the FOMC should focus on core or headline inflation when setting a nominal anchor for inflation. Governor Mishkin extolled the importance of core inflation because it monitors only what the Federal Reserve can control, but believes that headline inflation should be the ultimate focus of any nominal anchor by the FOMC.

Fred Bergsten of the Peterson Institute asked about the role of the international economy in Governor Mishkin's proposal given the US dollar's standing as a global currency. Governor Mishkin suggested that the same benefit of monetary policy transparency—managing the expectations of the American public—also applies to managing the expectations of foreigners.

Other questions concerned the role of Congress and the Executive branch in setting a nominal anchor, the relevance of economic shocks, the importance of FOMC rhetoric, mean reversion to a nominal anchor after large swings in the inflation rate, and the transparency of future Federal

Reserve money market actions. These questions and Governor Mishkin’s responses can be heard here.