

The Evolution of Fed Communications

BY DOUG CAMPBELL

In a pivotal 1994 meeting, Fed leaders debated whether to open up about their actions



Former Federal Reserve Board Chairman Alan Greenspan, seen here testifying before Congress in February 1994, led a movement toward greater openness in Fed communications.

The Fed is evidently capable of confounding people — absolutely flummoxing them — by saying what it plans to do, then doing it, and then promptly announcing what it had done.

— Dow Jones News Service
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Just before 11 a.m., Feb. 4, 1994, the Federal Reserve released a three-paragraph statement. The Federal Open Market Committee, Fed Chairman Alan Greenspan said in part, had decided to “increase slightly the degree of pressure on reserve positions. The action was expected to be associated with a small increase in short-term money market interest rates.”

Though vague by today’s standards, the release’s import was clear. It marked the first time the Fed announced a change in monetary policy as soon as it was made. Until the winter of 1994, indications of the central bank’s stance on the fed funds rate were indicated primarily through operations in the money market. The Feb. 4 release was in fact the beginning of an evolution — if not quite a revolution — in Fed communications.

Why did the Fed keep such a veil of secrecy over its formulation and stance of monetary policy for so long, and why has it taken more steps toward openness recently? Almost all the main issues are laid out in FOMC transcripts from that two-day February meeting. During that landmark session, FOMC members debated the pros and cons of immediately announcing their policy stance, wondering aloud about the implications for the Fed’s flexibility and credibility. Of paramount concern was the prospect that the FOMC would be misunderstood, no matter what it did.

Message Moratorium

The Fed has always found ways to communicate with the public. But until recently, few of those ways were terribly direct, and none very immediate.

Beginning in 1935, with the modern-day creation of the FOMC, the Fed issued brief summaries of its policy decisions, called the Records of Policy Actions, on an annual basis. At the same time, it kept minutes of policy deliberations for internal use.

In 1967 came the release of the FOMC minutes, 90 days after each meeting. Also published with a 90-day lag were the Records of Policy Actions. In 1975, the lag in release of minutes was shortened to 45 days, and then in 1976 to 30 days.

Other communication vehicles included the chairman’s semiannual reports to Congress, the so-called Humphrey-Hawkins Report. Since 1983 the Beige Book has publicly summarized economic conditions in each of the 12 Federal Reserve districts throughout the country. Finally, there were speeches by Fed governors and Reserve bank presidents.

But announcements immediately following FOMC meetings simply didn’t exist. The main way the Fed disclosed its policy actions was through open market operations — chiefly, daily repurchase agreements in which the New York Fed’s trading desk pumps up or drains reserves of the nation’s banking system. Even there, information was limited: Only the amount of the repurchase agreements transacted was released, with nothing about rates, prices, or size of propositions for the overnight loans.

FOMC members justified this shroud as key to their effectiveness. They even spelled it out at their meeting on June 20, 1967. “For years, Federal Reserve officials argued that immediate release of policy decisions

would make markets more unstable and policy implementation more costly and difficult,” said St. Louis Fed President William Poole in a 2005 speech, referring to the 1967 meeting. “Creating these effects through disclosure would obviously be inconsistent with the Fed’s public responsibilities.”

Michael Woodford, a Columbia University economist who has studied Fed communications, suspects another motivation as well. “My guess is that bureaucrats in most organizations would prefer not to have to explain to outsiders what they’re doing.”

Views on how much the Fed should say in public about its formulation and stance of monetary policy began to change in the early 1990s. Politicians were pressuring the Fed to open up. Henry Gonzalez, then-House Banking Committee chairman, was demanding that the Fed make public details of its deliberations on monetary policy. Motivating some of this pressure was the 1993 discovery that the Fed had kept unedited transcripts of its FOMC meetings since 1976.

Facing these developments, FOMC members decided to release lightly edited versions of those transcripts with a five-year lag. But it wasn’t enough to satisfy those seeking more communication. Milton Friedman, a frequent critic of the Fed, was one of the leaders in the early 1990s in calling for openness. He noted that a cottage industry of Fed watchers had sprouted up on Wall Street, reading the tea leaves of repurchase agreements and opaque speeches.

“Prompt release of the directive would deprive the Fed watchers of their employment but would improve the operation of the money market by ensuring that prompt information was available to all participants alike,” Friedman wrote in a *Wall Street Journal* commentary with his longtime collaborator Anna Schwartz. “It would also increase the effectiveness of the Fed’s operations, since better informed market participants would have an incentive to speed the attainment of the Fed’s objectives.”

The Debate

So it was that FOMC members began to air their positions on the merits of opening up. Members were steadfast that they wouldn’t bow to political pressure. At the same time, they were willing to reconsider FOMC communications with a view toward making it easier for the public to understand their stance on monetary policy.

The Feb. 3-4, 1994, FOMC meeting was widely anticipated as a possible landmark occasion, both inside and outside the Fed. Besides the communication issue, it had been five years since the last rate increase, and two since any move whatsoever. A few days earlier, Greenspan had strongly indicated in Congressional testimony that a rate hike was afoot. Transcripts from the meeting reveal a lively discussion, one in which members fretted about preserving flexibility while living up to their responsibilities.

Greenspan’s views on an announcement were already known to members. He favored an immediate public statement but wanted to make clear that it would not set precedent. He opened the monetary policy section of the Feb. 3 gathering by outlining his case. “I am particularly concerned that if we choose to move tomorrow [meaning, tighten monetary policy], we make certain that there is no ambiguity about our move,” Greenspan said. “I would very much like to have the permission of the committee to announce that we’re doing it and to state that the announcement is an extraordinary event.”

In addition, Greenspan argued, nothing was forcing the Fed to make this announcement a regular occurrence. “The issue of whether something is precedential or not is under our control. We don’t have to announce our policy moves; there’s nothing forcing us to do so, and I cannot believe that there will be legislation requiring that.”

Richard Syron, Boston Fed president, also favored a public announcement on the upcoming policy move. But he wondered if the reaction would serve as a guide on whether to

make future such announcements. “My own forecast would be that this would pull the teeth in a longer-term sense, which we are not resolving now, on a lot of these issues about disclosure. I know these issues wouldn’t all go away.”

If there was a precedent to be set, Greenspan said, it was that announcements would be expected when the Fed had acted after a long time of leaving policy unchanged. “What I’m saying is that the first time we move the funds rate after this extended period, we are hitting a ‘gong.’”

San Francisco Fed President Robert Parry was the first to speak in favor of a commitment to continued announcements: “We ought to have a discussion as quickly as is feasible about the desirability of similar statements in the future because I think some of us believe there is some advantage to doing it on a continued basis.”

Robert Forrester, president of the Atlanta Fed, disagreed about the need for regular announcements. His suggestion was to make explicit in the announcement that further announcements would not necessarily be forthcoming. “I have a real concern that there’s a risk that we’re going to be pushed by pressures — not necessarily legislation but other pressures — to make this an ongoing operating procedure. If that’s the case, I think we would lose some flexibility,” Forrester said. “If we can draft a statement that clearly indicates this is not a precedent but a one-time event because of the peculiar circumstances, then I would support your [Greenspan’s] recommendation.”

Worries about setting precedent aside, some members noted that an announcement carried certain advantages, the main one being that the FOMC could better control the message of the day. Jerry Jordan, Cleveland Fed president, said that without an announcement, the press and public might wrongly conclude that the committee was trying to curb growth, when in fact such price stabilization efforts were also pro-

growth. “The rationale for it [the tightening] as a growth-sustaining move is extremely important. Only by putting out a statement can we get that message out there, or at least make an effort to say that this is not an antigrowth move but one that is designed to enhance the longevity of this expansion.”

Jordan’s comment gets to the heart of what was really going on in the boardroom that day. Many FOMC members were interested in transparency because they believed it would make monetary policy more effective. By announcing why they acted, members could influence the public’s expectations about the future course of inflation — and the Fed’s ability to deal with it.

That may not sound like such a radical idea in 2007. But for the Fed in 1994, paying attention to public expectations was still relatively new. It was former Chairman Paul Volcker who first implemented the practice. Starting in 1979, the Fed began a famous fight against inflation, slowing the growth of the money supply so as to bat down rising prices. It took five years of mostly tight monetary policy for the public to finally believe that the Fed was serious and committed about fighting inflation.

By 1994, open communication was seen as a tool to further manage expectations about the future path of interest rates, and by extension enhance the Fed’s hard-won credibility. As economist Woodford put it in a 2005 paper: “Better information on the part of market participants about central-bank actions and intentions should increase the degree to which central-bank policy decisions can actually affect these expectations, and so increase the effectiveness of monetary stabilization policy.” That’s why it was so important to Jordan that any statement include an explanation of the Fed’s rationale for raising rates.

Around the Table

The debate was not entirely linear, bopping back and forth between the issues as members were polled. Thomas

Hoenig, Kansas City Fed president, revisited the “precedent” problem, arguing that there was no way around one being set. Without saying whether he favored an announcement in the first place, he argued that doing so would essentially back the FOMC into a corner: “I have a hard time understanding how this would not be precedential. ... I think it will be difficult from a credibility point of view to argue against announcing in the future should we want to make that argument.”

Greenspan responded: “We’re saying there are different types of changes [requiring statements]. For example, in 1979 there was a major change. Chairman Volcker and his staff went out and had a big press conference. There are certain individual events where periodically the Federal Reserve has made special statements; I’m merely stipulating that this is one of them. Frankly, with the exception of the stock market crash in October 1987, it’s the first one since I’ve been here.” If the committee four weeks later raised rates again, “I don’t see any reason why a statement would be appropriate at that later time,” Greenspan said. In the end, it was a question of whether the FOMC could control the issue and, in Greenspan’s view, it could.

Thomas Melzer, president of the St. Louis Fed, envisioned some potentially embarrassing media coverage with an announcement that went out of its way to say it was a one-time thing. “I think there is a risk of a headline along the lines of ‘In an unprecedented move, the Fed announced ... saying it wasn’t setting a precedent,’” Melzer said.

And then came an animated back and forth between Melzer and Greenspan.

Melzer: “Are we obligated to say anything about the vote, for example? I’m not sure. Again, I’d prefer just to say what the action was. It’s a decision of the committee, but if we get into disclosing the vote, that begins to set other types of precedents that could be relevant when we

get to the point of deciding this issue on a permanent basis.”

Greenspan: “Look, the main issue here is that, as far as I’m concerned, I would like us to stand up and be counted. We are the central bank and we are making a major move.”

Melzer: “Right, I agree.”

Greenspan: “And to do it in an ambiguous manner I think is unbecoming of this institution.”

How to get around the precedent problem? Greenspan suggested that a partial solution was to have the announcement made by him, not by the committee, a proposal that prompted a few jokes. “Now, if we decide to do it on a permanent basis, then it’s a committee issue,” Greenspan said. “But marginally it’s of a less precedential nature if I do it.”

Edward Boehne, president of the Philadelphia Fed, responded: “If it doesn’t work, the committee could fire the chairman!”

Parry chimed in: “That’s right.”

“Well, maybe we ought to bring that issue up before the vote!” Greenspan said amid laughter.

A Consensus Builds

A few participants spoke up in favor of the statement, particularly if it came with some sort of “one-off” language. Joan Lovett, manager for domestic operations with the New York Fed, put it this way: “I think that it can’t be harmful ... It tells everybody what’s happening and it leaves no room for ambiguity, and if it’s phrased the way you are suggesting, it’s not setting a stage for people to have expectations of an announcement every time there is a policy change going forward.”

Gary Stern, president of the Minneapolis Fed, made the case that an announcement would level the playing field in terms of market participants understanding the Fed’s message: “I happen to agree with those

who think this will turn out to be precedential and from my perspective that's fine because I think we've been in an awkward situation where we have kind of acknowledged that people in the markets get the news and the signal immediately, but for those who are not close to the markets the news kind of dribbles out depending on how quickly they read the financial press or consult other sources of information."

Richmond Fed President Al Broaddus was among those arguing in favor of a release: "There are risks of not doing this [making a statement]. If there were any confusion tomorrow going into the weekend or this thing gets played out in the *New York Times* on Saturday and Sunday or on CNN, I think we would have a real mess." And Dallas Fed President Robert McTeer went so far as to say, "I personally wouldn't mind seeing it become a precedent."

The afternoon was turning dark and it was time to wrap up. They would gather again the next day at 9 a.m. Adjourning the meeting, Greenspan warned against leaks of the day's discussion, alluding to the embarrassing release of notes from a fall 1993 conference call to Rep. Gonzalez. "I just beseech you to be as careful as you possibly can and not even tell your doorman where you've been!"

Nobody leaked, and the next day the Fed released an announcement just as planned to an unsuspecting public. It was, as the Associated Press described, a bolt from the blue: "In a rare display of openness, the central bank issued a three-paragraph statement Friday stating it had begun to clamp down on credit ... The disclosure took the guesswork out of Fed-watching and caught the financial markets off guard. For

analysts accustomed to appraising subtle shifts in money market interest rates for clues to the Fed's thinking, the news release was a bombshell."

More Changes

Despite the initial surprise, market watchers quickly adjusted to the Fed's new openness. More moves toward transparency followed. In 1995, FOMC members agreed to release all future transcripts of their meetings with a five-year lag. On July 6, 1995, the FOMC for the first time mentioned the actual federal funds rate, saying the policy action reflected "a decline of 25 basis points." On Jan. 31, 1996, came the first mention of the actual federal funds *target* rate.

Such announcements were forthcoming every time the FOMC initiated a policy action. In 1999, announcements became standard practice, whether the target rate was changed or not. From that year on, there have been immediate announcements following each FOMC meeting.

The language contained in these regular announcements has also grown more precise. After meetings in which there were shifts in FOMC views about the future, announcements included a "balance of risks" assessment — whether the risks were greatest with regards to either inflation or growth. In 2003, the committee began adding an additional sentence about the future, such as whether present policy actions were likely to be continued. The May 2004 FOMC announcement, for example, explained that "the committee believes that policy accommodation can be removed at a pace that is likely to be measured."

More than a decade after the pivotal FOMC meeting, there is no looking

back. "On the whole it's been a successful experiment," says Columbia economist Woodford. "People in the institution have come to understand that there are advantages to the institution of being clearer about what the policy targets are and what the Fed is trying to achieve in the markets."

Beyond policy announcements, FOMC minutes now are usually released three weeks after a meeting. In addition, each open market operation is followed with a detailed report of the transaction, including its amount, the sizes of propositions, and the stop-out rates and ranges. All of it has added up to a considerably more transparent Fed.

Not that there are no longer any surprises. As recently as 2004, five-year Treasury notes jumped 25 basis points — the largest swing in more than a decade — immediately after an FOMC announcement that had been widely anticipated. No policy action was taken that day. What wasn't anticipated was the FOMC's move to eliminate wording in its announcement that had indicated no rate changes would be happening "for a considerable period." The Fed had essentially signaled that it was now closer to lifting interest rates than it had been before, which is why the Treasury notes rose with the announcement.

Even now, after more than a decade of moves toward greater transparency, the Fed remains capable of confusing the markets. But Woodford says that FOMC communications are likely to become even more explicit, not less.

"There's still a search for even better and perhaps more flexible ways to communicate what the outlook for future policy is," Woodford says. "The recent experience is that it can be useful to talk about that." **RF**

READINGS

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