THE FEDERAL RESERVE SYSTEM

Date: October 15, 2014

To: Federal Open Market Committee

From: Stanley Fischer, Loretta J. Mester, Jerome H. Powell, and John C. Williams

Subject: Upcoming Discussion of the *Statement on Longer-Run Goals and Monetary Policy Strategy* (the "Consensus Statement")

The upcoming meeting of the FOMC will include a discussion of possible revisions to the Committee's Consensus Statement on longer-run goals and monetary policy strategy, which is scheduled for its annual renewal at the January 2015 FOMC meeting. In approving the Consensus Statement for the third time in January 2014, the Committee informally agreed that before renewal in 2015, it would be appropriate to consider whether the statement would benefit from any revisions.

Partly due to the relatively short time until the January 2015 meeting, we intend to take a two-pronged approach to the process of potentially revising the statement. Our focus through the balance of this year will be on three issues that we feel are the most promising on which to make progress before the January 2015 meeting. These issues, which generated the most discussion at our January 2014 meeting and at subsequent meetings, are possible clarifications to: (1) the symmetry of the 2 percent inflation goal; (2) the "balanced approach" characterization of policy strategy; and (3) the relationship between the objective of financial stability and the dual-mandate goals of price stability and maximum employment. As a second step, should other issues emerge during the Committee's discussion, the subcommittee will take these up next year when we consider further enhancements to the Committee's communications vehicles.

The questions included in this memo are intended to serve as a guide to the October meeting discussion. Of course, we would appreciate any comments or suggestions you might wish to provide to us in advance of the meeting. Also included, for your reference, is the current version of the Consensus Statement. Finally, you will also find an accompanying memo on this topic, prepared independently by the staff, which should serve as background information for your deliberations.

In light of the tight timeline until scheduled renewal of the Consensus Statement at the January 2015 meeting, we have in mind an approach similar to the one used for the normalization principles. If the discussion at the October meeting indicates there is some common ground, the subcommittee will prepare and circulate a memo before the December meeting outlining some possible revisions to the Consensus Statement with a request for feedback via the SDS comment system. Taking those comments into consideration, the subcommittee will then provide a draft revised Consensus Statement for further Committee consideration at the December meeting. We feel that such a process will help ensure there is ample discussion and comfort with any proposed changes before the scheduled renewal at the January 2015 meeting.

Questions for the Committee Discussion of the Consensus Statement on Longer-Run Goals and Monetary Policy Strategy at the October 2014 Meeting

1. Should the Consensus Statement be modified to clarify the symmetry of the Committee’s preferences for inflation relative to its 2 percent longer-run objective? For example, should it be made clearer that inflation below the Committee's 2 percent longer-run objective is considered to be equally as undesirable as inflation the same amount above that objective?

2. Should the Consensus Statement elaborate on the “balanced approach” language used in paragraph 5, or do you judge that there is no further elaboration which would still encompass the diversity of views among Committee participants regarding their preferences over the dual-mandate goals?

> 2.a Do you interpret “balanced approach” as connoting equal weights on the two parts of the dual mandate goals – specifically, that a miss of inflation relative to its longer-run objective is generally as costly in the Committee’s objective function as an equal-sized miss in the unemployment rate relative what the Committee judges to be its’ mandate consistent level? If so, should this be stated explicitly in the Consensus Statement?

3. Should the Consensus Statement be modified to further clarify the relationship between the objective of financial stability and the dual-mandate goals of price stability and maximum employment, or are you comfortable with the current statement’s treatment of financial stability?

If you prefer enhancements,

> 3.a Should financial stability be included in paragraph 5 in the discussion of the approach the Committee takes in promoting its dual-mandate goals?
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> 3.b Should the statement include the recognition that in some circumstances when financial stability appears to be at risk, the stance of monetary policy may have to be adjusted in order to mitigate risks to financial stability?

4. Looking ahead, are there other portions of the Consensus Statement that you would like the subcommittee to study during 2015? Are there revisions to other communications tools or additional tools that the subcommittee should consider on behalf of the FOMC? For example, do you see promising opportunities to improve the SEP? Do you believe it is time again to consider a consensus forecast?

Statement on Longer-Run Goals and Monetary Policy Strategy
As amended effective January 28, 2014

1. The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term interest rates. The Committee seeks to explain its monetary policy decisions to the public as clearly as possible. Such clarity facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society.

2. Inflation, employment, and long-term interest rates fluctuate over time in response to economic and financial disturbances. Moreover, monetary policy actions tend to influence economic activity and prices with a lag. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals.

3. The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee reaffirms its judgment that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. Communicating this inflation goal clearly to the public helps keep longer-term inflation expectations firmly anchored, thereby fostering price stability and moderate long-term interest rates and enhancing the Committee's ability to promote maximum employment in the face of significant economic disturbances.

4. The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market. These factors may change over time and may not be directly measurable. Consequently, it would not be appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the maximum level of employment, recognizing that such assessments are necessarily uncertain and subject to revision. The Committee considers a wide range of indicators in making these assessments. Information about Committee participants' estimates of the longer-run normal rates of output growth and unemployment is published four times per year in the FOMC's Summary of Economic Projections. For example, in the most recent projections, FOMC participants' estimates of the longer-run normal rate of unemployment had a central tendency of 5.2 percent to 5.8 percent.

5. In setting monetary policy, the Committee seeks to mitigate deviations of inflation from its longer-run goal and deviations of employment from the Committee's assessments of its maximum level. These objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it follows a balanced approach in promoting them, taking into account the magnitude of the deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate.

6. The Committee intends to reaffirm these principles and to make adjustments as appropriate at its annual organizational meeting each January.