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Come with Me to the FOMC

Remarks by

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Thank you for inviting me to be here and to help you fulfill one of the Money Marketeers' key objectives, "to enhance knowledge and understanding of the financial marketplace."

I was a banker for more than 30 years before becoming a member of the Board of Governors, so I've spent my career trying to deepen my own knowledge and understanding of the financial marketplace. In particular, because the outlook for interest rates and the economy was so important to my bank and my customers, I spent considerable effort trying to understand the Federal Open Market Committee (FOMC), the Fed's primary monetary policymaking body, and trying to anticipate the decisions coming out of individual FOMC meetings. In fact, the first bank investment class I ever took included instruction on how to use the weekly reports of monetary aggregates to decipher Fed actions. That will give you some idea of how long ago that was: It was before the Committee began expressing its objective in terms of the federal funds rate—actually before the Committee began saying much at all. Now, after two years of participating in the decisionmaking process, I would like to share some observations that I believe might help you better understand the formulation of monetary policy.

Before I joined the Board, I was advised to read two speeches, "Come with Me to the FOMC" given by Governor Laurence Meyer in 1998, and an updated version presented by Governor Mark Olson in 2004.[1] It turns out that Governor Meyer's speech was inspired by one given in 1967 by Edward Wayne, the president of the Federal Reserve Bank of Richmond. As I thought about how to frame this discussion, a reprise of these earlier speeches seemed appropriate.

[1] See Laurence H. Meyer (1998), "Come with Me to the FOMC," the Gillis Lecture, Williamette University, Salem Oregon, April 2, www.federalreserve.gov/boarddocs/speeches/1998/199804022.htm; and Mark W. Olson (2004), "The Federal Open Market Committee and the Formation of Monetary Policy," speech delivered at the 26th Conference of the American Council on Gift Annuities, Orlando, Florida May 5, www.federalreserve.gov/boarddocs/speeches/2004/20040505/default.htm.

In some ways there has been little change since the first edition of the “Come with Me” speech was given more than four decades ago: Members of the Board of Governors and presidents of the 12 Reserve Banks still meet regularly in Washington, D.C., to discuss how best to set monetary policy to foster full employment and stable prices. But the ways in which these policymakers think and talk about the economic outlook, the formulation of monetary policy, and the communication of that policy have all changed dramatically, especially lately.

So without further ado, I’d like to invite you to come with *me* to the FOMC. We’ll start with a recent meeting and I will try to point out the things that have changed within the meetings themselves since previous speeches.

As we enter the room, you will notice a large oval table, big enough to seat about 25 people. Chairman Bernanke sits at the center of the table. Members of the Board of Governors sit to his left, beginning with the Vice Chair and then continuing in order of seniority. On the Chairman’s right is the deputy secretary of the Committee, next to whom sits the president of the Federal Reserve Bank of New York. The other Reserve Bank presidents are arrayed around the ends of the table, and staff who will be presenting sit on the side of the table opposite the Chairman. The voting members of the Committee include all the members of the Board of Governors, seven in all when we have a full Board, the New York Fed president, and four of the other presidents on a rotating basis. But you won’t be able to tell the difference between voters and nonvoters in any of the discussions because everyone participates equally in the meeting until the vote is taken. Incidentally, as I read the 1967 version of this speech, I noted that it referred to the 19 *men* on the Committee. The first woman joined the FOMC in 1978. I am proud to say that at our next meeting, there will be four women on the Committee.

After the Chairman calls the meeting to order, the manager of the System Open Market Account (SOMA) describes developments in the financial markets since the last meeting. The SOMA, which is managed by the New York Fed, is the Federal Reserve's portfolio of securities used to implement monetary policy.

In many two-day meetings, the manager's report is followed by the discussion of a special topic, such as inflation measurements or the use of unconventional monetary policy tools. After any special topics or briefings, the discussion turns to the economy. The director of the Division of Research and Statistics and the director of the Division of International Finance at the Board give a tag-team presentation on the status and outlook for the domestic and international economies. In the four meetings a year when we make formal economic projections, there also is a presentation that summarizes the projections of the FOMC participants and how they have changed since the previous projections. Following a question-and-answer period, it is time for each FOMC participant to give his or her input on the economy in what is referred to as the "economic go-round."

The speaking order of FOMC participants changes a bit each time, but generally the Reserve Bank presidents go first, followed by the members of the Board. Each participant has his or her own style. Everyone talks about his or her views on current and expected national and international economic conditions. The presidents' remarks usually include comments about conditions in their districts, while the contributions of the Board members tend to reflect their individual backgrounds. Chairman Bernanke concludes the economic go-round with a summary of what all the other policymakers said about the economy, then makes his own comments. I always marvel at his ability to quickly and coherently summarize a diverse set of observations into a cohesive narrative and use it to transition the discussion to appropriate policy.

The director of the Board's Division of Monetary Affairs then kicks off the policy discussion with a presentation of monetary policy alternatives. For each alternative, he talks us through the rationale for choosing it and the anticipated financial market response if the action were taken. Following questions, we begin the monetary policy go-round.

Interestingly, all of the previous "Come with Me" speeches highlight the way the Chairman influences the outcome of the meeting through his leadership rather than domination or dictatorship. In 1967, the staff made recommendations for participants to consider. Chairman William McChesney Martin generally spoke at the end of the single go-round, which included both the economic outlook and policy. According to Governors Meyer and Olson, Chairman Greenspan did not speak during the economic go-round but would begin the policy go-round with his views about what the policy decision should be. Participants would then follow after him and respond to his proposal. As I said, Chairman Bernanke speaks at the end of the economic go-round. Then in the policy go-round, he usually waits until everyone else has stated their views before he shares his own opinion and suggests a path forward. After a bit more discussion, the Committee votes, confirms the date of its next scheduled meeting, and then the meeting adjourns.

I came out of my first FOMC meeting—which began just half an hour after I was sworn in at the Fed—pumped full of adrenaline but also exhausted from the intense level of my concentration as I tried to follow everyone's comments. Most importantly, I came out with an understanding that the meeting itself was just the tip of the iceberg, the culmination of thousands of hours of work and thought leading to a single policy statement, a process that would be repeated for each FOMC meeting. Even after two years on the Committee, I still leave feeling impressed by the level of preparation for, and the focus and intensity at, these meetings.

Each FOMC participant has his or her own approach to the process. Some of the preparation rituals are as old and as time-tested as the go-rounds in every meeting. Other aspects of preparation have developed in response to the unprecedented actions we have taken recently. As I get ready for a meeting, I try to formulate my own answers to three key questions:

- First, how is the economy likely to evolve in the near and medium term?
- Second, given the economic outlook, what is the appropriate policy response?
- Finally, how should we communicate our actions so that the public can understand them?

As I discuss the steps in the FOMC process, I think you'll see that these questions come up a lot and are deeply intertwined. While the outlook for the economy and the appropriate instrument selection and calibration for policy are fairly obvious parts of the monetary policy decisions, I believe that communication of that policy is equally important. Moreover, communication is perhaps the way in which the FOMC has changed the most in recent years, so I think it deserves some extra attention here.

First Question: How is the Economy Likely to Evolve in the Near and Medium Term?

Any discussion of monetary policy has to begin with an assessment of current economic conditions and the outlook. People often assume that we have secret economic data that no one else gets. Actually, our forecasts are based on the same data used by private forecasters. What we do have is a group of extremely knowledgeable, experienced, and talented people who study all aspects of the economy. We also have a number of powerful economic models that have been developed and tested over the years. In addition to the economists and researchers at the Board, every Reserve Bank has economic research groups. We also have financial market experts at the

New York Fed and at the Board. And we gather thousands of tidbits of anecdotal information from a wide range of sources.

Given my background in banking and the important role lending has played in both the crisis and the recovery, I try to provide the Committee with insight into current lending conditions, including loan quality and credit availability. I begin my preparations about two weeks before the meeting by contacting a number of bankers from banks of different sizes, geographic market coverage, and business models. Then I meet with a staff group drawn from all the disciplines at the Board who bring data from surveys, supervisory observations, and their own research to help me round out the anecdotal information. Finally, I spend a great deal of time studying the materials furnished to all participants.

About a week ahead of the meeting, the process really ramps up as the staff distributes its analysis of the economy and participants begin to formulate their own forecasts. On the Tuesday before the meeting, the staff distributes to the Board members and Reserve Bank presidents for comment a document with a range of options (usually three) for the statement that will be released after the meeting. At this point in the process, we aren't debating which option is best or even necessarily what the best words are, but rather, we are trying to ensure the options span the range of plausible alternatives.

On Wednesday, the staff circulates a discussion of economic developments since the last meeting and a forecast of economic performance, including hundreds of charts, tables, and graphs.[2] In addition to the baseline forecast, which is the staff's estimate of the most likely path for the economy, several alternative simulations are included to provide a sense of the impact of

[2] Transcripts of FOMC meetings and copies of the materials provided to participants are released with a five-year lag. For more information and to access materials from previous FOMC meetings, see www.federalreserve.gov/monetarypolicy/fomc_historical.htm.

other plausible developments, such as faster or slower recovery or a change in inflation expectations, that were not included in the baseline forecast.

I find it impossible to form a preference for a policy to improve the path of economic performance without forming some opinion about what the performance would be absent any policy action. So I suppose you could say that I formulate an implicit economic forecast for every meeting. But four times a year, I submit an explicit forecast to be used along with the forecasts of other participants in the Summary of Economic Projections (SEP) that is later published with the minutes for that meeting.

Second Question: Given the Economic Outlook, What is the Appropriate Policy Response?

Armed with this study of the economy, projections, and often a few specific areas of concern, it is time to think about appropriate policy. On Thursday the staff provides a policy-focused book designed to help with this question. It contains a number of estimates of the "Equilibrium Real Federal Funds Rate"—the interest rate that if maintained would return the economy over time to its so-called potential, the highest level of output that does not lead to undue inflationary pressures. The book also includes calculations of policy solutions using policy rules as well as model-based estimates of optimal policy. And it contains an analysis of each of the policy alternatives that were circulated in draft form on Tuesday.

Often, the staff also provides the FOMC with memos on special topics. As you can imagine, in recent years the memos have covered topics such as use of large-scale asset purchases, ways the Federal Reserve might exit from nonstandard programs when the time comes, or financial stability indicators. As we contemplate the possible need for additional monetary accommodation and the tools we have remaining, staff memos are quite helpful in assessing the potential costs and benefits of various approaches. With our target for the federal funds rate close to zero, the policy decisions are all the more complicated.

Third Question: How Should We Communicate our Actions?

Communication is often described as one of the tools of monetary policy. I think it is one of the most powerful aspects of our overall policy. Let's examine the communication vehicles we use and how they have changed over the years.

Speeches

One of the obvious ways FOMC participants communicate with the public is through speeches. With the exception of the Chairman, individual participants speak only for themselves and not for the Committee. Still, the information in participants' speeches and testimony is useful because it offers the public insights into the current discussion under way within the Committee and where individuals tend to fall in the debate. In recent months, as interest in our policies has risen in light of the continued slow recovery, some Fed watchers and reporters have worked especially hard to piece together individual opinions to try to characterize FOMC meeting discussions and the likely outcome of our future deliberations. While this is a legitimate and resourceful way to understand the current state of play in monetary policy, I would caution against reading too much into any individual speech, news story, or public appearance. Instead, I would draw your attention to the official communications that are actually approved by an FOMC vote: the post-meeting statement, the minutes that are published three weeks after each meeting, and the economic forecasts that accompany the minutes each quarter. I would focus as well on the Chairman's speeches and testimony, both because he leads the Committee and because he has the best sense of the current consensus on the Committee.

Projections

To understand policy, it is important to understand policymakers' views of the economy. In the early years of the Committee, it was hard for the public to know, in any numerical way, what FOMC participants were thinking about the outlook for growth, unemployment, or inflation. Starting about 30 years ago, though, bank presidents and Board members began submitting twice-a-year economic forecasts for a year or two ahead that were published and available to the public. In November 2007, the Committee made a major change in its projection practices. The change had two important dimensions: The projections window was extended to three years, and the frequency of projections was doubled from two times a year to four times a year. Then, a little over a year later, the Committee participants began making projections for key variables over the "long run" as indicators of their views on the steady state of the economy.

Because of the press coverage that the quarterly economic projections often garner, it is likely that most observers are somewhat familiar with this development. Now, I'd like to talk about the evolution of the post-FOMC statement and the minutes of the FOMC meetings. Both of these documents are obviously closely watched, but I'd like to highlight here how they developed into their current forms.

Statements

Anyone who reads the newspaper has probably read some report based on the statement the FOMC releases after each meeting.[3] Reporters, investors, and others track changes to the statements word-by-word. If I start with a little background on how the Committee's focus on the statement has developed, I trust that you'll come to see that the market's focus on the statement is not entirely unfounded.

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[3] For FOMC statements, see www.federalreserve.gov/monetarypolicy/fomc.htm.

It's hard to believe, but it was only 16 years ago that the FOMC began releasing any information immediately after its meeting. Before 1994, the public wasn't formally made aware of the FOMC's decisions until the minutes were published many weeks later. Instead, market participants would closely watch the actions of the New York Fed's trading desk and would then infer when policy changes were made. On February 4, 1994, Chairman Greenspan released the first post-meeting statement describing an FOMC policy action. At that point, the statement was the Chairman's alone, and there were no promises about future statements being released. A year later, the Committee indicated that a statement would be made after each FOMC policy change and by January 2000, the Committee decided to make a statement after each meeting, regardless of whether a policy change was made. In March 1997, the statement began being released without attribution to the Chairman, connoting that it was a statement of the whole Committee.

I'd note that these early statements were not completely transparent; for example, the statements used code such as "the degree of pressure on reserve positions" to indicate a change in the interest rate target. Not until the middle of 1995 did the statements directly state the target for the federal funds rate.

Over time, the Committee began to see the statement as more integral to its mission and to pay more attention to the statement wording. Starting in late 2000, for instance, recognizing the public focus on word changes, the Committee began looking at versions of the statements that tracked the changes in wording from the prior statement. As focus on the statement language took more time and attention, the Committee got involved in its development at earlier stages. In early 2004, the staff began providing a full set of draft policy statements, one associated with each of the policy choices, in the pre-meeting information package distributed on

Thursday. Not long after that, the staff began the current practice of circulating even earlier drafts of the statements so that policymakers could let them know if the various alternatives covered the plausible set of options for the meeting.

Initially, the Committee discussed the statement wording only after the policy vote was taken. But by March 2001, the full statement was actually discussed before voting on the policy itself. Then in October 2007, the FOMC formally recognized the value of the post-meeting statement by changing procedures to reflect that the policy vote officially encompassed the full statement, not just the policy action. This spelled out what was already understood: What was said about a policy action was almost as important as the action itself because it helped explain what the Committee was doing and set up expectations for what it might do down the road.

I think what you can glean from this little history is that the post-FOMC statement has evolved into anything but an afterthought. Rather, my colleagues and I begin thinking about our communication almost at the same time we start thinking about the policy decision itself, and we usually debate language as a way to nuance policy. But in case you're tempted to think the statement is "baked in the cake" by the time the FOMC meets, I'd suggest you take a look at some of the meeting transcripts on our website. The policy go-round has actually become the policy/communications go-round, with frequent, lively debates about everything from changing entire paragraphs in the statement to changing clauses, individual words, and sometimes even punctuation.

Using new tools to manage policy as we have in the last two years does create particular challenges in communicating our actions, intentions, and reasoning to the public. The statement has been an essential element in addressing these challenges. For example, the announcement of a target for the federal funds rate combined with a phrase such as "extended period" gives the market a sense of current policy and the policy expectations for the future. Over time, market participants have learned how to translate that sort of statement into expectations for market and economic conditions. When we began large-scale purchases of mortgage-backed securities and agency debt, however, that decision was much more difficult to interpret. So we communicated that we expected to purchase x amount of securities over y amount of time. In subsequent statements, we reiterated that intention, added to some totals, subtracted from others, added purchases of Treasury securities, and ultimately stated our intentions to stop purchasing the securities.

Minutes

If you are interested in the debate, though, the best place to look for information on the topics discussed and views presented in FOMC meetings is in the minutes.[4] Although the minutes have always been of interest to market participants, for a long time, the minutes of a meeting were not released until after the next FOMC meeting had occurred. Starting with the December 2004 FOMC meeting, the Committee began releasing its minutes three weeks after each meeting. This expedited timing enabled market participants to gain insight into the Committee's previous decision as well as participants' views on important issues before the next FOMC meeting.[5] The minutes are not just a longer, more detailed version of the statement. An enormous amount of effort goes into making sure the minutes accurately reflect the discussion that took place at the meeting so that the public can see the full range of ideas and assessments considered by the Committee in reaching its decisions.

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[4] For minutes and transcripts of the FOMC meetings, see www.federalreserve.gov/monetarypolicy/fomc.htm.

[5] For more information, see Deborah J. Danker and Matthew M. Luecke (2005), "Background on FOMC Meeting Minutes," *Federal Reserve Bulletin*, vol. 91, pp. 175–179, www.federalreserve.gov/pubs/bulletin/2005/spring05_fomc.pdf.

In my time at the Fed, I have come to see the range of viewpoints on the FOMC as a unique strength of the Committee. Yet, I have seen numerous reports recently about the different views expressed by various FOMC participants, emphasizing the perceived level of discord. After reading the descriptions of meetings covering four decades, I have the sense that differences of opinion have been quite common throughout the years. So I would like to share three observations I've gleaned from participating in discussions covering a period that, I believe, has been one of the most difficult times ever faced by the FOMC. First, the diversity of views adds richness to the debate and ensures that we consider numerous possibilities. Second, all the FOMC participants share a deep respect for each other and for the process. And third, Chairman Bernanke has an extraordinary ability to lead us to conclusions that are designed to best meet our responsibilities and that are, in the end, supported by most members of the Committee.

My comments today aren't made in an attempt to focus more attention on our communications—it is hard to imagine more attention! But I do want to highlight just how much progress we, as a Committee, have made over the years. The actions we take are intended to have specific effects on the structure of interest rates and the economy. Some of the impact comes from the transactions themselves, but most of the impact comes from expectations of what we are going to do. A shift in monetary policy or, as importantly, a shift in the expectations for monetary policy can have a huge impact on financial markets and the economy. And it is our communications that most directly shape expectations. For this reason, I think it is critically important that we use our official communication to be as clear as we can possibly be about our assessments of economic conditions, our policy decisions and intentions, our targets, and our implementation strategies for nonstandard monetary policy tools.

Conclusion

I hope this discussion has helped you to understand what we do, how we do it, and how you can best follow our actions. I urge you to pay close attention to our official communications, and I pledge to you that we will continue to strive to communicate as clearly as possible. I would like to close with a quote from the original "Come with Me to the FOMC" speech by Edward Wayne: "This is your central bank. This is your Federal Open Market Committee. This is your country. May we all hope that a kind providence will give us the wisdom, the judgment, the patience, the tact, the diplomacy, and the courage to do what seems right and best day by day."