SPEECHES

Federal Reserve Communication: Striving for Clarity in a Fast Changing World

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Key Points

- Lockhart expects **GDP growth** for the rest of this year and over the next couple of years to be in the range of 3 to 4 percent annually. He anticipates that over the next two years**, inflation** will converge to the Fed's de facto inflation objective of 2 percent or a bit less.
- Lockhart believes that **communication is integral to the monetary policy process**. In his view, the better that financial markets and the public understand what the Fed is trying to accomplish in the medium and long term, the more effective monetary policy ought to be. Communication is also a primary channel through which the central bank achieves transparency and accountability to the public for its decision making.
- According to Lockhart, a particularly big challenge lies ahead as the Federal Reserve contemplates when, and how, to exit today's accommodative policy. In his opinion, formally communicating as a committee about an imminent change in policy will actually start the process of changing the policy. The exact timing of initiating the exit remains to be determined by the FOMC. Lockhart is confident that **the committee will provide guidance when it has enough certainty that the guidance will provide more signal than noise to financial markets and the public**.

I want to welcome you to Atlanta, a city that has made a contribution to the world of communication and media over the years and gained economically as a result. You may know that Henry Grady, famous editor of the Atlanta Journal Constitution, was an enthusiastic advocate and promoter of the New South following the Civil War. Ted Turner developed his vision of a worldwide cable news network here in Atlanta.

Communications media have been an arena for innovators and visionaries, including those who foresaw the power of words on paper, of voices over radio airwaves, and moving pictures on televisions. Today our world integrates all those channels with digital and social media aimed at engaging audiences in new ways.

Central banks seem always to face formidable communications challenges, and certainly that is the case for the Federal Reserve in these times. In addition to conveying what is sometimes dense content on monetary policy and regulation, the Fed must adapt to both an evolving mix of media and the public's increasing expectation of transparency and accountability.

As regards monetary policy, Federal Reserve communication plays two critical roles as I see it. First, central banks have to inform the public about the state of the economy, the economic outlook, and the intent of policy choices made.

Second, communication is itself a policy tool. The implementation of policy is an interactive process in engaging the public and markets.

Today in my remarks, I will first discuss the economic outlook. Then, with this outlook in mind, I will discuss the role of communication as a policy tool. An aspect of the current context is the implementation, at some point, of an exit strategy. By exit I mean an unwinding of the extraordinary interest rate and asset purchase policies put in place to counter the recent recession and promote a sustained recovery.

As always, I am expressing my own views that may not be shared by my colleagues on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.

Economy and outlook
For nearly two years, the U.S. economy has been recovering from the deep and protracted recession brought on by the financial crisis and the housing market collapse.

The cadence of the recovery has been halting. After a few quarters of postrecession bounce-back, economic growth decelerated notably last summer. It then came back strongly in the last few months of 2010, but it appears that once again the expansion slowed in the first quarter of this year.

A number of shocks have affected this recovery, including the recent run-up in oil and other commodity prices. The economy has shown resilience in absorbing these various shocks, but they at times held back the pace of the recovery.

Although measured growth of gross domestic product (GDP) was relatively weak in the first quarter, private demand seems to have sustained its solid growth pace. Consumer spending continued to grow in the first quarter, even as gasoline prices jumped. Business investment in equipment and software grew at a double-digit rate. Exports also posted healthy gains. Anecdotal feedback from many of our business contacts in the Southeast also suggests the economy was stronger than the first quarter's preliminary GDP number suggests.

I expect GDP growth for the rest of this year and over the next couple of years to be in the range of 3 to 4 percent annually. I expect growth of consumer and business spending to be sustained, reflecting increased confidence in the durability of the recovery. Robust economic growth of some of our major trading partners should boost exports. The manufacturing sector is likely to contribute significantly to growth, as domestic and foreign demand for U.S.-made goods increases.

Unfortunately, recovery has been too slow so far to reduce unemployment meaningfully. Over the next two years, I expect a gradual decline in unemployment. At the gradual pace I'm expecting, it could take up to three years to get employment back to prerecession levels.

Let me now address inflation. Since last fall and until very recently, commodity prices were on a very strong upswing. Most of these input cost increases were absorbed somewhere along the production chain, but some rises in commodity prices were passed through to retail prices, notably gasoline and food.

Prices of many commodities, including oil, have either leveled off or declined recently. Many analysts have begun to speculate that this softening in commodity prices might be reflected in consumer prices later this year.

It's the Federal Reserve's responsibility to ensure that short-run increases in the rate of headline consumer inflation do not turn into a persistent inflationary trend over the medium and longer term. Confidence in the Fed's ability to deliver on this responsibility is closely tied to the inflation expectations of households, businesses, and investors. At the moment, longer-term measures of inflation expectations are reasonably stable. I anticipate that over the next two years, inflation will converge to the Fed's de facto inflation objective of 2 percent or a bit less.

This fairly optimistic outlook—continued expansion with moderate inflation—is subject to several risks.

At the top of my list of risks at the moment would be a further decline in home prices, a renewed run-up in oil prices, and the possibility that sustained elevated headline inflation could dislodge inflation expectations.

But assuming my optimistic outlook narrative plays out over the course of this year and next, policy will be in transition, in all likelihood. Federal Reserve policy actions and the communications that accompany policy changes will play an important role in sustaining a balanced and durable expansion with the low and stable rates of inflation the public has come to expect. So let me now turn to the subject of communication.

Federal Reserve communications

As I mentioned earlier, communication is integral to the monetary policy process, both here in the United States and elsewhere.

Communication can help shape public and market understanding and expectations about the objectives of monetary policy, the monetary policy strategy, the economic outlook, and the prospect of future policy changes. The better that financial markets and the public understand what the Fed is trying to accomplish in the medium and long term, the more effective monetary policy ought to be. Clear and cogent communication that serves to keep participants in the economy well-informed creates a positive, interactive dynamic between the Fed and businesses, consumers, and financial markets. In short, saying is part of doing.

Communication is also a primary channel through which policymakers achieve transparency and accountability to the public for their decision making. Real outcomes of policy decisions in the economy are the ultimate test, of course, of both policy and the communication surrounding it. Accountability for results builds from effective communication.

The Federal Reserve has an ample number of communication tools. They include postmeeting statements on policy actions, meeting minutes, testimony, publications, Chairman Bernanke's press conferences (just recently initiated), and, increasingly, the use of social media. And Fed officials are frequently out talking to a wide variety of public groups—as I am today—discussing the reasoning behind policy decisions and how those decisions are expected to affect the economy.

Of course, talk can be cheap. For policy to work best, the public must have confidence that Fed officials will follow through on our words with appropriate policy actions. Talk plus action producing intended results creates confidence. And public confidence is an active ingredient in effective policy action.

Despite the multiple communications channels and methods that the FOMC uses, I know there are many who still maintain that monetary policy lacks transparency. One current complaint is that the FOMC has not been forthcoming about the hows, whys, and whens of changes in the direction of policy.

To some extent, that's true, in my opinion, and there's a good reason. The reason is the uncertainty already noted about the course of economic growth, employment, financial conditions, and inflation. Central banks conduct monetary policy against a backdrop of imperfect knowledge about the overall economy and the shocks that could affect the economy's path. Policymakers must be able to respond to future developments that cannot be predicted. Conveying a false precision does not increase confidence about economic outcomes, and it ultimately damages future credibility. Very specific pronouncements about the course of policy may feel like greater transparency, but the opposite is the case if commitment to that course is not credible.

Current communication challenge—the exit strategy

The Fed has its share of immediate and tangible communication challenges in the current circumstances. In my view, a particularly big challenge lies ahead as we contemplate when, and how, we exit today's accommodative policy.

At some point, the committee will have to begin removing monetary accommodation. This will be a major transition point for policy and, arguably, one of the great communications challenges our central bank has faced.

I'm of the view that formally communicating as a committee about an imminent change in policy will actually start the process of changing the policy. In other words, talking about doing actually begins the process of doing. As a case in point, last summer Chairman Bernanke spoke in an August 27 speech about the potential need to purchase additional long-term securities. After his comments, markets began to price in this move, which was ultimately not effected until after the November 3 FOMC meeting. I think a similar approach might be used for exit. In other words, the first step toward implementation of an exit strategy could start with communication, recognizing that what the FOMC says has real economic impact.

Even if they are a bit premature in my view, questions are already arising about the specifics of the Fed's exit strategy. When will the Fed signal the start of raising interest rates by removing the "extended period" language in its postmeeting statement? When will interest rates actually rise? When and how will the Fed start reversing QE2? What will be the pace of actions along the exit path? Will the path be predetermined and explicit or flexible in order to deal with contingencies? In short, the questions are when, how, how fast, and how fixed?

It's clear from some media commentary that there's some amount of frustration that specific answers to these questions are not yet available. Occasionally, I hear or read that the absence of details about the FOMC's exit strategy represents a lack of central bank transparency or accountability—or, what may be worse, that the FOMC lacks a framework for addressing these questions.

The existence of these views represents a communication challenge in itself. I'd like to make two points in response. First, it is in the nature of policymaking in an uncertain environment that a central bank has to employ some amount of ambiguity in the forward guidance it gives the public. That ambiguity should not be confused with a lack of transparency or the failure of policymakers to come up with a coherent framework for making decisions. Second, uncertainty evokes divergent thinking among policymakers about the operational details of a policy-implementation plan, even when there is broad agreement about the desired outcomes of policy actions. Expressing these divergent ideas on the part of policymakers in advance of committee deliberations can cause some confusion, but I see this as a necessary and healthy process of pursuing the aim of transparency while working as a true committee of independent thinkers toward an eventual policy decision.

If you are a careful reader of the financial press, you probably have noticed that some of my colleagues have already begun to weigh in on the details of exit. I will not do so today, but I think it would be a mistake to assume that these public conversations on exit are much more than an open discussion of the options the central bank should consider.

Communications of individual policymakers

Each participant in the FOMC enjoys a great deal of freedom to express his or her views publically. I feel this independence carries with it the overriding obligation to keep in focus the aim of contributing to the effectiveness of policy. Further, I feel it's my obligation to tell the public what I think. At the same time, it's my obligation to give an honest assessment of the consensus view of the FOMC (the committee) even if I disagree. And it's my obligation to respect the committee process.

In my public comments, I try to stay within boundaries drawn by certain self-imposed guidelines. I speak only for myself, not for the Federal Reserve or the FOMC. Only the chairman speaks for the system or the committee.

Because I genuinely value the discussions and contributions of my colleagues at the FOMC table, I try not to front run the committee by speaking about a matter that I know will be on the next agenda. Likewise, I try not to "send in my vote," so to speak, before the meeting by committing to a position directly in advance of a meeting.

To conclude, I have a rather optimistic outlook for continued expansion with moderate inflation and unemployment declining gradually. Once the expansion becomes more clearly sustainable, it will be appropriate to begin the process of normalization of interest rate policy and the Fed's balance sheet. The exact timing remains to be determined by the FOMC. I am confident that the committee will provide guidance when we have enough certainty that the guidance will provide more signal than noise to financial markets and the public.

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