The Fed Should Improve Communications by Talking About Systematic Rules

Jeffrey Lacker and Charles Plosser

Hoover Monetary Policy Conference

Hoover Institution, Stanford University

May 12, 2023

Communication challenge: “Sufficiently restrictive” = ?

“The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is **sufficiently restrictive** to return inflation to 2 percent over time. In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.”

- *FOMC Statement, March 21, 2023, emphasis added*

An opportunity to improve communication: *Talk about systematic monetary policy rules*

- History provides evidence about what it will take to be "sufficiently restrictive" to reduce inflation
- *Successful systematic policy rules, like Taylor's rule, summarize that evidence*
  - Capture how the funds rate varied with incoming data in periods in which the Fed successfully brought inflation under control
- *Successful rules satisfy intuitive properties:*
  - Funds rate responds more than one-for-one to inflation (Taylor Principle)
    - Raises real interest rates when inflation is above target, in order to encourage postponing or forgoing outlays
  - Funds rate responds positively to resource utilization (Goodfriend-King)
    - Raises real interest rates when resource utilization is tight, in order to encourage postponing or forgoing outlays
- *Such rules work well in a range of models*

Talking about systematic monetary policy rules

Fed officials could:

- Note that successful pursuit of the Fed's mandate is likely to require policy settings that are broadly in line with past Fed behavior when inflation has been reduced and contained
- Observe that systematic policy rules capture how the Fed behaved
- Cite the current quantitative prescriptions from a range of different rules and note how current rate settings compare
- Also cite rule prescriptions conditional on FOMC projections and compare to their own rate projections
- Show how prescriptions vary with alternative future paths for inflation and unemployment
- Discuss reasons why current rate settings differ from rule prescriptions

Talking about systematic monetary policy rules

- The Fed publishes policy rule calculations in the *Monetary Policy Report to Congress*, and on the Board's website
  - Routinely distributed to FOMC participants prior to meetings
  - Cleveland and Atlanta Feds maintain online DIY Taylor Rule calculators
- Referring to rule prescriptions would improve public understanding
  - Would help guide expectations about how high interest rates might need to rise to restore price stability
  - Would help public understand how the rate path is likely to vary with incoming data
  - Would be a better basis for providing forward guidance
  - Would dampen perception that policy decisions are politically motivated
- Would *not* require committing to mechanically follow any one particular rule
  - The Fed could depart from rule prescriptions, presumably with an explanation
- FRB St. Louis President Bullard (Nov. 17, 2022) demonstrated what we suggest

Table 1. Policy Rule Prescriptions Using March 2023 FOMC Economic Projections

Federal Funds Rate	2022 Q4	2023 Q1	2023 Q4	2024 Q4	2025 Q4
Taylor (1993)	8.42	7.24	4.15	2.88	2.28
Taylor (1999)	8.79	7.69	3.85	2.50	1.90
Taylor (1999) with core inflation	7.51	7.38	4.30	2.65	1.90
Median FOMC Projections			5.10	4.30	3.10
Actual federal funds rate	3.65	4.51			
Economic data and projections	*Actuals*		*Median FOMC Projections*		
PCE price index*	5.69	4.86	3.30	2.50	2.10
Core PCE price index*	4.84	4.65	3.60	2.60	2.10
Unemployment rate	3.60	3.50	4.50	4.60	4.60
*Year-over-year percent change					

Source: FRED, Federal Reserve Bank of St. Louis; Federal Open Market Committee, Summary of Economic Projections, March 22, 2023; author's calculations.

Table 2. Policy Rule Prescriptions With More Persistent Inflation					
Federal Funds Rate	2022 Q4	2023 Q1	2023 Q4	2024 Q4	2025 Q4
Taylor (1993)	8.42	7.24	**6.49**	**4.08**	2.28
Taylor (1999)	8.79	7.69	**6.19**	**3.70**	1.90
Taylor (1999) with core inflation	7.51	7.38	**5.88**	**4.15**	1.90
Median FOMC Projections			5.10	4.30	3.10
Actual federal funds rate	3.65	4.51			
Economic data and projections	*Actuals*		*Alternative projections*		
PCE price index*	5.69	4.86	**4.86**	**3.30**	2.10
Core PCE price index*	4.84	4.65	**4.65**	**3.60**	2.10
Unemployment rate	3.60	3.50	4.50	4.60	4.60
*Year-over-year percent change					

Source: FRED, Federal Reserve Bank of St. Louis; Federal Open Market Committee, Summary of Economic Projections, March 22, 2023; author's calculations.

Table 3. Policy Rule Prescriptions With Persistent Inflation, Tight Labor Market

Federal Funds Rate	2022 Q4	2023 Q1	2023 Q4	2024 Q4	2025 Q4
Taylor (1993)	8.42	7.24	**7.24**	**4.15**	2.28
Taylor (1999)	8.79	7.69	**7.69**	**3.85**	1.90
Taylor (1999) with core inflation	7.51	7.38	**7.38**	**4.30**	1.90
Median FOMC Projections			5.10	4.30	3.10
Actual federal funds rate	3.65	4.51			
Economic data and projections	*Actuals*		*Alternative projections*		
PCE price index*	5.69	4.86	**4.86**	**3.30**	2.10
Core PCE price index*	4.84	4.65	**4.65**	**3.60**	2.10
Unemployment rate	3.60	3.50	**3.50**	**4.50**	4.60
*Year-over-year percent change					

Source: FRED, Federal Reserve Bank of St. Louis; Federal Open Market Committee, Summary of Economic Projections, March 22, 2023; author's calculations.