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Options for Evolving the Statement Language in Preparation for Liftoff

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Introduction

Many FOMC participants currently anticipate that it will likely be appropriate to begin raising the target for the federal funds rate around the middle of the year. If the Committee thought that the first increase in the target range might be warranted at the time of the June meeting, it may wish to replace its current forward guidance at the time of its March meeting, provided the economy continues to evolve broadly as anticipated. Removing the language that the Committee "can be patient in beginning to normalize the stance of monetary policy" would signal to the public that liftoff at one of the next couple of meetings was no longer unlikely.

To facilitate a smooth progression in FOMC communications through the time of liftoff, the Committee may, at the time the "patience" language is removed, want to choose statement language that conveys the continuity in its policy approach both before and after liftoff. To this end, this memo begins by spelling out three aspects of the current and future conduct of policy about which the Committee's current forward guidance provides information. It then presents possible statement language for the meeting at which the Committee first decides to raise the target range for the federal funds rate and for the meeting at which the Committee decides to remove the current "patience" language, and compares how these statements address the three aspects. The options presented here focus only on the forward guidance aspect of the statement, and leave open the contents of paragraphs 1 and 2, which would presumably evolve in line with economic developments. The examples of specific language are intended to promote discussion at the January meeting regarding the most promising approaches for FOMC communications in the run-up to, and early stages of liftoff.

Aspects of the Conduct of Monetary Policy Addressed by the Statement

Before turning to the specific language in the draft statements, we enumerate the main ideas that the Committee may want to communicate in the policy statement around the time of liftoff and beyond. Three key elements, which are present in the current policy statement, seem particularly salient:

1. The policy decision for the federal funds rate target range and its rationale.
2. An articulation of the factors that will govern future movements in the federal funds rate—incoming data on real activity, inflation, and other factors relevant to the outlook—and the goal orientation of policy.
3. Guidance about the expected path for the federal funds rate (conditional on the modal economic outlook and the policy framework), with accompanying qualifications that the actual path will be data dependent.

Possible Language for the Two Statements

Drafts of possible statements for pre-liftoff and liftoff are included in the appendix. Here, we describe how the language in these statements achieves the communication objectives outlined above, along with a comparison to the current statement language, where appropriate.

The policy decision for the federal funds rate target and its rationale.

The pre-liftoff statement would continue the current language: "To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to ¼ percent target range for the federal funds rate remains appropriate."

The liftoff statement would replace this language with an affirmative expression of the progress that has been made, thus justifying a policy change: "In light of the considerable progress that has been achieved toward the attainment of the Committee's objective of maximum employment and the Committee's expectation that inflation will rise to its 2 percent objective over the medium term, the Committee decided today to raise the target range for the federal funds to ¼ to ½ percent."

Factors that will govern future movements in the federal funds rate

Both the pre-liftoff and liftoff statements could indicate: "In determining future adjustments of the target range for the federal funds rate, the Committee will assess realized and expected deviations of employment and inflation from its objectives of maximum employment and 2 percent inflation."

In this formulation, "realized and expected deviations from its objectives" replaces the phrase "progress—both realized and expected—toward its objectives" in the current statement. Whereas "progress toward its objectives" was arguably understood as the approach to maximum employment and 2 percent inflation from below, some overshoot of employment may occur going forward while inflation is still running below 2 percent. The new language is intended to convey more explicitly rule-like behavior in terms of employment and inflation gaps irrespective of their signs.

The draft statements retain the language that "This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments."

Guidance about the expected path for the federal funds under the modal outlook

To signal that liftoff is likely getting close, the pre-liftoff statement indicates that: "Based on its current assessment, the Committee judges that economic conditions [may | could potentially] warrant an increase in the target range for the federal funds rate in a couple of meetings. However, if incoming information indicates slower progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur later than currently anticipated." The first of these sentences would clearly indicate that liftoff could potentially come soon, and the phrase "in a couple of meetings" allows this guidance to remain consistent with the "patient" guidance from the preceding statement (which would have indicated a low likelihood of liftoff at both the meeting when "patient" is removed and the subsequent meeting). The second sentence would continue to emphasize that the liftoff decision will be data-dependent. However, with liftoff seen as more likely coming soon, there would no longer be a sentence indicating that, if progress were faster, liftoff would come sooner.

In the liftoff statement, there would be no comparable language emphasizing the data dependence of the liftoff decision since that decision is being announced. That data-dependent language was originally introduced in the statement to push back against the possible interpretation that "considerable time" was a time-based commitment. With no such time-based guidance in the liftoff statement, this language would no longer be needed.

Turning to the post-liftoff path for the federal funds rate, both the pre-liftoff and liftoff statements omit the current sentence: "When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent." According to the Committee's Statement of Longer-run Goals and Monetary Policy Strategy, the Committee will take a balanced approach in "circumstances in which the Committee judges that the objectives are not complementary." The "balanced approach" language was initially introduced into the policy statement because it was thought that inflation might overshoot 2 percent after liftoff, while employment remained below its maximum sustainable level, implying that the objectives would not be complementary for a time. However, such a circumstance is no longer anticipated at the time of liftoff or soon after, and hence this sentence is no longer necessary.

To provide some information about the post-liftoff path of policy, both statements retain the current sentence: "The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run." To emphasize the data dependence of this anticipation, the pre-liftoff statement adds the prefatory phrase "Based on its economic outlook." And to reinforce this point, both statements add another sentence: "In response to unanticipated economic and financial developments, the Committee will adjust the target federal funds rate to best promote the attainment of its objectives of maximum employment and 2 percent inflation."

Finally, the liftoff statement includes a new sentence in the final paragraph: "Even after today's adjustment to the target range for the federal funds rate, the stance of policy remains highly accommodative and will continue to support a strong economy." This sentence is intended to remind the public that the increase in the federal funds rate marks only the beginning of the normalization process and that there has not been a dramatic shift in the policy stance. This point is reinforced by the remainder of the paragraph, which continues language from the current statement: "Moreover, the Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions." The Committee may also wish, at the time of liftoff, to add guidance as to the expected date at which reinvestment will end or begin to be phased out.[1]

[1] The Committee could choose to make such a decision contingent on the evolution of the economy and the associated implications for the federal funds rate. For example, the statement could indicate: "The Committee currently anticipates that phasing out reinvestments of principal payments on its existing securities holdings will likely begin after the federal funds rate has moved significantly above its effective lower bound, provided that the Committee remains confident of progress toward its long run objectives."

Appendix

December 2014 FOMC Statement

1. Information received since the Federal Open Market Committee met in October suggests that economic activity is expanding at a moderate pace. Labor market conditions improved further, with solid job gains and a lower unemployment rate. On balance, a range of labor market indicators suggests that underutilization of labor resources continues to diminish. Household spending is rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow. Inflation has continued to run below the Committee’s longer-run objective, partly reflecting declines in energy prices. Market-based measures of inflation compensation have declined somewhat further; survey-based measures of longer-term inflation expectations have remained stable.
2. Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators moving toward levels the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for economic activity and the labor market as nearly balanced. The Committee expects inflation to rise gradually toward 2 percent as the labor market improves further and the transitory effects of lower energy prices and other factors dissipate. The Committee continues to monitor inflation developments closely.
3. To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to ¼ percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress—both realized and expected—toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy. The Committee sees this guidance as consistent with its previous statement that it likely will be appropriate to maintain the 0 to ¼ percent target range for the federal funds rate for a considerable time following the end of its asset purchase program in October, especially if projected inflation continues to run below the Committee’s 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored. However, if incoming information indicates faster progress toward the Committee’s employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.
4. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee’s holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

5. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Statement for a meeting or two before liftoff

1. Information received since the Federal Open Market Committee met in…
2. Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that…
3. To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to ¼ percent target range for the federal funds rate remains appropriate. In determining **future adjustments of the target range for the federal funds rate**, the Committee will assess realized and expected **deviations of employment and inflation from** its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. Based on its current assessment, the Committee judges **that economic conditions [may | could potentially] warrant an increase in the target range for the federal funds rate in a couple of meetings**. However, if incoming information indicates **slower** progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur **later** than currently anticipated.
4. **Based on its economic outlook,** the Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run. **In response to unanticipated economic and financial developments, the Committee will adjust the target federal funds rate to best promote the attainment of its objectives of maximum employment and 2 percent inflation.**
5. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

Statement for the time of liftoff

1. Information received since the Federal Open Market Committee met in…
2. Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that…
3. **In light of the considerable progress that has been achieved toward the attainment of the Committee's objective of maximum employment and the Committee's expectation that inflation will rise to its 2 percent objective over the medium term, the Committee decided today to raise the target range for the federal funds to ¼ to ½ percent**. In determining future adjustments of the target range for the federal funds rate, the Committee will assess realized and expected deviations of employment and inflation from its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. Based on its current assessment, the Committee **continues to** anticipate that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run. In response to unanticipated economic and financial developments, the Committee will adjust the target federal funds rate to best promote the attainment of its objectives of maximum employment and 2 percent inflation.
4. **Even after today's adjustment to the target range for the federal funds rate, the stance of policy remains highly accommodative and will continue to support a strong economy.** Moreover, the Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.