Fed Shows Rate Forecasts, Boosts Transparency

By Caroline Salas Gage and Craig Torres - Jan 4, 2012

Federal Reserve Chairman Ben S. Bernanke is betting that announcing Federal Reserve officials’ own forecasts for borrowing costs will make monetary policy more effective while also supporting the two-year expansion.

A decision to reveal forecasts for the federal funds rate starting this month represents the biggest step toward openness since Bernanke took office in 2006 promising greater transparency, according to Michael Feroli, chief U.S. economist at JPMorgan Chase & Co. and a former Fed board economist. The central bank didn’t even start announcing changes in interest rates until 1994.

“This is a complete 180-degree shift from the old mysterious-institution approach,” said Ethan Harris, co-head of global economic research at Bank of America Merrill Lynch in New York. “There’s been a steady move toward opening up the central bank to outside scrutiny and trying to explain to the public the logic of what they’re doing.”

The first forecasts will be announced after the Jan. 24-25 meeting of the Federal Open Market Committee, according to minutes of the Dec. 13 gathering released yesterday. That may boost economic growth by delaying expectations for an increase in the benchmark rate, which has been kept close to zero since December 2008, according to Feroli. At the same time, publishing a range of forecasts risks sowing confusion by showing disagreement among policy makers, Harris said.

“It’s a bit awkward -- you’re going to reveal to the public how much uncertainty the Fed itself has about where it’s going,” Harris said.

Additional Accommodation

The minutes said “a number of members indicated that current and prospective economic conditions could well warrant additional policy accommodation.” Those members also decided that “any additional actions would be more effective if accompanied by enhanced communication” about the FOMC’s longer-run economic goals and policy framework.

The decision to publish forecasts “is a part of trying to manage expectations,” said Diane Swonk, chief economist in Chicago at Mesirow Financial Inc., which managed $59 billion as of Sept. 30. “The theory is that if households and companies are convinced that the Fed is not going to tighten too quickly, there is reason to invest now.”

Central bankers in August decided to replace their statement that interest rates would stay near zero for an “extended period” with a date of mid-2013. Bernanke said at his Nov. 2 press conference that the statement “says at least mid-2013” and that “clearly it could well be some point beyond that.”

Stocks maintained gains yesterday after the release of the minutes, buoyed by a report showing that manufacturing in the U.S. expanded at the fastest pace in six months in December. The Standard & Poor's 500 Index (SPX) rose 1.6 percent to 1,277.06 at the close of trading in New York. The yield on the 10-year Treasury note increased to 1.95 percent from 1.88 percent on Dec. 30.
Danger of Confusion Seen

Some Fed officials voiced concerns at last month’s meeting that publishing the forecasts would “confuse the public,” as there is an “appreciable risk that the public could mistakenly interpret participants’ projections of the target federal funds rate as signaling the Committee’s intention to follow a specific policy path rather than as indicating members’ conditional projections,” according to the minutes.

While “most participants viewed these concerns as manageable,” some Fed officials “did not see providing policy projections as a useful step at this time,” the minutes said.

Releasing the forecasts will also demystify officials’ abilities to predict the economy’s path, according to Ward McCarthy, chief financial economist at Jefferies & Co. in New York.

Risks of Forecasting

“You run the risk of every other forecaster, and that is of making an idiot out of yourself,” McCarthy said.

The increased disclosure may make monetary policy “less flexible” if markets perceive the Fed as committed to a particular path of action, said Christopher Low, chief economist at FTN Financial in New York.

“The Fed is no better at forecasting than the best market economists, none of whom are right all the time,” Low said in an e-mailed response to questions. He said he worries that “it will be harder for the FOMC to change direction quickly if it means there is a risk of embarrassment or diminished credibility when they do so.”

Bernanke has made an unprecedented push for Fed openness as chairman. He has aired his views on monetary policy and the financial crisis in television interviews and taken his message on the road in town hall meetings with ordinary citizens in places such as El Paso, Texas.

Press Conferences

In 2011, the 58-year-old former Princeton University professor began holding press conferences four times a year. The FOMC now publishes forecasts for economic growth, inflation and unemployment four times a year, up from twice during the tenure of Bernanke’s predecessor, Alan Greenspan.

Fed officials have also been considering ways to make more explicit the conditions under which the benchmark federal funds rate would remain near zero. Fed Bank of Chicago President Charles Evans has advocated a promise to keep rates low until either unemployment falls below 7 percent or the medium-term inflation outlook rises above 3 percent, while Charles Plosser of Philadelphia has pushed for an inflation target of 2 percent.

Bernanke said Nov. 2 that the central bank may take new steps to boost growth, including changing the way it communicates its policy goals to the public.

“They have developed a potentially powerful easing tool,” and publishing rate forecasts “is a great move,” said Antulio Bomfim, senior managing director at Macroeconomic Advisers LLC in Washington.

“You can’t be against greater transparency,” said Bomfim, a former senior economist at the Fed. “It’s like motherhood and apple pie.”

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