

Reflections *of a* Media Insider

BY STEVE LIESMAN

*What the Fed gets
wrong ... and right.*

It's 1:59 p.m. and 59 seconds on Fed Day and, in one second, I will deliver the headlines from the Fed's monetary policy statement live on CNBC. Reuters, AP, and Bloomberg, and a host of others at the exact same time—not a nanosecond earlier—will punch a button and send their headlines flashing around the globe.

Instantaneously, computers scrape the headlines and algorithms execute trades. Around the planet, traders buy or sell the news or just tune in for the spectacle of it all.

Thus culminates a six-week inter-meeting period that included numerous Fed interviews and speeches, economic data releases, and market swings that could have seen sentiment flip several times between hawkish—the Fed could hike—and dovish—they're gonna cut. The Dow might have moved hundreds of points after a speech by the Fed chair, only to reverse the next day on an inflation report.

It's a process that many complain has become too chaotic. Too many Fed officials speak. The Fed is too powerful. The markets are too beholden to policy. There are Fed watchers who pine for the old days when the Fed said very little, when rate decisions were made in smoke-filled, wood-paneled conference rooms; when central banking was more mystique than method.

As the market reacts to the statement, and the Fed chair steps to the podium for the press conference, it's clear those days are long past. You can't smoke in the Fed meeting any more, and you can't keep secret what happened in there. The chair—unheard of under Alan Greenspan—will now take questions from the press.

Steve Liesman is CNBC's senior economics reporter.

THE INTERNATIONAL
ECONOMY
THE MAGAZINE OF INTERNATIONAL
ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
www.international-economy.com
editor@international-economy.com

As he does, it's clear for those who remember the past that the Fed has undergone a dramatic change in communications. From Greenspan to Bernanke to Yellen to

As both a participant and an observer

in the communications process,

I'd suggest that it somehow works.

Powell, each chair brought their own individual personality and policy to the podium. But it's all led in one general direction: toward greater transparency.

On these pages a few months ago, Treasury Secretary Scott Bessent penned a full-throated criticism of the Fed, some of which I agree with and some of which I don't. It's hard to argue against the Secretary's insistence that the Fed and the making of monetary policy could benefit from thorough and systematic review. Its forecasting errors are the subject of routine lampooning on Wall Street; the effects of quantitative easing, as Bessent opines, are poorly understood. (I disagree with his claim that QE is a new mandate. It's just a new tool.) There has been little public review of its communication strategy.

That said, as both a participant and an observer in the communications process, I'd suggest that it somehow works. There's considerable scope for improvement, and it should be better understood why it works. But it does. While there's Fed speak galore leading up to the meeting,

several studies show that Fed futures markets are able to predict with about 75–85 percent accuracy what the Fed will do at the upcoming meeting.

It's quite a remarkable achievement for the Fed, the press, and the market. Somehow, all of the data and the speeches and interviews are distilled and the market comes up with right answer.

Indeed, when the Fed statement is released, if the Fed has accomplished its goal, little should change in markets. What should be the climax of the latest rate policy announcement from the world's most important central bank is really denouement. And it is denouement by design. The fact is, there are very few surprises when it comes to what the Fed actually does. Hike, cut, or pause—it is nearly always correctly priced in. It's not written in the Federal Reserve Act, but the Fed operates under a simple communications rule: Thou Shalt Not Surprise the Market.

Three principles underpin the communications strategy. First, transparency is thought to be a necessity for an agency of unelected bureaucrats exercising so much power in a democracy. Second, transparency is believed to lead to better policy. (Note that these two principles are usually not in competition.) Third, markets have time to prepare for the decision, so smaller bouts of volatility are exchanged to avoid more massive swings that might erupt from an unexpected Fed decision.

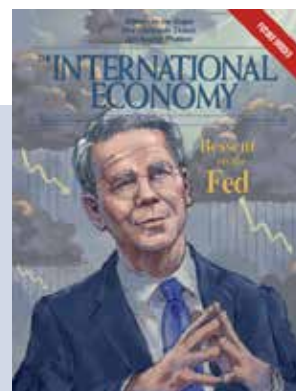
When thinking about Fed communication, it's worth considering that the idea of steering a \$30 trillion economy by the movement of a single short-term rate is a ridiculous proposition on its face. It's the equivalent of a captain trying to propel his sailboat by blowing on the sail. It should have little or no effect.

What the Fed effectively does is hitch the sailboat to a large cargo ship that pulls it along. That's the idea of communication. By broadcasting

I Mostly Agree With Bessent's Call for Review

On these pages a few months ago, Treasury Secretary Scott Bessent penned a full-throated criticism of the Fed, some of which I agree with and some of which I don't. It's hard to argue against the Secretary's insistence that the Fed and the making of monetary policy could benefit from thorough and systematic review. Its forecasting errors are the subject of routine lampooning on Wall Street; the effects of quantitative easing, as Bessent opines, are poorly understood. (I disagree with his claim that QE is a new mandate. It's just a new tool.) There has been little public review of its communication strategy.

—S. Liesman



U.S. Treasury Secretary Scott Bessent offered his thoughts on reform of the U.S. Federal Reserve in the Spring 2025 issue of TIE.



Ben Bernanke served as chairman of the U.S. Federal Reserve from 2006 to 2014.

A Watershed Moment

The taper tantrum of 2013 was a watershed moment in Fed communication. Then-Fed Chairman Ben Bernanke suggested that the Fed might soon reduce its purchases of bonds. Markets were unprepared for such a remark—benign as it may have been.

The takeaway for the Fed was to be considerably more careful in its communications about future policy, that is, much firmer in its commitment to its forward guidance, especially about the balance sheet.

—S. Liesman

its rate decision and its expected path of rates, along with its general reasoning, the Fed influences not just the overnight rate, but the full tenor of fixed-income instruments in the \$36 trillion U.S. bond market. That, in turn, influences rates around the world, exchange rates, and equity markets, and creates—at least in theory—the financial preconditions for the economic outcomes sought by the Fed through its rate policy. (It also becomes very powerful and attracts the attention of Treasury secretaries and presidents, some of whom feel it rivals the political sphere.)

Thirty minutes after the release of the statement, reporters find their assigned seats and Fed Chair Jay Powell steps to the podium for his press conference. He gives a brief overview of the economy, the meeting, and the decision, and then takes questions from reporters. This is part democracy (being accountable) and a big part of the communications suite, where word changes are explained in detail, the chair answers for contradictions in the forecast, and the general contours of the policy debate that took place in the meeting unfold.

It's important to note that Harvard researchers have found added volatility around the chairman's press conference, sometimes sending the market the opposite way from the statement reaction. As discussed later, this may be because the chair has too much responsibility for the communication process.

But for those complaining about the difficulty in discerning Fed policy amid all the Fed speak, it's well to remember the foggy days when traders decoded policy under Chairman Paul Volcker from the movement of monetary aggregates. The statement was actually issued

ninety days after the meeting, later shortened to forty-five days. Under Greenspan, markets were steered by his whispers to a single reporter from the *Washington Post*. Greenspan took pride in confusing his listeners, saying he must have misspoke if he was understood.

At CNBC, we routinely joked that you could tell how Greenspan would move rates (notice we talked about Greenspan, not the committee) by the size of his briefcase and so was born our famous Briefcase Indicator.

But behind the scenes, just before and during the Greenspan era, the academic literature was changing, suggesting that optimal monetary policy was not borne of opacity but rather transparency. In 1986, Marvin Goodfriend, research and policy advisor at the Richmond Federal Reserve, openly questioned the Fed's secrecy, arguing convinc-

ingly that it led to worse policy outcomes. In the early 1990s, economist John Taylor published his Taylor rule, showing that the Fed had actually been following a rule and offering the idea that monetary policy could be more systematic and predictable.

In a sense, Fed Chair Ben Bernanke was a logical progression from Greenspan. While Greenspan launched the

*Under Greenspan, markets were steered
by his whispers to a single reporter
from the Washington Post.*

statement, Bernanke brought transparency to whole new level with the quarterly forecasts and press conferences.

When the Great Financial Crisis hit, transparency became the Fed's best friend. Once the Fed cut rates to zero, it hit what is known as the zero lower bound, a fancy way of saying once you cut to zero, you can't cut anymore. (Actually you can, but negative interest rates weren't a thing yet and even when it was in Europe, was not a thing the Fed wanted to do.)

Enter forward guidance, which had existed before, but combined with the new transparency, became a powerful way to convince the market that not only was the

Fed at zero, but it would stay at zero for the foreseeable future, until the Fed had achieved its inflation and unemployment goals.

And so from 2009 thru 2015, the Fed stayed at zero. Significantly, for much of that time, it predicted (correctly) that it would stay at zero.

The taper tantrum of 2013 was a watershed moment in Fed communication. Then-Fed Chairman Ben Bernanke suggested that the Fed might soon reduce its purchases of bonds. Markets were unprepared for such a remark—benign as it may have been.

The takeaway for the Fed was to be considerably more careful in its communications about future policy, that is, much firmer in its commitment to its forward guidance, especially about the balance sheet. So, during the pandemic, Fed Chair Powell said several times he was “not even thinking about thinking about raising rates.” That was, essentially, forward guidance about forward guidance. And the Fed was firm. It committed to keeping rates low and continuing QE. This could have been a reason why it was slow to end QE when the rise in inflation became more obviously not “transitory.”

But when it turned its attention to addressing the pandemic inflation, it projected rate hikes and followed through on them. It eventually brought down inflation.

While the overall process seems to work, I’d suggest these areas to look to for improvement:

■ **The statement.** Two things are true under Powell—the statements have gotten shorter and the num-

now the chair who describes the views of the committee, rather than the statement. The paper by the Harvard academics showed about equal volatility after the statement

*It’s clear for those who remember
the past that the Fed has undergone
a dramatic change in communications.*

between Yellen and Powell, but much more volatility after the press conference under Powell.

(It needs to be said that Powell’s tenure has largely overlapped with President Trump who has brought in a time of enormous uncertainty for economic policy.)

The statement could be lengthened to show more of what a majority of the committee agreed. While that could precipitate more dissent, it would make more clear before the minutes are released three weeks later what the committee is generally thinking now.

■ **Dot comm.** The Fed needs to figure out its communications around the dots, the outlook for rates from each Fed official. At times they are leaned on as forward guidance by the Fed, at other times they are dismissed as just the median of officials’ forecast and not policy. One idea is to release the dots the day after the meeting, so the rate outlook is separated from policy and agreed-upon forward guidance in the statement is the controlling message. A lengthier statement (see above and below) could take

Continued on page 72

*You can’t smoke in the Fed meeting
any more, and you can’t keep secret
what happened in there.*

ber of dissents lower. Just 2.8 percent of votes under Powell have been dissents, compared with around 7 percent for both Bernanke and Yellen.

The effect of the shorter statement, it could be argued, is to take power away from the committee and give it to the chair. To be sure, that power can be a reason why some months the market is able to figure out what the Fed will do: a definitive guidance statement by the chair steers expectations to the right place. But all the nuance about the outlook now comes out during the press conference. It is

A History of Fed Communication

- 1967: Statement issued ninety days after meeting
- 1975: Statement issued forty-five days after meeting
- 1976: Statement issued thirty days after meeting
- 1994: Statement issued after meeting
- 2007: Quarterly forecasts first published
- 2011: Quarterly chair press conferences
- 2019: Press conferences every meeting

LIESMAN

Continued from page 23

pressure off the dots as the manifestation of the committee's view of where policy is headed.

■ **Forward guidance.** Solving the forward guidance dilemma is the next frontier for Fed communication. Is it the dots? Is it in the statement? Is it in the collective comments on the outlook in the speeches and interviews of Fed officials? Maybe it's all of the above. But it's a critical part of making policy effective, yet there is no systematic way that it appears. Greenspan used a risk bias that seemed to work. A risk bias towards inflation was a signal of coming rate hikes and a risk bias towards the employment mandate could signal cuts. A neutral bias meant pause and served as an uncharacteristic bit of clarity from the Greenspan Fed.

There are many critics of forward guidance, including the Treasury Secretary, but not a lot of clarity on what exactly they're talking about. It needs to be understood

that there is no transparency without forward guidance. A Fed official in an interview will always be asked what comes next. It's what the public wants to know. And not providing forward guidance would seriously diminish the Fed's effectiveness.

The press conference ends. Reporters sit until Powell leaves. We get up to file our stories. I'll go on television to discuss the most important parts. Maybe I'll appear a few more times to recap what happened. Some will spend time debating what the Fed did. But the focus changes almost immediately. What just happened is quickly far back in the rearview mirror. Fed futures, the bond and the stock markets will begin trading on expectations for the next meeting. Speeches will be scheduled. Data will be released. A nanosecond after the press conference ends, the process of pricing in the next meeting starts all over again. ◆