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Forward Guidance: The Richmond Fed finds evidence that forward guidance is effective and increasingly important. In a speech, Michelle Bowman talks about the importance, but also the risks of forward guidance.

Richmond Fed – Evidence Supports Forward Guidance

- "For much of the Fed's history, its leaders prided themselves on their inscrutability. Alan Greenspan, who served as Fed chair from 1987 to 2006, famously perfected the art of "Fedspeak," carefully crafting his statements on monetary policy to be vague and obscure so that he could avoid roiling financial markets. But by the end of his tenure, the Fed had become increasingly transparent in its communications with the public. Today, Fed Chair Jerome Powell holds a press conference after every FOMC meeting, and the committee issues a post-meeting statement explaining both its current policy stance as well as how it expects policy to evolve in the future."
- "This prognosticating language, known as "forward guidance," has become an increasingly important tool for policymakers since the Great Recession of 2007-2009."
- "Empirical evidence supports the idea that forward guidance is effective. In a 2021 paper in the Journal of Monetary Economics, Eric Swanson of the University of California, Irvine examined FOMC announcements from July 1991 to June 2019 to identify the separate effects from changes to the federal funds rate, forward guidance, and QE. He found each tool had significant and distinct effects on financial markets. Forward guidance had the largest impact on shorter-term Treasury yields and assets — those dated between one and five years — while QE was more effective at moving longer-term Treasuries and corporate bonds with 10-year maturities."

Richmond Fed, Report: The Future of Forward Guidance, 12/19/22
<https://fedunfiltered.com/richmond-fed-report-the-future-of-forward-guidance/>

Michelle Bowman – The Importance and the Risks

- "Forward guidance is official FOMC communication that is intended to signal to the public the likely future path of monetary policy ... The intent of all forward guidance is to influence the public's expectations about the FOMC's future monetary policy actions, and in doing so, affect longer-term interest rates and broader financial conditions to help support a path for inflation and economic activity that would be consistent with accomplishing the Committee's price-stability and maximum-employment goals."

- "It is important to note that the degree of specificity contained in the Committee's forward guidance comes with tradeoffs. Explicit forward guidance hasn't always been viewed as a helpful addition to the monetary policy toolkit, particularly before the 2008 financial crisis. Before that time, while there was some acknowledgement that forward guidance could meaningfully affect financial conditions, there was a great deal of concern about the "costs and risks" of providing this type of guidance. These costs and risks included the confusion and potential financial market volatility that could result if the public did not fully understand the Committee's forward guidance. Another common concern was that, if the Committee had to alter its forward guidance too frequently in response to rapidly changing economic conditions, its forward guidance could become ineffective (meaning that the public could heavily discount or simply disregard the guidance) or, worse, the public could come to question the Committee's overall credibility."

Michelle Bowman, Speech: Forward Guidance as a Monetary Policy Tool, Considerations for the Current Economic Environment, 10/12/22
<https://fedunfiltered.com/michelle-bowman-speech-forward-guidance-as-a-monetary-policy-tool-considerations-for-the-current-economic-environment/>

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