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The following article in the *Wall Street Journal* on December 5, 2011 discusses the fact that Federal Reserve may be close to announcing a new communications system when it meets for its usual Federal Open Market Committee (FOMC) interest rate meetings. According to reports, the new communications system is meant to essentially provide a more explicit path regarding future interest rates (e.g., an expectation, in the probability and statistics sense), in addition to just the current interest rate.

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Federal Reserve Prepares to Make Itself Perfectly Clear

By JON HILSENRATH And LUCA DI LEO

Federal Reserve officials are close to completing an overhaul of how they signal their policy plans to the public.

Bloomberg News

Fed Chairman Ben Bernanke wants better central-bank communications.

They are likely to spend much of their Dec. 13 meeting ironing out unresolved pieces of the new communications strategy and seem on pace to unveil it early next year. They have two major objectives: Be more explicit about the Fed's goals for inflation and employment, and articulate more clearly the interest-rate strategy to meet those goals.

The new communications plan is more than simply public relations. The right words from a central bank about goals and plans for interest rates can move markets, interest rates and the broader economy. And Fed Chairman Ben Bernanke has long wanted to reduce the public guessing games about the Fed's goals and possible actions

Moreover, the new communications strategy could lay the groundwork for Mr. Bernanke and his colleagues to take other measures to spur growth if the economy fails to improve or deteriorates.

At least some of the impetus for the new strategy comes from public reaction to the Fed's $600 billion Treasury bond-buying program last year. From the moment the Fed announced the plan, there was confusion among investors about whether the Fed would stick to the $600 billion, reduce it or increase it—in part because it wasn't very clear about its goals and strategy

The Fed has been working on revamping its communication strategy for months. Its approach has become clearer in recent Fed releases, speeches and interviews with officials.

Informally, the Fed already has made clear it wants the annual inflation rate to run at 2% or a bit lower over the long-run. A formal statement would codify the commitment. Such a declaration would likely run alongside a description of the Fed's goals for employment, which Congress requires it to mind along with inflation. Most Fed officials believe the unemployment rate could fall to 5% or 6% without triggering higher inflation.

To articulate its interest-rate strategy, the Fed would expand its quarterly release of the officials' projections for economic growth, inflation and unemployment. It would add details on the Fed's interest rate expectations underlying its economic projections, along with some description of the policy it expects to employ to reach its goals.

Most other central banks already have formal inflation targets. Mr. Bernanke has advocated an inflation target since long before he became chairman in 2006.

Being clear about interest-rate strategy is especially important when short-term interest rates are pinned near zero and can't go lower, as they are now. In such circumstances, one way to influence financial markets is to send signals to investors about how long interest rates are likely to remain this low.

The Fed has taken ad hoc steps in this direction. During the financial crisis, it said rates would stay low for an "extended period." In August, it said they would stay low "at least through mid-2013." Quarterly projections would formalize this guidance and make it more specific. If the Fed signals that rates will stay lower even longer than investors expect, it could push long-term interest rates down now, spurring investment, spending and growth.

"The scope remains to provide additional accommodation through enhanced guidance on the path of the federal funds rate," Fed vice chairwoman Janet Yellen said in a speech last week. She is chairing the Fed subcommittee designing the communications overhaul.

The "mid-2013" formulation is especially problematic. At some point it will need to be updated. With unemployment high and not falling quickly, it is possible the Fed won't raise interest rates until much later. Of course, if inflation surprisingly picks up, it might need to move rates up sooner.

Some Fed officials still aren't convinced this is the right approach. Giving interest rate guidance "might be an interesting exercise," Richard Fisher, president of the Dallas Fed, said in an interview last week. "Its utility I wonder about."

Some officials, like Mr. Fisher, doubt it will accomplish much. One risk is the Fed's signals about the expected path of rates might even confuse the public, rather than clarify the central bank's intentions.

It's unclear whether Fed officials will take other easing steps. To lower long-term interest rates, the Fed has already purchased more than $2 trillion worth of long-term government bonds and mortgage debt.

Mr. Bernanke and other Fed officials are considering additional purchases of mortgage-backed securities to boost growth. More purchases could help by driving long-term interest rates— especially mortgage rates—even lower, pushing stock prices higher and the dollar down. That could drive spending, investment and exports.

Some officials believe more action is needed. Inflation appears to be settling down after jumping earlier in the year. But the unemployment rate, at 8.6% in November, is well above the Fed's goals.

The problem for Mr. Bernanke is that it isn't clear that more bond purchases would bring unemployment down faster. And some Fed officials oppose them, arguing they won't help the economy and risk higher inflation.

While looking stronger overall, the U.S. economy is sending mixed signals. Consumer spending has picked up in recent months, but inflation-adjusted, after-tax household incomes are down. That means the pickup in spending might not be durable. Meantime, Fed officials are worried about the headwinds to growth traveling from Europe.

Some Fed officials hope that more clearly articulating their goals and strategy would make additional asset purchases—if they are to come—more effective. For instance, the Fed could say it would purchase securities until it made progress toward certain objectives.

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