Discussion of Fischer et al.’s “Fed Transparency and Policy Expectation Errors”

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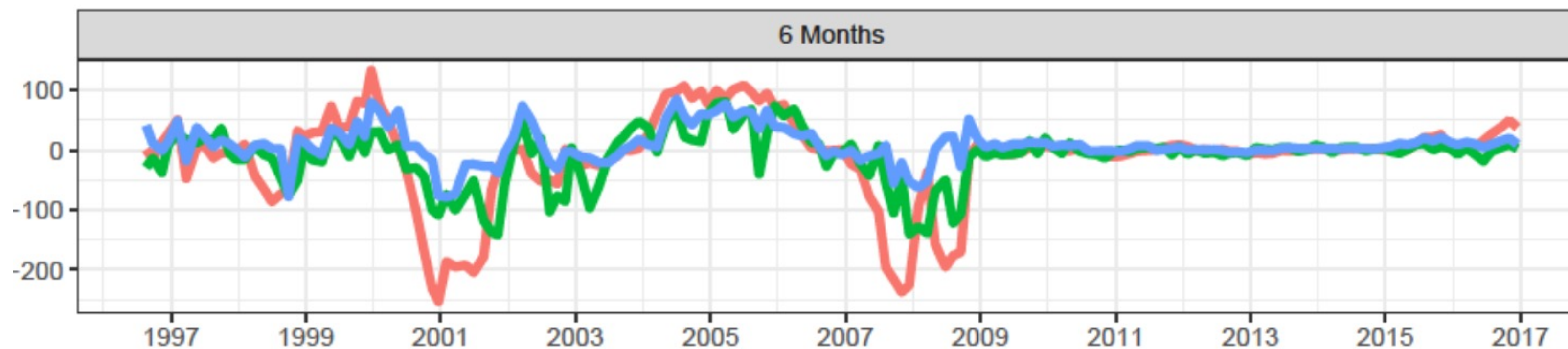
*The views here do not reflect official positions of the Chicago Fed or the Federal Reserve System.

Summary

- FOMC transcripts contain information that is not immediately available to the market.
- Extracting this information using text analysis would have improved on rate forecast from futures markets.
  - This occurs only during easing cycles.
  - The information advantage persists for at least several weeks.
  - Hypothetical “forecasts” of FOMC sentiment are too optimistic during easing cycles.



Summary

- Basic result is very convincing—FOMC knows something the market doesn't.
  - Similar flavor to recent findings on *risk premia* by Cieslak and McMahon (2023).
  - But this information is about *expectations*, and it takes a long time to leak out.
- Less clear exactly what this information is or what we should do about it.
  - Some black-boxiness to these methods.
  - Policy implications aren't obvious.

Is it easing cycles, or just big shocks?

- Identification comes from two recessions in sample. These are times of high uncertainty.
  - Tightening periods in the sample are less volatile.
  - Possible that the market just has a hard time understanding what the Fed will do in extreme situations.
  - What would the model say for the 2022-23 tightening?

- What is the model doing with *contingent* statements?
  - Policymakers often say things like, "if the economy gets worse I would favor easing more."
  - Suggests *interaction* between outlook and reaction function may be important.

Economy or reaction function?

- Most predictability is orthogonal to TB forecasts and subsequent macro data.
  - But policymaker view may differ from TB, and macro data may not fully capture the outlook.
- An alternative idea: revisions in forward-looking measures.
- If predictability is due to reaction function:
  - Stock market should outperform after meeting
  - Survey forecasts of economy should improve

What are the policy implications?

- Results imply that releasing more information about meetings would improve forecasting.
- Intuitive that this should improve welfare. But how much?
  - Better forecasting leads to smaller “shocks.”
  - Allows less risk, more consumption smoothing.
  - Would not be hard quantify these effects in a simple model.

- If the welfare effects are large, then what?
  - Implications for communications strategy?

What are the policy implications?

- Two interpretations of the results:
  - Policymakers are deliberately concealing their plans from the public.
  - The FedSpeak model knows policymakers’ plans better than they do themselves.
  - Policy prescription depends on which it is.

- There may also be offsetting effects.
  - For example, if markets react too strongly to signals or misinterpret.
  - D’Amico and King (2023) shows the signal-to-noise ratio in FOMC communication is low.