

## “Measured Pace” in the Conduct of Monetary Policy

At the May 2004 meeting, the Federal Open Market Committee (FOMC) introduced the phrase “policy accommodation can be removed at a pace that is likely to be measured” into the statement it makes at the conclusion of each meeting. The “measured pace” language, which was repeated in the next 12 statements, became widely regarded as a signal that the FOMC would raise the funds rate target by 25 basis points at its next meeting. This language was modified at the December 2005 meeting and discontinued at this year’s January meeting. Now that that experience is over, it is useful to consider the extent to which policymakers should signal their next policy action.

The “measured pace” language appears to be a product of the economic conditions that accompanied it. Beginning in January 2001, on evidence that the economy was weakening and that inflation was contained, the FOMC began to ease policy: The Committee reduced the federal funds target from 6.5 percent to 1.75 percent in 2001 and again in 2002 and 2003 to the historically low level of 1 percent. The 1 percent rate was well below anyone’s estimate of the so-called “neutral” nominal rate—the real interest rate (which is independent of monetary policy) plus the FOMC’s implicit objective for inflation. It was understood that a 1 percent funds rate was not sustainable. Faced with strong productivity growth and no evidence of deteriorating inflation expectations, the FOMC decided to increase the target at a “measured pace.”

While signaling the timing and magnitude of the next funds rate target change appears to have been useful under these unusual circumstances, it is unlikely to be useful in others, particularly when the difference between the target and estimated neutral rates is relatively small. The neutral nominal rate changes over time and is subject to considerable uncertainty. Consequently, it is difficult to determine or predict; furthermore, in circumstances where the difference between the target and estimated neutral rates is smaller than it has been in recent years, policymakers may be uncertain whether the target will need to be increased, decreased, or maintained at the next meeting. Indeed, it is not surprising that the measured pace language was phased out when the target rate got closer to a level that some analysts considered “neutral.”

Signaling the policy action at the next meeting is further complicated by the fact that the current level of the policy rate incorporates policymakers’ best guess of the future state of the economy. Even if policymakers’ expectations are correct on average, what will occur by the time of any particular meeting is not perfectly forecastable. This could make policymakers understandably reluctant to decide on the action they’ll take at the next meeting before they receive information about the accuracy of their current expectations.

There may be situations where policymakers believe they can achieve a particular objective by increasing or decreasing the funds rate by  $x$  percentage points over a period of time and, thereby, signal the direction and magnitude of the policy action at the next meeting. For example, fearing recession, policymakers might believe that the target may be reduced slowly by some cumulative amount. In such a circumstance, the direction of the next move might be predictable, but the magnitude would likely be less so. Moreover, the further the target gets below the estimated neutral rate, the more wary policymakers will be of signaling a reduction at the next meeting, preferring instead to examine the behavior of inflation indicators between meetings before deciding whether a further reduction is advisable.

That the FOMC may find it difficult, and consequently inadvisable, to signal the next policy action does not prevent the Committee from providing “forward guidance”—a statement of the Committee’s thinking based on the information available at the time of the meeting and the Committee’s expectation of what might happen. Forward guidance is not a commitment. The Committee would act in accordance with its forward guidance only if the Committee’s expectation of what might happen actually occurred. Indeed, as argued in Poole (1999), transparency of this sort likely enhances the efficacy of monetary policy.

—Daniel L. Thornton

Poole, William (1999). “Synching, Not Sinking, the Markets.” Remarks made at a Meeting of the Philadelphia Council for Business Economics, Federal Reserve Bank of Philadelphia, August 6, 1999.