”Information Transmission … from the Governors’ Calendars”: A Discussion

Narayana R. Kocherlakota
University of Rochester

July, 2020

US Monetary Policy Governance: De Jure

- The Federal Open Market Committee (FOMC) meets (at least) 8 times per year to make monetary policy.

- Permanent voting members of the FOMC: *governors* of the Federal Reserve System and the President of the New York Fed.

    - Governors are appointed by POTUS; Presidents are appointed with approval of the Board.

- The 11 non-New York Fed presidents rotate as voting members annually.

- Note: I was a non-NY Fed President from 2009-15.

US Monetary Policy Governance: De Facto

- Kocherlakota (2016, JEL): The permanent voters are the true monetary policy committee.

- The non-New York Fed presidents are viewed as "outsiders" – they typically have little influence on the making of, and direction of, policy.

- Some evidence:
  - Many non-NY Fed pres. dissents since 2005 but there have been *no* permanent voter dissents in that time.
  - In contrast: three governors secretly forced the 2013 QE taper (see *The Courage to Act* (Bernanke's memoir)).

Prior Literature

- Label weeks relative to last FOMC meeting.

- FOMC even-weeks: 2nd (4th) (6th) full business week after FOMC meeting ends on Wednesday).

- Cieslak, Morse, and Vissing-Jorgensen (CMV) (2019) show that stocks earn large amount of excess returns in FOMC even-weeks.

- They suggest that this is due to informal communication from the FOMC during these periods.

This Paper

- Innovative and thoughtful addition to this literature.

- Uses information from governors' calendars.

- Finds that > ½ of the excess returns in FOMC even-weeks is earned on days in which governors met with Fed presidents.

- Argues that this suggests that Fed insiders trigger the informal communication.

Opening Comments

- I find this agenda to be a very interesting one.
- Intellectually: it provides potentially valuable information about monetary policy communication and transmission.
- Policy: I hope that the Fed is following up with their own internal studies of information flows, as these could make use of more confidential data than CMV have available.

Immediate Suggestion

- Given my comments about Fed governance …

- I would suggest dropping the NY Fed president-governor meetings from the *baseline* analysis.

- The NY Fed president is completely different from all other Presidents.

  - I understand from Annette that the results are robust to doing so.

The Rest of My Comments

1. Endogenous OR Exogenous

2. Informal Communication: Examples and Benefits

3. Wrap-Up

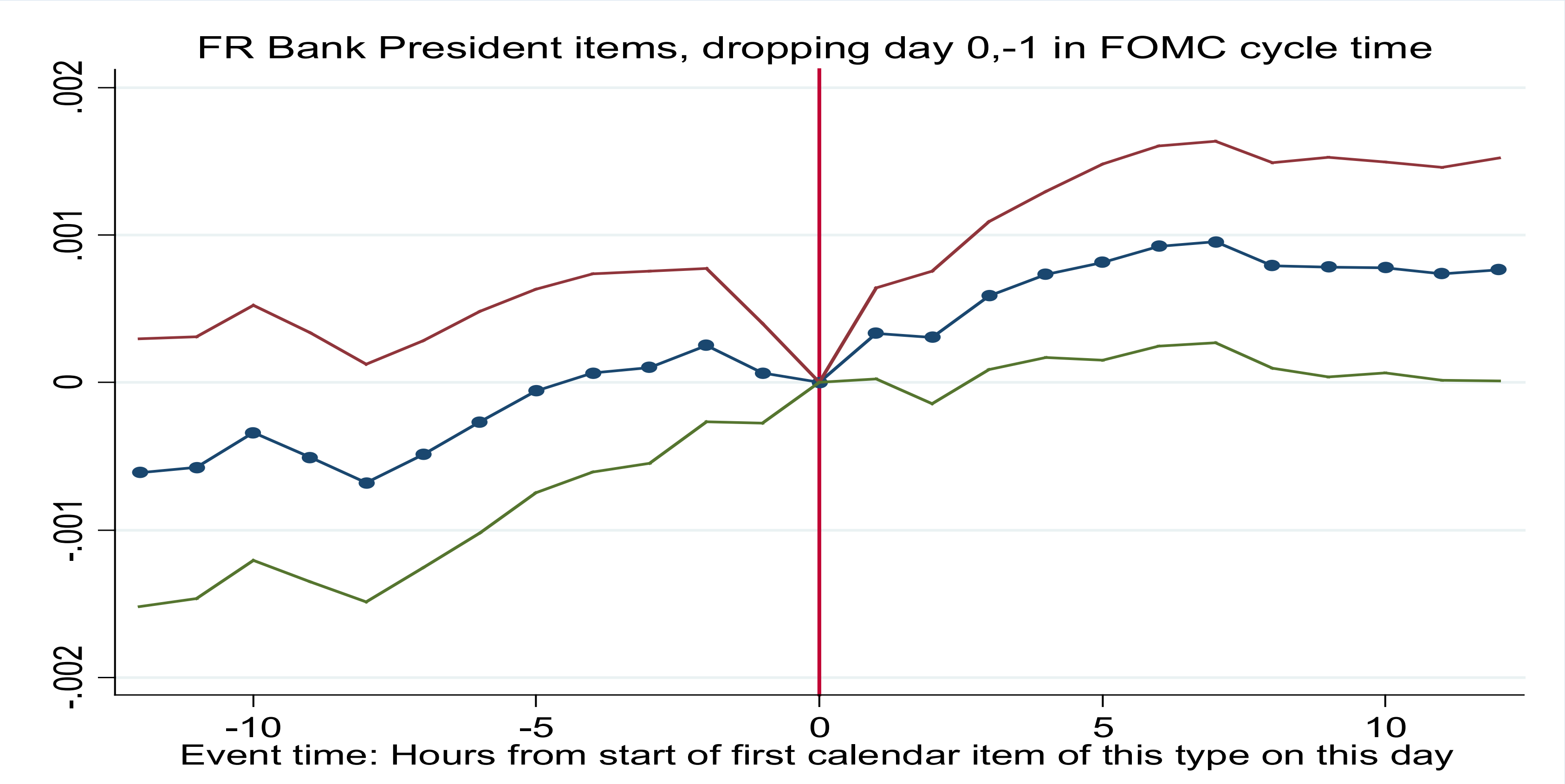
Endogenous OR Exogenous

The Usual Question

- What is the source of the variation in the “independent” variable?
- Here: why do the Presidents talk to the governors on some even-week days and not others?
- **MV story**: these meetings are discussions of future monetary policy easing that is not known to markets given observable economic data.

Hourly Evidence

Panel C. Reserve Bank president items, dropping day 0 and -1 in FOMC cycle time



Another Story?

- Adverse “risk-off” shock hits financial markets in hour -10 or earlier.
  - That is, increase in conditional variance of SDF.

- Prices fall and then future excess returns rise (above 0 at hour -5).
  - Admittedly: Process is more “dragged out’ than one might think.

- In the middle: policymakers talk over what to do.

Suggestions

- What is the impact of these president-governor even-week meetings on fed fund futures?

- Do these meetings have much forecasting power for excess returns (or CME fed fund futures) beyond what is in lagged values of VIX?

Informal Communication: Examples and Benefits

Informal Communication

- To return to MV's story:

- They argue that president-governor meetings trigger *informal communication* to media or markets about future monetary policy.

    - Informal = not in speeches or testimony

Informal Communication Can Be Good

- But why is this bad?

- Annette argues in a separate paper that the informal communication represents unauthorized attempts by FOMC participants to “front-run” the Committee.

- In my view: much (most?) informal communication is initiated by FOMC insiders (the true monetary policy committee) so as to shape policy expectations.

A Basic Schematic

- FOMC insiders decide that policy should change at the next meeting.

- But they want to make sure that financial markets don't respond too rapidly (gradualism).
  - There is lots of evidence to support Fed's gradualist tendencies.

- So, they now want markets to learn about the policy change only slowly.

Example 1:

- In late June 2010, Fed wasn't reinvesting maturing MBSs.

- But NY Fed president Dudley warned Bernanke that meant that an incoming flood of refinancing could act as a large *anti-QE*.

- Bernanke decided that Fed needed to start reinvesting maturing MBSs into long-term Treasuries. (source: *The Courage to Act*).

Example 1, cont'd

- WSJ article on August 3, 2010, reveals change in policy will be under discussion at the next FOMC meeting on 8/10/10.

- Who was the source of the "leak"? I always assumed (admittedly without evidence) that it was fully authorized by the Chair.
  - Chair met with media extensively in July 2010.

- Takeaway: Fed leadership can always get their message out!

Example 2: March 2017 Rate Hike

- February 2017: fed funds futures implied 20% probability of a rate hike at March meeting.
- But Fed leadership decided that rates should rise at the next meeting.
- We see a flurry of phone calls to Reserve Bank presidents on Chair Yellen's calendar.
- Fed communication (formal and presumably informal) pushes the idea to media and markets.

Example 2, cont'd

- On March 3, 2017, Yellen gave a speech that essentially announced the upcoming rate hike.
- But, by then, the market estimate of the probability of a rate hike was > 90%.
- The Fed leadership had used phone calls with RB presidents to help coordinate a media press so as to accomplish a (somewhat) gradual change in policy.

Why Informal Communication?

- For a variety of reasons (good and bad): Formal communication by permanent voters is extremely time-intensive.

- For example, Bernanke began to hint at upcoming QE2 in a speech in late August 2010.

- That speech (about an important and delicate policy move) took dozens (hundreds?) of person-hours around the System to complete.

Why Informal Communication?

- Informal communications such as:
  - Non NY-Fed president media interviews (both on and off the record).
  - Or off-the record media interviews by permanent voters

are much less expensive in terms of time.

- Informal communications can also help the media gain better understanding of policy relative to more opaque formal communications.

Unauthorized vs. Authorized Communication?

- For MV: It seems critical to distinguish *authorized* vs. *unauthorized* informal communication.

- Fed leadership may well be using Presidents as a vehicle to accomplish desired gradualism in monetary policy changes.

- This has clear benefits, given the costs of formal communication by Fed permanent voters.

A Suggestion

- Suggestion: consider all even-weeks in which there is only one or two president-governor interactions.
  - These *isolated* meetings seem less likely to be associated with authorized communication.

- What fraction of cumulated even-week excess returns is explained by the days in which these isolated president-governor interactions have transpired?

Wrap-Up

Suggestions I

- Separate NY Fed president-governor meetings from other president-governor meetings [I believe this has been done, but it should be the baseline.]

- Use fed funds futures as dependent variable.

- Use VIX_{t-k}*even-weeks as an additional independent variable.

Suggestions II

- See what fraction of excess returns is due to days in even-weeks with a small number of president-governor meetings.

- These isolated meetings seem more likely to be associated with unauthorized communication.

Finally: On FOMC Leaks

- This agenda is motivated in part by the FOMC's (perhaps surprisingly) frequent internal discussions of leaks (see transcripts).

- I agree with CMV that some leaks (such as in October 2012) do seem potentially problematic.
  - They could be (inappropriately) providing valuable information to a limited set of market participants.

- But researchers should be careful not to adopt the FOMC's own institution-specific view of leaks.

On Leaks, Cont'd.

- Like all organizations, the Fed and its leaders always want to control their story.

- So, if the WSJ provides a detailed account of who-said-what inside the preceding week's FOMC meeting, the Fed talks about this internally as a big deal.
  - Potential loss of reputation? Loss of collaborativeness? Etc, etc.

Leaks, Cont'd.

- But it could easily be argued that these leaks to the broader media are in the public interest.

- While many in the Fed don't agree, I believe that:

- We might well get better macroeconomic outcomes if there were more public visibility into Fed deliberations as opposed to less.