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# Fed speak on main street: Central bank communication and household expectations☆

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ABSTRACT

Central banks emphasize the use of communication as a tool of monetary policy. As central banks increasingly recognize that low public informedness limits their ability to communicate with the general public, several have begun to explicitly tailor their communication strategies for a broader audience. Most research focuses on central bank communication with financial markets, but several recent strands of literature address aspects of communication with households. I survey the literature addressing the rationales and efficacy of central bank communication with households, supplementing this with new evidence from an assortment of consumer survey data. I draw from the literature on rational inattention, financial literacy, and political communication to suggest explanations for limited household receptiveness to central bank communications. Finally, I focus on one specific aim of central bank communication, which is to anchor inflation expectations. Previous literature finds that the announcement of an explicit inflation target helps anchor expectations among financial market participants. Using U.S. consumer survey data, I show that consumers' expectations are imperfectly anchored and that the anchoring of more informed consumers' expectations increased more than the anchoring of less informed consumers' expectations following the Fed's announcement of a 2% inflation target.



## 1. Introduction

In recent years, the Federal Reserve and other central banks have expanded their emphasis on communication as a tool of monetary policy. Effective monetary policy communication can shape the public's expectations, reduce uncertainty, and provide accountability for politically independent central banks (Stiglitz, 1998; Blinder et al., 2008; Dincer and Eichengreen, 2009). Moreover, when interest rate policy is constrained by the zero lower bound, a central bank's ability to influence macroeconomic conditions depends on its ability to communicate credibly about policy objectives and plans (Yellen, 2006). Many central banks explicitly attempt to communicate not only with financial market participants, but with the general public.

In 2008, Blinder et al. noted that "virtually all the research to date has focused on central bank communication with the financial markets. It may be time to pay some attention to communication with the general public" (p. 941). Several recent strands of literature, which I survey in this paper, address different aspects of central bank communication with the general public (households). This survey also draws from literature in other fields of social science, including political

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communication and media studies. While these fields have not specifically investigated central bank communication, they provide highly relevant information about the transmission and reception of messages sent by policymakers.

I begin in Section 2 by providing a brief history of central bank communication, summarizing the intellectual and institutional transformation from central banking as a deliberately “esoteric art” (Brunner, 1981, p. 5) towards an emphasis on transparency and clear communication. I point to examples of central banks that have recently acknowledged that communication with the general public requires a different approach than communication with other target audiences.

Next, in Section 3, I review the rationales for central bank communication with households. These fall into two categories: maintaining accountability and shaping expectations. First, as most central banks maintain some degree of independence from the political process, clear communication with the public is viewed as essential to accountability and democratic legitimacy. Second, household expectations of inflation and other variables are notably different than those of professional forecasters and financial market participants (Carroll, 2003). Several papers suggest that these differences have meaningful economic implications, as household inflation expectations affect inflation dynamics and consumer decisionmaking. Therefore, if central bank communication can influence household expectations, this in turn can influence economic conditions.

Section 4 questions whether central bank communications are effectively transmitted to households. Drawing on recent literature, surveys conducted by a number of central banks, and U.S. consumer surveys, I document gaps in households' informedness that likely limit receptiveness to central bank communications. Two literatures are especially relevant in providing an explanation: the rational inattention literature and the political communication literature. The rational inattention literature implies that high costs or low perceived benefits will limit households' attentiveness to monetary policy communications (Sims, 2003; Lamla and Lein, 2006). High costs might arise from low economic literacy, difficulty comprehending communications, or lack of media coverage. The political communication literature documents the importance of news media to public informedness, and notes that other powerful institutions have devoted considerable efforts to adapting to the communication demands of an evolving media environment, tailoring communications in recognition of increased sociocultural heterogeneity, massive growth in media outlets and channels, growing professionalization of political communication, growing disengagement and cynicism among citizens, and expectations of individualization (Blumler and Gurevitch, 2000; Lee, 2014). Research on central bank interaction with the media and use of new media outlets remains limited.

Finally, Section 5 considers a specific and much-emphasized goal of central bank communication: anchoring inflation expectations. Well-anchored expectations theoretically promote price stability and facilitate efforts to achieve output stability (Orphanides and Williams, 2007; Mishkin, 2007). While previous literature shows that communications regarding price stability, particularly in the form of an explicitly announced inflation target, help anchor inflation expectations of financial market participants, there is less evidence on whether such communications anchor households' expectations. I provide new evidence that in the United States, households' expectations, while still weakly anchored, are somewhat more anchored after the 2012 announcement of a 2% inflation target. Following the announcement, anchoring improved most for college-educated, male respondents with stock market investments—those most likely to be informed about the Fed. Other groups were likely unreceptive to the Fed's communication of its target.

## 2. A brief history of central bank communication

The early Fed, like most central banks, kept communications rare and cryptic due to perceived benefits of keeping the markets guessing (Mishkin, 2004). As Brunner (1981, p. 5) describes, “The mystique thrives on a pervasive impression that Central Banking is an esoteric art... revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences.”

Legislative and intellectual changes gradually transformed central bank communication. In the U.S., the Full Employment and Balanced Growth Act of 1978 obligated the Fed Chair to make biannual reports to Congress (Moore, 1990). The Fed began to release semiannual economic projections in 1979 and to publish the Beige Book in 1983, but did not fully embrace the idea of transparency. Alan Greenspan, for instance, was notorious for his vague communication style nicknamed “Fed speak.” Attitudes shifted dramatically in the 1990s (Blinder, 1998). By the early 21st century, academics and policymakers largely agreed on the wisdom of promoting transparency through more extensive and clear communication (Woodford, 2001; Bernanke, 2003; Kozicki and Tinsley, 2005; Blinder et al., 2008).

A survey of 94 central banks by Fry et al. (2000) found that 74% consider transparency to be very important or vital to monetary policy. One manifestation is that more central banks publish macroeconomic forecasts and explanations of policy decisions (Geraats, 2009). Another was the adoption of inflation targeting by New Zealand in 1990; many other central banks followed suit within the decade. Although the Fed did not, Bernanke (2003) notes that the Fed did adopt hallmarks of the inflation-targeting approach, including an emphasis on transparent communication of policy choices to the broader public. In 1994, the FOMC began to release postmeeting statements disclosing changes in monetary policy, and in 2003 began the use of forward guidance, announcing that its low interest rate policy would be “maintained for a considerable period.” Yellen (2013) describes this as a landmark: “For the first time, the committee was using communication —mere words— as its primary monetary policy tool.” Under Bernanke, the Fed altered the form and content of its communications, expanding the use of forward guidance, introducing quarterly press conferences, and announcing a 2% goal for inflation.

Transparency appears to be associated with macroeconomic benefits, including lower inflation (Chortareas et al., 2002; Geraats, 2009). A more recent literature focuses on the optimal level of central bank transparency, and whether there are any