

Monetary Policy Independence and Building Trust in an Uncertain World

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Introduction

Thank you for that very kind introduction and thank you, Simon Grant, for inviting me to present this Sir Leslie Melville Lecture. It is an honor to speak with you today in the lecture series that honors Sir Melville, an esteemed central banker, academic, and public servant, on the campus of the Australian National University, an esteemed institution.

“Esteemed” is an attribute earned by few, but it sits at the center of my lecture, which will focus on trust in institutions and central bank independence, with a focus on the Federal Reserve System, the central bank of the United States. This seems a fitting topic because this lecture was established to honor Sir Melville, who made such significant contributions to central banking and played a key role in designing the foundations of two other important international institutions, the World Bank and the International Monetary Fund.

But let me begin with a story.

My husband, George Mailath, grew up in Canberra and received his undergraduate degree from the ANU. We travel back to Canberra on a regular basis to see his family. Last December, I spent the Christmas holiday here. Overall, it was an excellent visit. However, it didn’t go as planned. Unfortunately, I spent Christmas Eve in Canberra Hospital, where it turned out I had to have eye surgery to repair a tear in my retina. It was a bit disconcerting, but it all worked out fine and I was even able to celebrate with everyone later that evening.

But the whole episode got me to thinking about the topic of trust. Why was I willing to let someone I had never met before in a hospital I had never visited before burn my eye with a laser? It was because I trusted them, but WHY did I trust them?

Pondering the question, I concluded that it came down to my having confidence in the institution. As Nobel Prize winning economist Douglass North emphasized, institutions matter.¹ As North tells us, institutions create order and reduce uncertainty.² In economics, institutions promote economic growth and social welfare.

The value of a well-run institution is that one can have confidence in it without having to know individual personnel or the intricate procedures of the place. Canberra Hospital is held in high esteem. Why? Because it has an excellent reputation of delivering exceptional patient care; it hires well-qualified doctors; and it provides the public with a summary of its framework for delivering high-quality care. I did not need to have details about the doctors because I knew that the institution sat on a well-constructed foundation. In short, I could trust the institution.

Trust in the Central Bank

Just like hospitals, central banks, like the Reserve Bank of Australia and the Federal Reserve System, are important institutions that make decisions that affect people's lives. Paraphrasing what that well-known central banker, Ben Parker, Spider-Man's uncle, said, central banks are given a lot of power and with that power comes a lot of responsibility. The economic and financial well-being of people and businesses depend on the central bank keeping inflation low and steady and financial markets and institutions stable. But how do we know we can trust them to make the right decisions, especially when the world does not always cooperate? After all, even decisions based on the best information and analysis will not be able to produce the intended results all the time because some of the factors that affect the economy are out of the central bank's control and are not anticipated.

¹ See North (1981, 1990, 1991).

² See North (1991).

[FIGURE 1: Uncertainty Indices: US, Australia and US trade]

World economies have dealt with tremendous levels of uncertainty in recent years.³ The Covid-19 pandemic was unprecedented in our lifetimes and it, along with the policy responses to it, had lasting effects on the economy.

Today, U.S. trade policy has increased levels of uncertainty. The tariff levels announced by the Trump Administration on April 2 and their on-again off-again nature have lent uncertainty to the economic outlook. In the country imposing the tariffs, high tariffs act like a tax, tending to lead to higher prices, lower employment and economic growth, and higher unemployment. But the ultimate size and persistence of these effects are not yet clear. In the U.S., will the tariffs act like a one-time increase in the price level without having a lasting effect on inflation? If so, the Fed can safely look through them. Or will prices rise as tariffs feed through the economy, raising household and business expectations about inflation, which then leads to more persistent increases in inflation? If so, the Fed will have to respond. Uncertainty around policy is now at or above what it was during the pandemic.

[FIGURE 2: Gallup data on confidence in institutions and Fed Chair approval] In uncertain times, it is particularly important for the public to have faith in the institutions charged with making important policy decisions. But faith in institutions has been declining over time. This includes confidence in the Federal Reserve.

[FIGURE 3: Satisfaction in the ECB and Bank of England] This is not a particularly American phenomenon. It is also true of other central banks, including the European Central Bank and the Bank of England.

³ Mester (2016) discusses different types of uncertainty and the importance of monetary policymakers acknowledging the uncertainty when setting policy.

[FIGURE 4: Inflation] Probably one of the best ways for an institution to build trust is to do its job well. Central banks are charged with maintaining price stability, but after the pandemic, we saw sharp increases in inflation in many countries to levels not seen since in 40 years.

[FIGURE 5: Inflation projections from Fed SEP]

Equally important, inflation moved up much faster and remained high for longer than many central banks anticipated. You can see this by looking at the evolution of central bank forecasts after the pandemic.⁴ Fed policymakers release projections four times a year. The March 2021 forecasts by the Fed showed that the median policymaker thought inflation would be 2.4 percent by the end of that year. They revised up their forecasts all year but still inflation ended up even higher, at 5.8 percent. By March 2022, Fed policymakers thought inflation would be 4.3 percent by the end of that year. Instead, inflation wound up being 6 percent.⁵

[FIGURE 6: Price level vs. wages in US and Australia]

And while inflation has moved back down from its peak, the level of prices remains high. In addition, prices went up more than wages did. So people are not as well off as they were before the pandemic, even though wages have been rising and inflation in several countries is nearing the central bank's goal.

⁴ Four times a year, the Fed releases its Summary of Economic Projections (SEP). The SEP provides information on individual Fed policymakers' economic projections, conditional on the path of policy that each participant sees as appropriate to promoting the FOMC's goals of price stability and maximum employment. The projected economic variables included in the SEP are real output growth, the unemployment rate, inflation, and core inflation, i.e., inflation excluding food and energy prices, with appropriate policy given by the federal funds rate. The projections are for the current year and for up to three additional years, and also include the participants' estimates of the longer-run values for these variables. See Federal Open Market Committee (2025).

⁵⁵ In the interest of full disclosure, I was one of the FOMC policymakers submitting projections during this period.

I believe this poor performance was a major contributor to a decline in trust in central banks. Indeed, research shows that public trust in institutions tends to fall quickly during a crisis, like the Global Financial Crisis in 2008-2009, or the pandemic in 2020. And once it falls, it takes time to rebuild.⁶

This matters because how the economy fairs partly depends on the credibility of the central bank in the eyes of the public. For example, people and businesses have some expectations about where inflation will be in, say, three to four years. If they believe the central bank will set policy and hit the inflation goal, then they will make economic and financial decisions based on that inflation rate. But if they are skeptical that inflation is going to move back down to goal, then they incorporate a higher inflation rate into their decisions. Workers might negotiate for higher wages and firms may be willing to pay them more because they believe they will be able to set higher prices for their products to cover the higher wage cost. This can result in higher inflation that is more difficult for the central bank to bring back down. That is why many central banks emphasize the importance of keeping inflation expectations at levels consistent with their inflation goal and why they work to ensure that hitting the goal is credible with the public.

Monetary Policy Independence

[FIGURE 7: Central bank independence]

If performing its duties well is an important contributor to public trust in the central bank, what can help the central bank do its job better? Over the past two to three decades we have learned some principles that are important for effective monetary policymaking. One of these is “independence.” Central bank independence refers to the authority of central bankers to make monetary policy decisions independently from short-run political interference.

⁶ Ehrmann (2024) and Bergbauer, et al. (2020).

While the government establishes the objectives it wants the central bank to pursue (e.g., price stability), in many countries, the government allows the central bank to decide the best way to achieve those goals using its own judgment and free from political control.^{7,8}

The benefits of independence stem from the fact that it takes time for monetary policy to affect the economy. Monetary policymakers need to take a longer-term perspective about where the economy is headed. If they were subject to short-term political influence they might be pressured to run a very stimulative monetary policy to prop up economic growth and employment for short-run gains, like before an election, and ignore the consequences in terms of higher inflation in the future. The government also might be tempted to print money to finance government spending and inflate away government debt rather than to take the hard actions needed to put fiscal policy on a sustainable path. Governments have an incentive to keep their debt-service costs low, so they may be biased to keep interest rates too low, leading to higher inflation over time. So there are good reasons to separate those who have the authority to make decisions about government spending and taxation from those setting interest rates to ensure price stability.

But independence does not mean that the monetary policymakers, who are unelected officials, should be unaccountable for their decisions. In fact, accountability must go hand in hand with independence or else independence from the political process will not be sustainable. So central bankers publicly report on

⁷ See Bernanke (2010) and Plosser (2024). As Warsh (2010) and Blinder (2012) point out, this independence applies to monetary policy decisions of the central bank during normal times. The central bank's financial regulatory policy typically is set with more coordination with the government. In addition, financial and economic crises appropriately elicit close coordination between the central bank and the Treasury.

⁸ Debelle and Fischer (1994) make a distinction between “goal independence” and “instrument independence.” The central bank has goal independence if it permitted to set the operational goals consistent with its statutory objectives, e.g., setting an inflation goal of 2 percent as consistent with a statutory mandate of price stability. The central bank has instrument independence if it has the authority to determine what instruments to use (and their settings) to achieve its statutory objectives.

their decisions via post-meeting announcements and press conferences, and they regularly report to government authorities through public hearings and testimony.⁹

[FIGURE 8: Indices showing increased central bank independence] Research developed in the 1980s and 1990s indicates that in both advanced economies and emerging market economies when central banks formulate monetary policy free from government interference and are held accountable for their decisions, better economic outcomes result.¹⁰ Inflation is lower and more stable and output is not more variable. For this reason, the trend in many countries has been an increase in the legal provisions giving monetary policymakers greater independence.

That independence is also supported by a social norm, whereby government officials refrain from speaking on monetary policy except in oversight hearings and monetary policymakers refrain from commenting on the government's policies.

Recently, that social norm has been broken in the U.S. President Trump has been regularly calling for the Fed to lower interest rates.

[FIGURE 9: U.S. presidents commenting on monetary policy] President Trump is not the first president to encourage the Fed to lower interest rates.

Indeed, the Fed did not have what we today consider independence to conduct monetary policy until the Treasury-Fed Accord of 1951. When the U.S. entered World War II in 1942, the Fed agreed to support the government by maintaining a low interest rate of 3/8 percent on U.S. Treasury bills and a low ceiling of

⁹ Fischer (2015) discusses the need for central bankers, who are unelected officials and whose decisions affect economic well-being, to regularly report to government authorities.

¹⁰ Fischer (2015) discusses some of the research results.

2-1/2 percent on long-term government debt. But by the late 1940s, inflation had risen to high levels and the Fed wanted to abandon this peg. President Truman and the Treasury wanted to keep the peg. Contentious negotiations ensued, leading to an accord that allowed the Fed to pursue independent monetary policy as we understand it today.¹¹

Even after the accord, some presidents would try to influence the Fed's monetary policy. For example, in December 1965, the Fed raised interest rates in response to emerging signs of inflationary pressures stemming from higher government spending on the Vietnam War and President Johnson's Great Society social programs, and a tax cut enacted the year before. President Johnson was incensed and summoned Fed Chair William McChesney Martin to his ranch in Texas where the president was recovering from gall bladder surgery. Although the president tried to intimidate him, Martin stood his ground arguing that the Federal Reserve Act gave the Fed responsibility for monetary policy.¹²

In his memoir, Fed Chair Paul Volcker discusses when he was called to the White House in 1984 for a meeting with President Reagan and his Chief of Staff James Baker. While Reagan remained silent, Baker told Volcker that the "president was ordering him not to raise interest rates before the election." Volcker speculated that the meeting was held in the library and not the Oval Office because the library did not have a taping system.¹³

In another example, Chair Alan Greenspan and the other Fed Governors received a letter from an Assistant Treasury Secretary in mid-January 1988 urging the Fed to ease monetary policy and referring to the coming election.¹⁴ Greenspan testified before the Senate Banking Committee in February 1988 that

¹¹ Hetzel and Leach (2001) present a fascinating account of these negotiations.

¹² See Fessenden (2016) and Meyer (2000).

¹³ See Volcker (2018) and Sorkin (2018).

¹⁴ See Pine (1988).

he had formally protested to the Treasury Secretary about this letter and reiterated that the Fed does not succumb to White House pressure.

[FIGURE 10: President Trump comments on the Fed] But President Trump went beyond this type of attempted influence when he commented in April that the termination of Fed Chair Jay Powell “cannot come fast enough.” Participants in the financial markets did not like the suggestion that the president was planning to fire Jay Powell because of policy differences. Stock prices had already been falling because of higher-than-expected tariffs announced on April 2, and this sent markets down further. In an environment in which gross U.S. government debt as a percent of GDP is projected by the Congressional Budget Office to reach an unsustainable 135 percent over the next 10 years, it should not be surprising that financial market participants value the continued ability of the Fed to make monetary policy decisions independently from government officials who may have an incentive to devalue the debt with higher inflation.

On April 22, President Trump backed off, saying that he never intended to fire the chair. A Supreme Court ruling issued on May 22 also suggested that it would be difficult for the president to legally remove the Fed Chair without cause.¹⁵ But even after this, the president has continued to try to pressure Chair Powell. Even though the president’s tweets will not affect the Fed’s policy decisions, they do complicate

¹⁵ The Supreme Court ruling came in response to an emergency request from the Trump administration to allow its firing of two officials, one at the National Labor Relations Board and one at the Merit Systems Protection Board, two independent agencies. The lower court based its decision to enjoin the Trump administration from removing the two officers on a precedent set in a 1935 case, *Humphrey’s Executor v. United States*, in which the Supreme Court had ruled that the president could not fire commission members before their terms expired, except in the case of malfeasance or dereliction of duty. In its ruling, the Supreme Court let the firings stand as the lawsuit against the firings works its way through the courts. But it also said that allowing those firings would not necessarily extend to the Fed since the “Federal Reserve is a uniquely structured, quasi-private entity that follows in the distinct historical tradition of the First and Second Banks of the United States.” This ruling was interpreted as indicating that the Supreme Court would not be amenable to a president firing a Federal Reserve Board member without cause before his or her term was up. However, some legal scholars question the logic of the ruling. (See Mangan, 2025.)

the monetary policy process as the Fed has to do more to realign market expectations with the economic fundamentals that are actually driving monetary policy decisions.¹⁶

The Supreme Court ruling that supported Fed independence referred to the unique structure of the Federal Reserve. In fact, independence was in the mind of the U.S. Congress from the very start when it designed and established the Fed in 1913 after a period of financial instability.¹⁷ So let me spend a few minutes on the structure of the Federal Reserve System.

Structure of the Federal Reserve System

[FIGURE 11: Map of Fed districts] Congress designed the Fed to operate in the public interest as a decentralized central bank: the Fed is independent *within* the government but not independent *from* the government. At the time, partly because of the country's earlier experience with central banks, there were concerns that the central bank would become dominated by financial interests in New York or political interests in Washington. So the design includes representation from across the country and balances public-sector and private-sector interests, and Wall Street and Main Street concerns.

The Federal Reserve System has 12 regional Reserve Banks and a seven-member Board of Governors that oversees those Banks.

¹⁶ Using event study techniques and fed funds futures contracts, Bianchi, et al. (2023) found that market participants' expectations about monetary policy did react to President Trump's tweets about the Fed during his first administration. Those tweets began in 2018 and urged the Fed to cut interest rates. The authors found that, on average, based on market prices, the probability of a 25-basis point cut in the fed funds rate over the next year rose about 1 percent per tweet. And the effects were persistent.

¹⁷ The Federal Reserve was actually the third attempt at creating a central bank in the United States. In 1791, Congress established the First Bank of the United States, modeled on the Bank of England, at the urging of Treasury Secretary Alexander Hamilton. Its 20-year charter was not renewed in 1811. Congress established the Second Bank of the United States in 1816, and it also lasted for only 20 years. Both banks became embroiled in politics. (See Clarida, 2021, and Plosser, 2009.) For more than 75 years after the demise of the Second Bank, the U.S. operated without a central bank. This was a period of great financial system development but also financial system instability that interfered with economic activity. The Panic of 1907 was severe enough to convince Congress to once again establish a central bank, the Federal Reserve System.

The 12 Reserve Banks are distributed around the country in locations that were the centers of economic activity back when the Fed was established.¹⁸ Each Reserve Bank has a board of directors whose nine members are chosen in a nonpolitical process, with three representing banks and six representing business, agricultural, industrial, and public interests in the Districts they serve. The nonbank directors are responsible for choosing a Reserve Bank's president, who is subject to approval of the Fed's Board of Governors.

[FIGURE 12: Organization of the Fed]

The seven-member Board of Governors is based in Washington, D.C. Fed governors are appointed by the president of the United States and confirmed by the Senate. Governors serve staggered terms of up to 14 years. But a governor can fill out an unexpired term and then be reappointed to their own 14-year term. This is how Alan Greenspan was able to serve as governor for over 18 years. These terms span several terms of the U.S. president and members of Congress, and the intention was to help insulate the governors from short-term political influence and to encourage them to take a longer-run perspective. However, in practice, governors typically serve far less than 14 years.¹⁹

The chair and vice chair of the Board of Governors, and the governor who serves as vice chair of supervision, are chosen by the president and confirmed by the Senate from among the sitting governors for four-year terms.²⁰ The chair and vice chairs can be reappointed until their terms as governors expire. Chair Powell's term as chair expires next May but his term as governor expires in January 2028.

¹⁸Some Reserve Banks also have branches. For example, the Cleveland Fed, where I was president, has two branches, one in Pittsburgh, Pennsylvania, and one in Cincinnati, Ohio. Each branch of a Reserve Bank has a board of directors with five or seven members.

¹⁹ According to Wessel (2025), the median term length of Fed governors is 5 years.

²⁰ The vice chair of supervision position was created by the Dodd-Frank Act of 2010, which initiated some financial system regulatory reforms after the Global Financial Crisis. Governor Miki Bowman was recently nominated and confirmed in this role.

In the wake of the Great Depression in the 1930s, there were calls for reforms of the Federal Reserve System to address what were widely viewed as policy mistakes by the Fed and to shift more control of monetary policy decisions to the Board of Governors from the Reserve Banks to foster better coordination of monetary policy decisions.²¹ The Federal Open Market Committee (FOMC) was established by the Banking Act of 1935 and is the body charged with making monetary policy decisions. The FOMC has 12 members: the seven members of the Board of Governors, the president of the New York Fed, and four other Reserve Bank presidents, who serve on a rotating basis. As president of the Cleveland Fed, I voted every other year, rotating my vote with the president of the Chicago Fed. Other than New York, Cleveland, and Chicago, the other presidents vote every third year. But all the Fed presidents, whether voting or nonvoting, participate in FOMC meetings, which are held eight times a year in Washington, D.C.

[FIGURE 13: Goals of the Fed and other central banks] The goals monetary policymakers are charged to achieve differ across central banks, but in all cases include price stability. The Fed's goals, given to it by Congress, are price stability and maximum employment.²² Some central banks, including those of Japan and Sweden, have a single mandate to deliver price stability.²³ The European Central Bank (ECB) has a primary objective of price stability and secondary objectives of full employment and economic growth.²⁴ In 2019, maximum sustainable employment was added to price stability as goals for the Reserve Bank of New Zealand, but in 2023 the remit changed back to a single mandate of price

²¹ Bordo (2016) discusses this history. The changes made in the 1935 Banking Act retained the Reserve Banks' role in the formulation of monetary policy. The original draft of the legislation, which was co-written by Marriner Eccles, President Franklin Roosevelt's selection as Fed chair, would have eliminated the Reserve Banks' role in making monetary policy. Also see Clarida (2021).

²² As amended in 1977, the Federal Reserve Act says that the Fed should conduct monetary policy to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." When prices are stable and the economy is at maximum employment, long-term interest rates are typically at moderate levels, so it is often said that the U.S. Congress has given the Fed a "dual mandate."

²³ See the monetary policy sections of the web sites of the Bank of Japan and the Riksbank (Central Bank of Sweden), as accessed on June 13, 2025.

²⁴ See European Central Bank, monetary policy section of the web site, as accessed on June 13, 2025.

stability.²⁵ The Bank of England has a mandate to deliver price stability, and subject to that, to “support the Government’s other economic aim, which is strong, sustainable, and balanced growth.”²⁶ As of 2024, the Reserve Bank of Australia’s goals are price stability and full employment.²⁷

How the goals are operationalized also differs across central banks. In the U.S., Japan, Sweden, and Europe, the central bank chooses its inflation goal. For example, the U.S. has an inflation goal of 2 percent.²⁸ But in the U.K., New Zealand, and Australia, the government sets the target, while the central banks have independence in setting policy to achieve the target.

Ways to Preserve Independence and Improve the Public’s Trust

By giving monetary policymakers independence, governments have tied their own hands. They have committed to not interfere in the setting of monetary policy because that will result in better economic outcomes. But the degree of independence has varied over time and is not guaranteed.²⁹

²⁵ See Reserve Bank of New Zealand, history of the remit and policy targets agreement section of the web site, as accessed on June 13, 2025.

²⁶ See Bank of England, monetary policy section of web site, as accessed on June 13, 2025.

²⁷ According to the 2024 amendments to the Reserve Bank Act of 1959, the Reserve Bank’s overarching objective is “to promote economic prosperity and welfare of the Australian people both now and into the future.” The Act says that this is best achieved by setting monetary policy “in a way that, in the [Monetary Policy] Board’s opinion, “best contributes to both price stability in Australia and the maintenance of full employment in Australia.” These two goals are linked. The Reserve Bank explains that sustained full employment, which is the Bank’s focus, is the “current maximum level of employment that is consistent with low and stable inflation.” (See Reserve Bank of Australia, monetary policy section of web site, as accessed on June 13, 2025.)

²⁸ The goal is measured by the year-over-year change in the price index for personal consumption expenditures, or PCE inflation. See Federal Open Market Committee (2024).

²⁹ The relationship between the Fed and the government has varied over time. For example, in 1993, U.S. Representative Henry Gonzalez proposed that Federal Reserve Bank presidents be appointed by the president, which would have given the president more ability to influence monetary policy decisions. (See Greenhouse, 1993.) More recently, there have been calls to audit the Fed’s monetary policy deliberations or even abolish the Fed and return to the gold standard. (See Bordo, 2016.) An “Audit-the-Fed” bill, The Federal Reserve Transparency Act, was reintroduced in Congress in 2024. The Fed’s financial statements are already audited. This bill would require the General Accountability Office to audit Federal Reserve monetary policy deliberations. In other countries, e.g., Turkey and Argentina, the president has fired the central bank governor over policy differences.

Let me conclude this lecture by focusing on two ways central banks can help ensure continued support for independence: (1) by building knowledge and fostering a diversity of views, and (2) by enhancing policy communications. I believe both steps would not only support monetary policy independence but would help to rebuild the public's trust in the central bank.

Building Knowledge and Fostering a Diversity of Views

Central bank independence is only sustainable if monetary policymakers do all they can to ensure they are setting appropriate monetary policy. This does not mean never making a policy mistake – that would be impossible in a world that is filled with uncertainty and when setting monetary policy entails projecting where the economy will be in the future. But it is important to ensure that the central bank has built up its expertise to limit policy errors and to minimize the cost of an error when one occurs.

The regional structure of the Federal Reserve System helps in this regard.³⁰ The U.S. economy is very diverse and the Fed's regional structure helps to ensure that a variety of information from all sectors of the economy and all parts of the country is taken into account in monetary policy decisions, and that the Fed is able to build rapport with constituencies throughout the country. But the regional structure also provides an avenue for alternative views based on different models and techniques to enter the policy discussion. Even at an institution like the Fed where policy decisions are made by consensus, having a diversity of views around the table allows the institution to avoid group think. It provides a way for sound ideas to gain traction, which leads to better policy outcomes.

[FIGURE 14: Reserve Bank economic ideas] Indeed, Bordo and Prescott (2023) discuss some of the innovative ideas that first came into the Federal Reserve System via a Reserve Bank and are now part of standard monetary policymaking.

³⁰ See Mester (2020).

In the 1960s, Keynesian economic models were developed and the Board of Governors' main model guiding monetary policy decisions was of this type. But the St. Louis Fed economists developed monetarism, an alternative view, which did a better job of explaining why inflation was not falling in the 1970s. While the Keynesian viewpoint was that the inflation was caused by high oil prices, a special factor not responsive to monetary policy, monetarism attributed the high inflation to high money growth. This view was adopted by Paul Volcker when he became Fed chair in the late 1970s and started raising interest rates, ultimately getting inflation under control.

In the 1980s, the concepts of rational expectations, time consistency, and credible policymaking were developed. The Minneapolis Fed contributed significantly to the development and application of these ideas to monetary policy. Up until then, macroeconomic models, including the Board of Governor's model, assumed that the expectations of households, businesses, and financial market participants were adaptive and based on past information. Rational expectations assumed that economic agents were forward looking and based their expectations on all the available information, including what they knew about future policy actions. If agents didn't believe that monetary policymakers would keep inflation low and stable, they would base their economic decisions on an expectation of higher inflation and this would influence actual inflation. Managing the public's inflation expectations is now a crucial aspect of monetary policymaking.

Another example is inflation targeting. Inflation targeting is now widely accepted as best-practice monetary policymaking, but that was not always the case at the Federal Reserve, which did not adopt an explicit numerical goal for inflation until 2012. In the late 1980s and early 1990s, the Cleveland Fed was an early champion of adopting an explicit inflation target as a way to increase policy credibility and commitment, thereby better anchoring inflation expectations.

In the 1980s, Marvin Goodfriend, a policy advisor at the Richmond Fed, began writing on the important role that transparency and good communications can play in making monetary policy more effective. It may seem surprising, but before 1994 there was no post-meeting FOMC statement announcing changes to its policy interest rate. Instead, the public had to infer what the FOMC had decided by looking at how it implemented policy through its open market operations in financial markets. Eventually, the idea that transparency and effective communications had benefits gained traction within the Fed and other central banks.

Of course, it is not enough to build expertise; an institution needs to learn from this expertise and its experience, take accountability for policy mistakes, and continually improve its methods. With a view toward continuous improvement, the Reserve Bank of Australia does an annual review of its forecasts and includes a summary in its Statement on Monetary Policy.³¹ In the wake of the post-Covid surge in inflation, independent reviews of the policy and forecasting approaches of both the Reserve Bank of Australia and the Bank of England were undertaken, and recommendations are now being implemented at both central banks.³² There has not been an independent review of the Fed, but the FOMC is in the process of evaluating its current monetary policy framework.³³ And I expect this includes an evaluation of where the Fed forecasting went wrong and ways to improve it.

Enhancing Monetary Policy Communication

[FIGURE 15: Greenspan quip] In addition to building expertise, allowing for diversity of views, and evaluating performance, enhancing policy communications is another way for central banks to gain support for their independence and build trust. We have come a long way from former Fed Chair Alan

³¹ For example, see Box D of Reserve Bank of Australia (2024).

³² See De Brouwer, Fry-McKibbin, and Wilkins (2023) and Bernanke (2024).

³³ See Powell (2025a).

Greenspan's quip: "Since I've become a central banker, I've learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said."³⁴

Today, central banks are much more transparent. The benefits of clear communication in monetary policymaking derive from the fact that households, businesses, and investors make economic and financial decisions based on their expectations of the future, including the future course of monetary policy. When the public gets a better sense of how monetary policy is likely to change as economic conditions evolve, households and firms can plan better: they can make better saving, borrowing, investment, and employment decisions, and a change made by monetary policymakers to short-term interest rates transmits more effectively to longer-term interest rates, which matter for economic and financial decisions.

[FIGURE 16: Communications challenges]

Many central banks have enhanced their policy communications over time, but effective communication is best viewed as a journey rather than a destination, and it remains challenging.

One challenge is that it has been difficult to give the public a good sense of the usual policy reaction function. It is hard to convey how policy is likely to respond *conditional* on how the economy evolves without implying that policy is pre-committed to a particular policy path *regardless* of how the economy evolves.

People and legislators need to hold policymakers accountable for their performance, but they should not be held accountable to an unrealistic standard. The public needs to understand that given the lags and revisions in the data, incoming information can alter not only the policymaker's view of the future

³⁴ *The Wall Street Journal* reported Greenspan made the comment at a panel discussion of financial services sponsored by Senator Christopher Dodd for a group of the senator's constituents. See Murray (1987).

evolution of the economy but also his or her understanding of current and past economic conditions. So new information could alter the expected future path of policy and might even result in *ex post* regret of a recent action. It is normal that policymakers will always be learning about whether their policy settings are the appropriate ones to promote their goals. Economist Robert Hetzel says that policymaking has a flavor of “guess and correct.”³⁵

One way to address this challenge is communicating in terms of scenarios. This can be done as part of the economic forecasts that many central banks release, but it can also be done in the narratives when monetary policymakers communicate to the public.³⁶ For example, in the U.S., higher tariffs could result in a one-time increase in prices that is short-lived or they could result in more persistent inflation if it takes time for tariffs to reach their ultimate level and passthrough to prices and, importantly, if longer-term inflation expectations are not well-anchored and drift up. Chair Powell has discussed both of these scenarios in recent post-meeting press conferences.³⁷ The implication is that policy would have to remain tighter in the second scenario than in the first. Using this type of scenario communication gives the public a sense of where policy is likely to go depending on how the economy evolves.

A second challenge for policy communications is that it is difficult to get messages through to households and businesses, even basic messages.

[FIGURE 17. Survey results on central bank goals] One survey of U.S. households taken in April with about 2,500 representative respondents finds that there is still confusion about what monetary policymakers are trying to accomplish. Respondents were asked to choose up to two of the Fed’s most

³⁵ See Hetzel (2019).

³⁶ See Mester (2025).

³⁷ See, e.g., Powell (2025b).

important objectives from a list.³⁸ Almost 40 percent selected “maintaining a strong dollar” and 35 percent chose “keeping interest rates low to reduce the government’s cost of borrowing.” Both of these exceeded the fraction choosing “ensuring price stability” or “promoting maximum employment,” the Fed’s actual mandated goals.

Part of the problem stems from the selective inattention of households. When inflation is low, people are inattentive but when inflation is high they become very attentive.³⁹ The recent inflation surge got everyone’s attention. They learned that the Fed’s inflation goal is 2 percent, but they also learned that the Fed was failing to achieve that goal.⁴⁰ If people are skeptical about policymakers’ ability and commitment to bring inflation back down, their inflation expectations become more affected by their actual inflation experience. As inflation expectations move up with inflation, the high inflation becomes more persistent.

To counteract the effect of selective inattention, it is important that policymakers ensure that the messages they send are effective, whether inflation is high or low. This raises a third challenge that stems from the reluctance of policymakers to send the wrong message.

In an uncertain environment, more communication is better than less. But it often seems that in uncertain times policymakers want to explain less because of the fear of being locked in or being perceived as making promises they may not want to keep if the economy moves differently than expected.

³⁸ See Coibion and Gorodnichenko (2025).

³⁹ See Coibion and Gorodnichenko (2025).

⁴⁰ The same survey taken in April 2025, which found that households did not know the Fed’s goals, also found that there was a shift in the distribution of households’ beliefs about the Fed’s inflation goal toward 2 percent compared to an earlier survey taken in 2018, when inflation was low. In the 2018 survey, the average response about the inflation target was 8.5 percent; in 2025 this had moved down to 3 percent. (See Coibion and Gorodnichenko, 2025, and Coibion, Gorodnichenko, and Weber, 2022.)

At the Fed, the trend has been toward shorter communications. At my first meeting as Cleveland Fed president in June 2014, there were 759 words in the post-meeting FOMC statement. At my last meeting in June 2024, there were only 295 words. The problem with this is that if monetary policymakers are not in control of their own narrative, market commentators or others will fill the void with their own interpretations, and these may differ from what policymakers intended.

Research points to steps that central banks can take to make their communications more effective. It turns out that shorter communications are not necessarily more easily understood by regular people.⁴¹ Instead, less complex communications appear to be more effective. For example, messages that talk about the goal variables of inflation and employment are more readily understood than messages that pertain to the policy interest rate instrument, and this more effective type of communication can help anchor people's expectations to the central bank's inflation goal even when inflation is rising.⁴²

[FIGURE 18: ECB infographic policy announcement] Findings also indicate that policymakers need to communicate differently to different audiences, including market participants, firms, and households. In addition to their traditional policy statements, some central banks are putting out infographic announcements of their policy decisions, which are more accessible to the general public.

[FIGURE 19: Pew data on news sources] There has been a shift in where people are getting their news, so several central banks are now using social media to communicate to the public.⁴³

[FIGURE 20: Bank of Jamaica video on inflation targeting]

Perhaps the most innovative has been the Bank of Jamaica, which produced a reggae music video

⁴¹ See McMahon and Naylor (2023).

⁴² See Coibion and Gorodnichenko (2025), Ehrmann, Georgarakos, and Kenny (2024), Coibion, Gorodnichenko, and Weber (2022), and Candia, Coibion, and Gorodnichenko (2020).

⁴³ Haldane (2017) discusses the change in news sources in the context of improving central bank communications.

explaining the benefits of targeting low and stable inflation.⁴⁴

Conclusion

So, to conclude, research and practice have indicated that allowing the central bank to set monetary policy independently from short-run political influence yields better economic outcomes for the public. But independence is not assured and as trust in the central bank has declined along with trust in other institutions, independence is more at jeopardy. The organizational structure of central banks like the Fed can support independence but it is not foolproof.

A central bank needs to constantly build its credibility with the public. It can do so by ensuring it is bringing the best expertise to policymaking, avoiding group think, taking accountability for policy missteps, and working toward continuous improvement. It can also garner support for continued independence by taking control of its own narrative and explaining itself to the various constituencies who depend on the central bank to keep inflation low and stable, financial markets functioning well, and the economy and employment growing at a healthy pace.

Thank you for your kind attention. I look forward to your questions.

⁴⁴ Bank of Jamaica (2019).

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Monetary Policy Independence and Building Trust in an Uncertain World

Loretta J. Mester

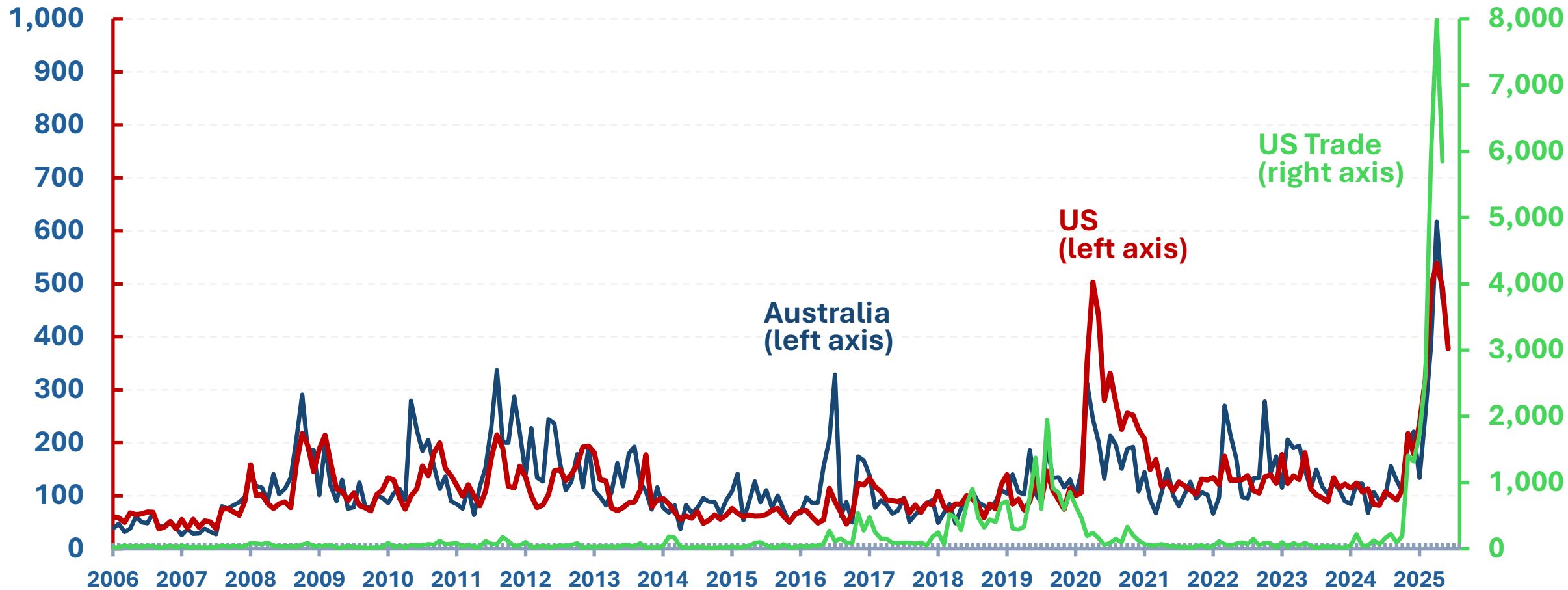
**Adjunct Full Professor of Finance, The Wharton School, University of Pennsylvania
and Former President and CEO, Federal Reserve Bank of Cleveland**

**Sir Leslie Melville Public Lecture
The Australian National University**

**Canberra, ACT
Australia
July 10, 2025**

Figure 1. Uncertainty levels are very high

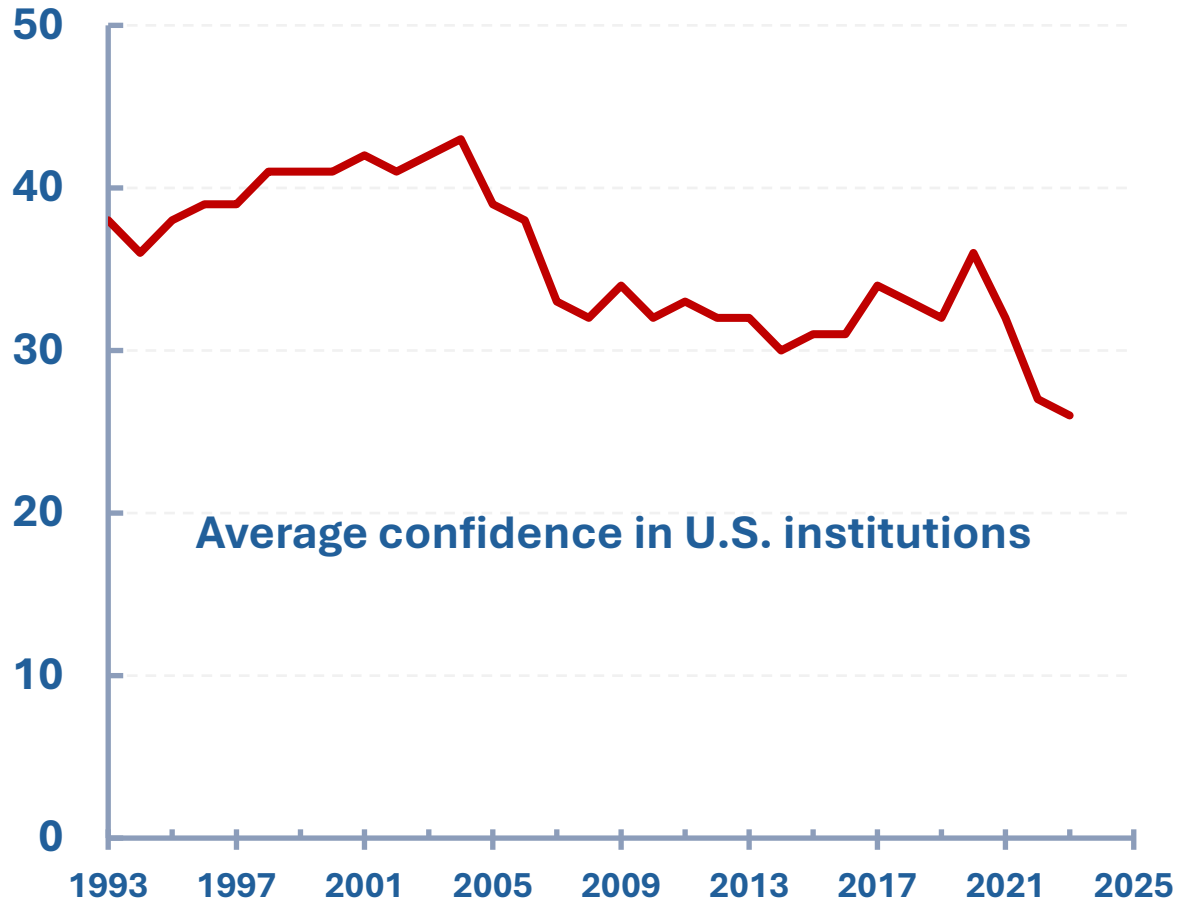
Index: 1985-2010 = 100



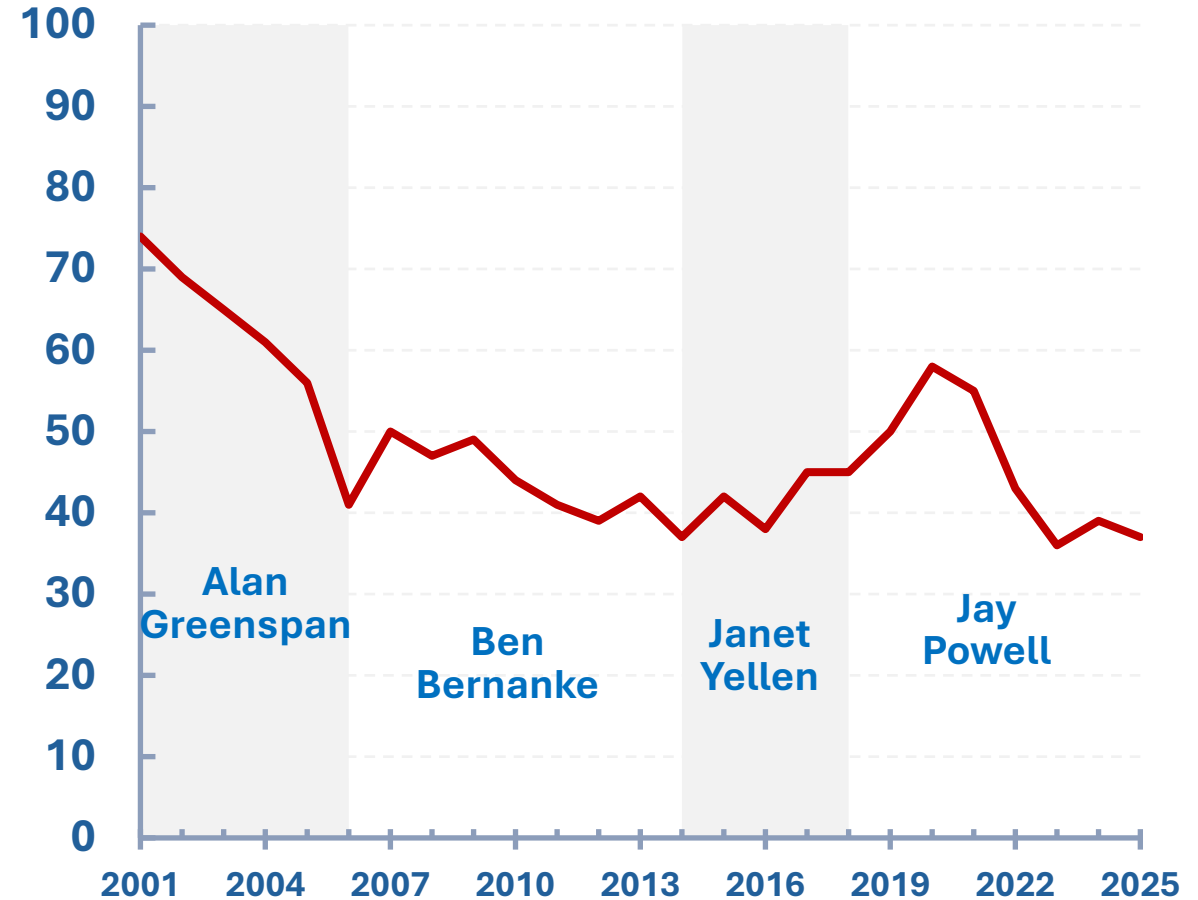
Source: Baker, Bloom, and Davis data at PolicyUncertainty.com
Monthly data: Last obs. May 2025

Figure 2. Confidence in U.S. institutions, including the Fed, has fallen

% of respondents with great deal/quite a lot of confidence



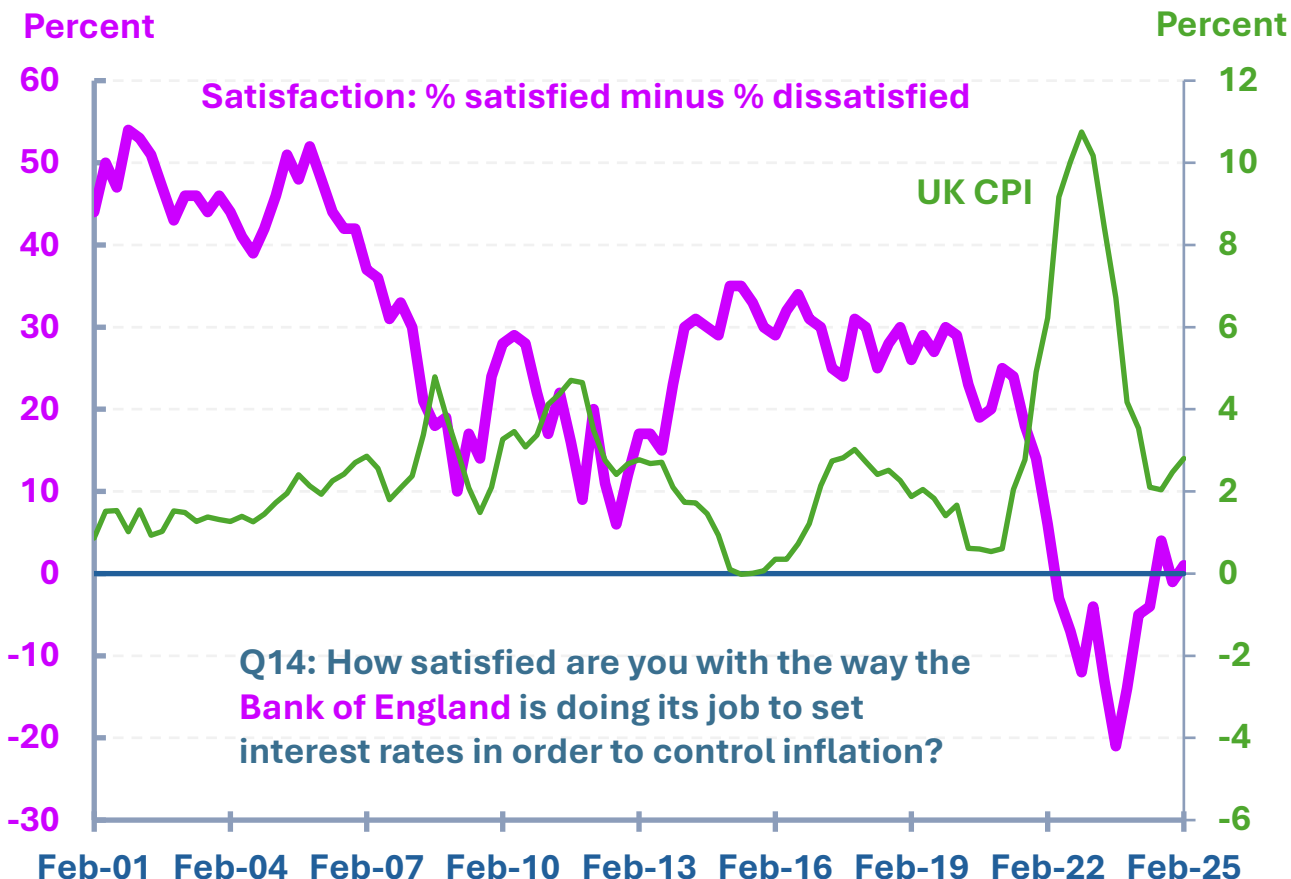
% of respondents with great deal/fair amount of confidence
Fed Chair will do or recommend the right thing for the economy



Source: Gallup data; See Brenan (2024 and 2025); also see Goldman Sachs Research (2025)
Annual data: Last obs. 2025

Figure 3. Satisfaction in central banks has fallen over the past few years

Bank of England



European Central Bank

Chart 1

Trust in the ECB according to the Eurobarometer and the Consumer Expectations Survey

(left-hand scale: net trust in the ECB across euro area respondents (Eurobarometer), percentages; right-hand scale: average trust in the ECB (CES), scale of 0 to 10)

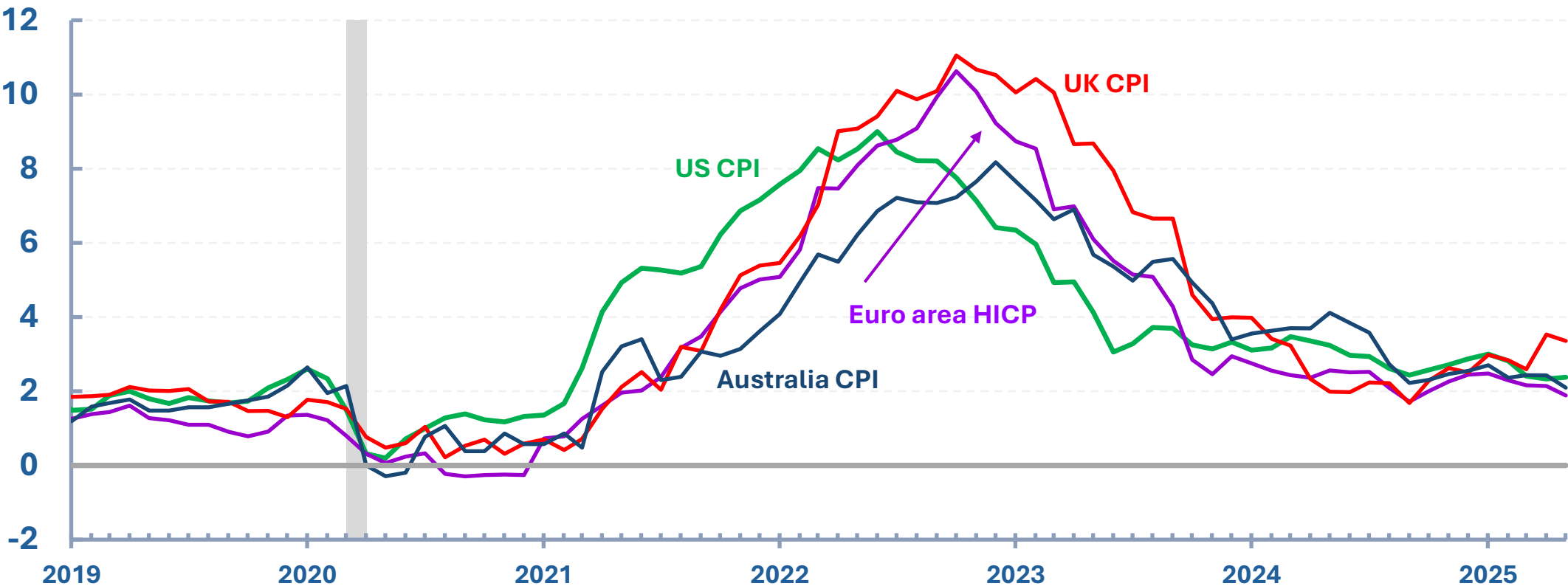


Sources: Standard Eurobarometer, ECB Consumer Expectations Survey and ECB calculations.
Notes: Standard Eurobarometer data cover survey waves 51 (spring 1999) to 100 (autumn 2023). Net trust is the percentage of respondents answering "tend to trust" minus the percentage answering "tend not to trust". Respondents who answered "don't know" are disregarded. CES data are a weighted average and cover monthly survey waves from April 2020 to December 2023. The CES trust question is answered on a scale of 0 to 10 (with 0 being no trust at all and 10 being complete trust).

Source: Satisfaction is from Bank of England/IPSO Inflation Attitude Survey; Trust in ECB is from Eurobarometer; See Ehrmann (2024)
Inflation is from UK Office of National Statistics via Haver Analytics
Quarterly data: Last obs. Feb 2025

Figure 4. Inflation reached levels not seen in 40 years

Year-over-year percentage change



Note: Shaded bar is US recession
Source: For US: Bureau of Labor Statistics; For UK: Office of National Statistics; For Euro area: ECB;
For Australia: Office for National Statistics; all via Haver Analytics
Monthly data: Last obs. May 2025

Figure 5. FOMC kept underpredicting inflation

Quarterly FOMC SEP Median PCE Inflation Projections

Q4-over-Q4 percentage change

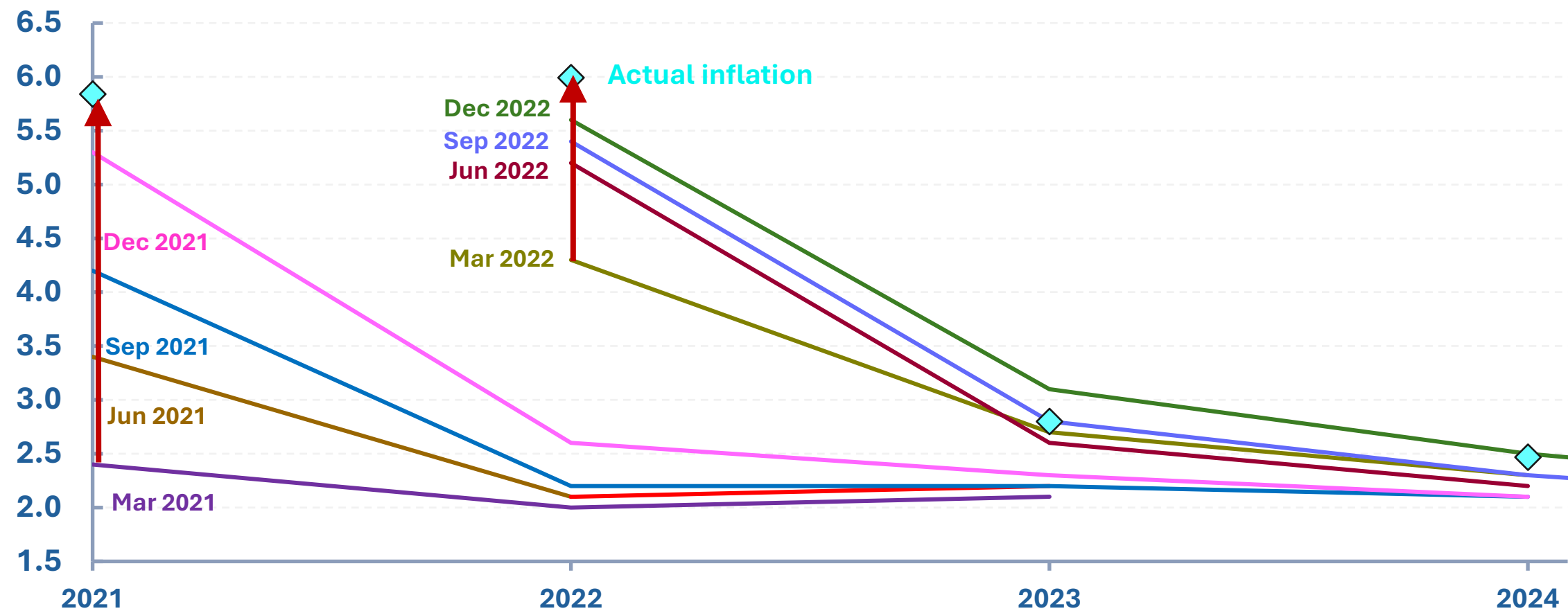
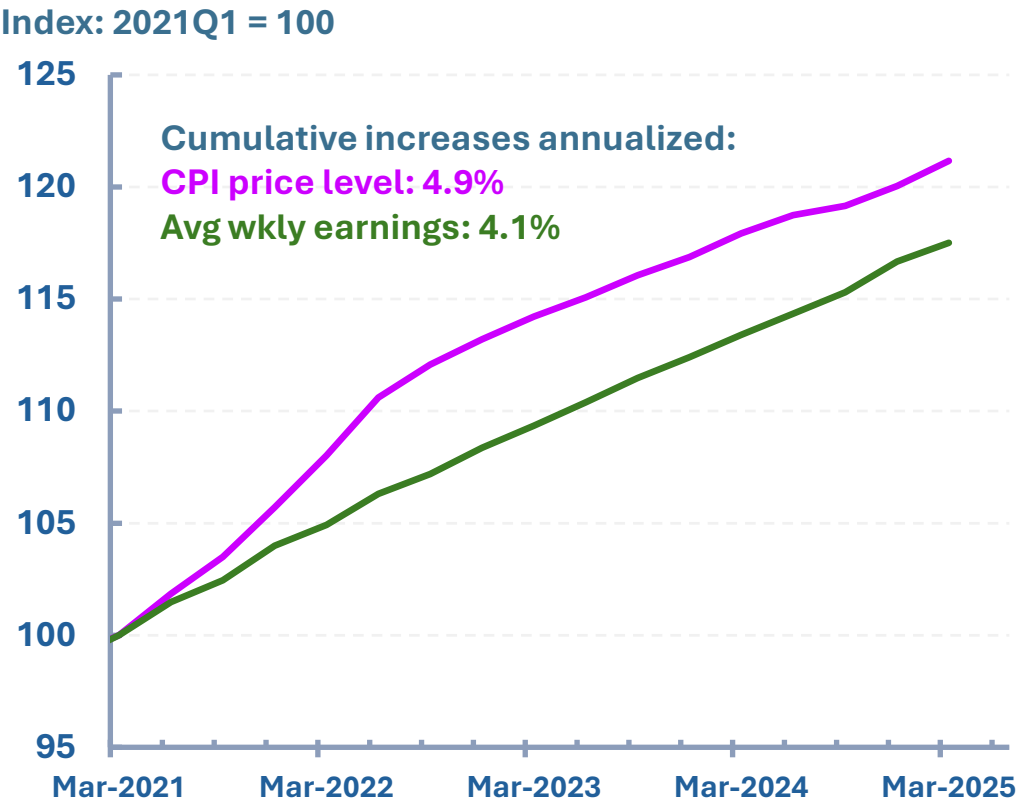


Figure 6. Wages did not keep up with inflation

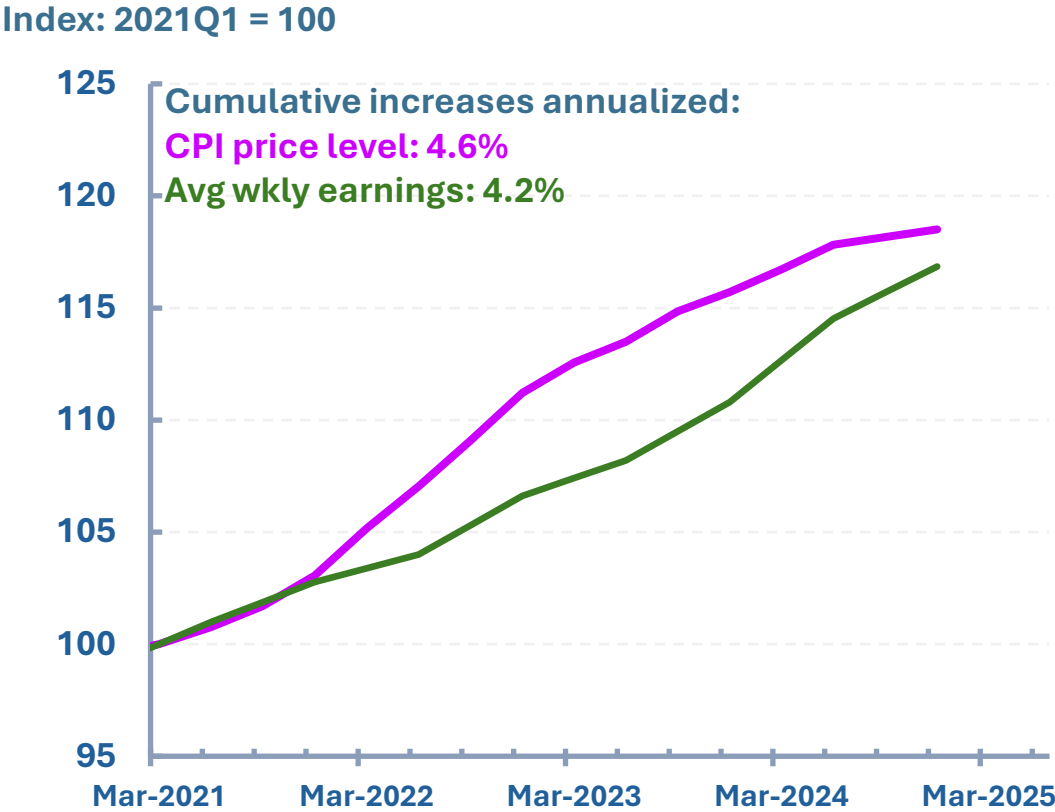
United States

CPI price level and Avg weekly earnings
(indexed so 2021Q1 = 100)



Australia

CPI price level and Avg weekly earnings
(indexed so 2021Q1 = 100)



Source: US Bureau of Labor Statistics and Australian Bureau of Statistics, via Haver Analytics
Quarterly data: Last obs. 2025 Q4 for US and 2025 Q3 for Australia (Australian avg weekly earnings is interpolated semi-annual data)

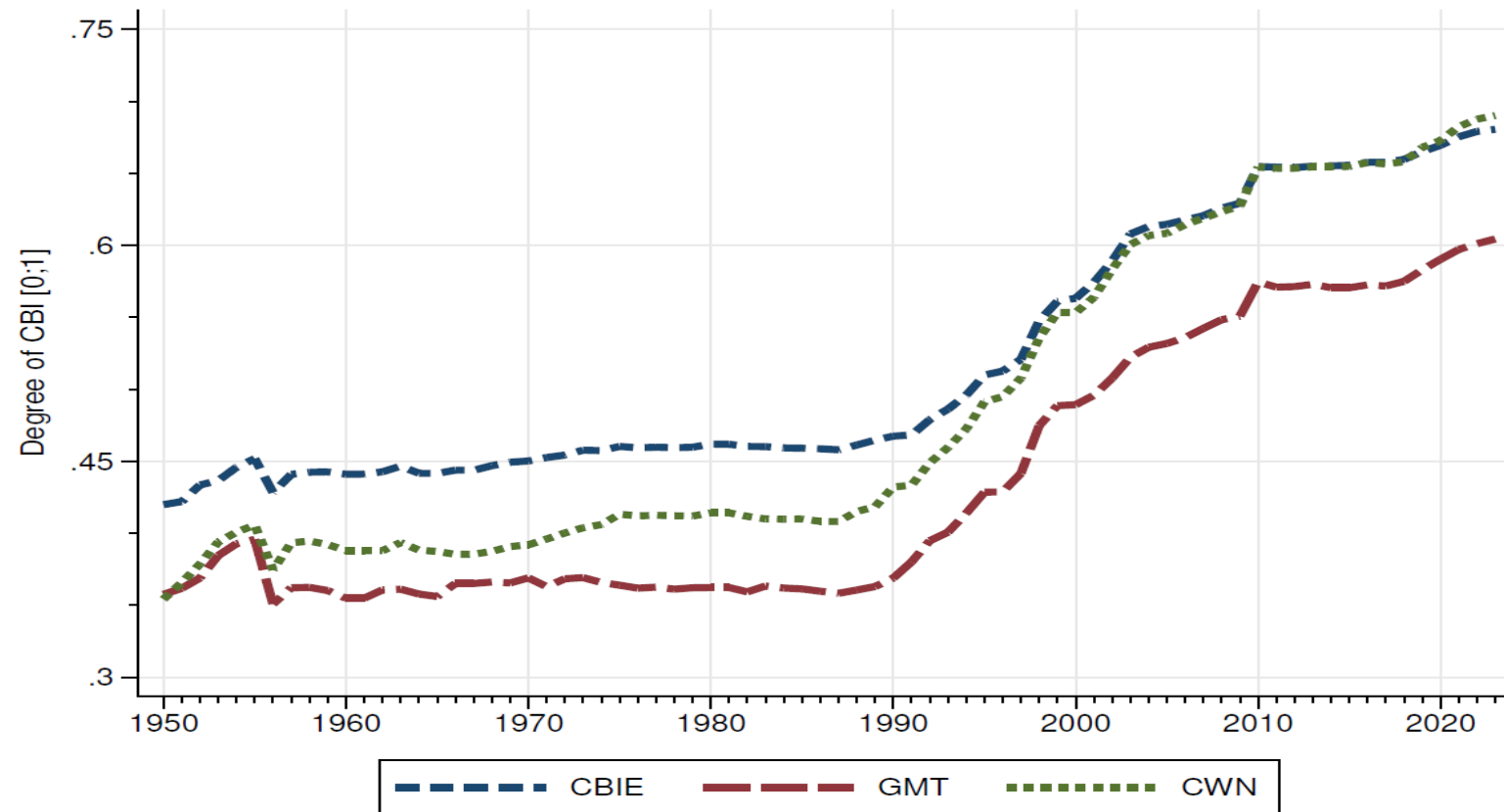
Figure 7: Central bank independence yields better economic outcomes

Central bank independence:

- Authority of central bankers to make monetary policy decisions independently from short-run political interference
 - Government sets monetary policy goals
 - Central bank decides how best to achieve those goals
- Independent \neq **unaccountable**
- **Benefits**
 - Long-term focus since monetary policy affects economy with a lag
 - Government has incentive to set interest rates low: spur economic growth and ignore longer-run inflation cost (esp. before elections)
 - Government can use inflation to keep debt-service costs low and inflate away debt
 - **Research: Independence => lower, more stable inflation; without cost of more variable growth**

Figure 8. Central bank independence has increased over time

Figure 3: Evolution of Central Bank Independence (1950-2023)



Note: The figure shows the evolution of the CBIE, GMT and CWN indices of central bank independence between 1950 and 2023.

Figure 9: Many US presidents have tried to influence monetary policy

- **1929:** President Hoover pressures Fed to cut interest rates after stock market crash
- **1951:** President Truman & US Treasury want Fed to maintain low-interest-rate peg while Fed wants to raise rates to combat inflation
=> **Results in 1951 Treasury-Fed accord that establishes Fed independence**
- **1953:** President Eisenhower wants Fed to lower interest rates in 1953-1954 recession
- **1965:** President Johnson calls Fed Chair Martin to his Texas ranch after Martin refuses to lower interest rates
- **1984:** President Reagan's Chief of Staff (in presence of President Reagan) demands Fed Chair Volcker not raise interest rates before the 1984 election
- **1988:** Assistant Treasury Secretary sends Fed Chair Greenspan a letter urging the Fed to cut rates before the election
- **1992:** President G.H.W. Bush tries to pressure Fed Chair Greenspan to cut rates ahead of election
- **2018-2019:** President Trump repeatedly calls for Fed to lower rates
- **2025:** President Trump repeatedly calls for Fed to lower rates and threatens to fire Fed Chair Powell

Figure 10. Markets reacted to President Trump's comments on firing Jay Powell

April 17, 2025, on Truth Social:

“The ECB is expected to cut interest rates for the 7th time, and yet, “Too Late” Jerome Powell of the Fed, who is always TOO LATE AND WRONG, yesterday issued a report which was another, and typical, complete “mess!” Oil prices are down, groceries (even eggs!) are down, and the USA is getting RICH ON TARIFFS. Too Late should have lowered Interest Rates, like the ECB, long ago, but he should certainly lower them now. **Powell's termination cannot come fast enough!**”



April 22, 2025, in response to reporters' questions after swearing-in ceremony for new head of U.S. Securities and Exchange Commission:

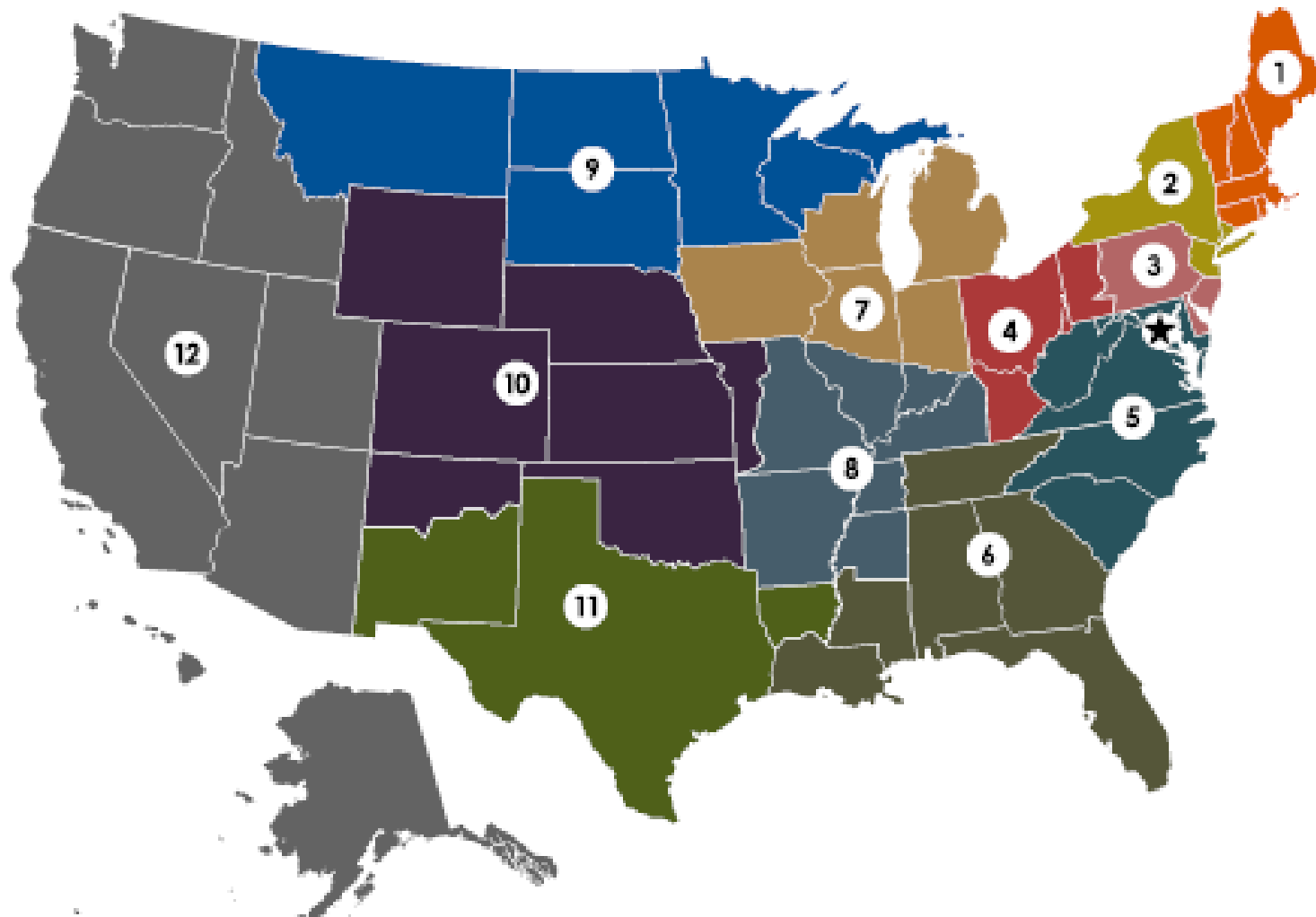
“I have no intention of firing him. I would like to see him be a little more active in terms of his idea to lower interest rates. This is a perfect time to lower interest rates. But no, I have no intention to fire him....”

“None whatsoever. Never did. The press runs away with things. No, I have no intention of firing him.”

June 17, 2025, at Whitehouse event:

“And the fake news is saying 'Oh if you fired him it would be so bad.' **I don't know why it would be so bad, but I'm not going to fire him.**” “We want to get rid of inflation and we have. We'll be paying more for debt. All he has to do is lower it.”

Figure 11: The Fed includes representation from across the U.S.



Federal Reserve Districts

1. Boston
2. New York
3. Philadelphia
4. Cleveland
5. Richmond
6. Atlanta
7. Chicago
8. St. Louis
9. Minneapolis
10. Kansas City
11. Dallas
12. San Francisco

Figure 12. The structure of the Fed supports the independence of monetary policy



Figure 13: Goals differ across central banks

Central Bank	Goals	Who chooses inflation target
Federal Reserve	Price stability and maximum employment	Central bank
Bank of Japan	Price stability	Central bank
Riksbank (Sweden)	Price stability	Central bank
European Central Bank	Primary: price stability Secondary: full employment and economic growth	Central bank
Bank of England	Price stability and subject to that, support strong, sustainable, and balanced growth	Government
Reserve Bank of New Zealand	Price stability (2019-2022: Price stability and maximum sustainable employment)	Government
Reserve Bank of Australia	Price stability and full employment (as of 2024)	Government

Figure 14: Reserve Banks have introduced major new ideas into monetary policymaking

- **1960s, St. Louis Fed:** Monetarism
- **1980s, Minneapolis Fed:** Rational expectations, time consistency, credibility
- **1980s-1990s, Cleveland Fed:** Inflation targeting
- **1980s, Richmond Fed:** Transparency and communications

Source: Bordo and Prescott (2023)

Figure 15: Central banks have become much more transparent

“Since I’ve become a central banker, I’ve learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said.”

Fed Chair Alan Greenspan, at a panel discussion hosted by
Senator Christopher Dodd, 1987

Figure 16: Effective monetary policy communications is challenging

- **Challenge 1**
 - Difficult to give the public a good sense of how policy is likely to respond *conditional* on how the economy evolves without implying policy is pre-committed *regardless* of how the economy evolves
- **Challenge 2**
 - Difficult to get even basic messages through to the public
- **Challenge 3**
 - Policymakers are reluctant to give the wrong message so they speak less when they should be speaking more

Figure 17. Knowledge of the Fed’s objectives is weak

April 2025 Survey of about 2,500 Americans:
Choose up to two of the Fed’s most important objectives

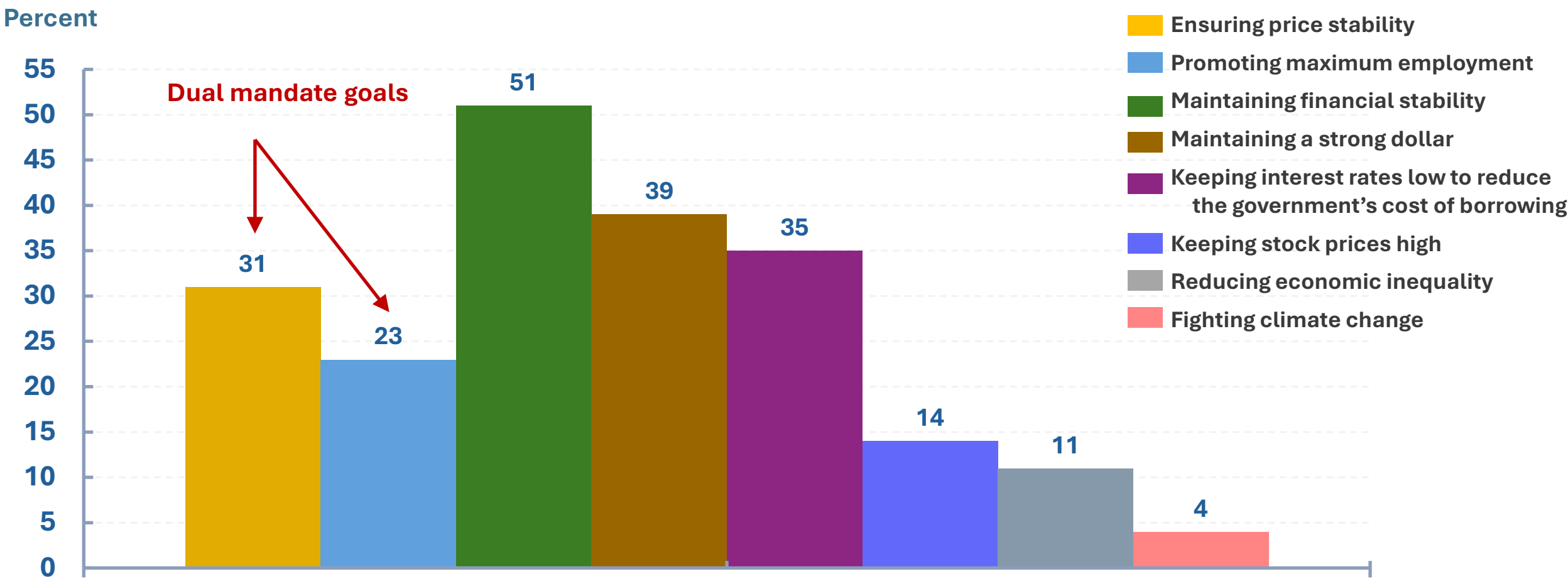


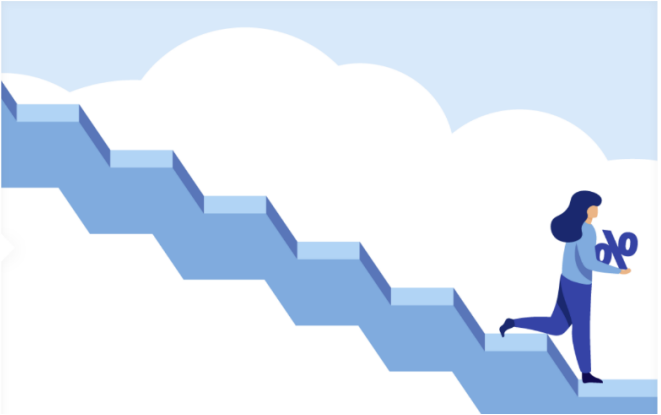
Figure 18. European Central Bank is using infographics as part of its policy communications

ECB Statement at a Glance, June 2025

What did we decide?

We cut our key interest rates by 0.25 percentage points

We did this because inflation is settling at around our 2% target, while the economy is facing headwinds.



We expect the economy to slowly recover and then grow faster in the years ahead

Projections for euro area growth in 2025 and the coming years
(projections from June 2025)



What is going on in the economy?

What is happening in the world is holding the economy back

Global uncertainties and trade tensions are weighing on the economy. How these are resolved will have an impact on how fast the economy can grow.



We expect inflation to settle at around our 2% target

Projections for euro area inflation in 2025 and the coming years
(projections from June 2025)

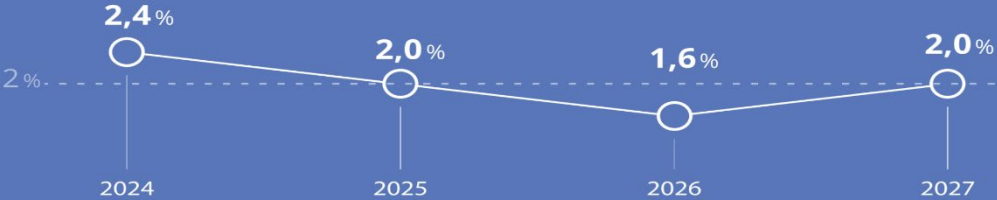
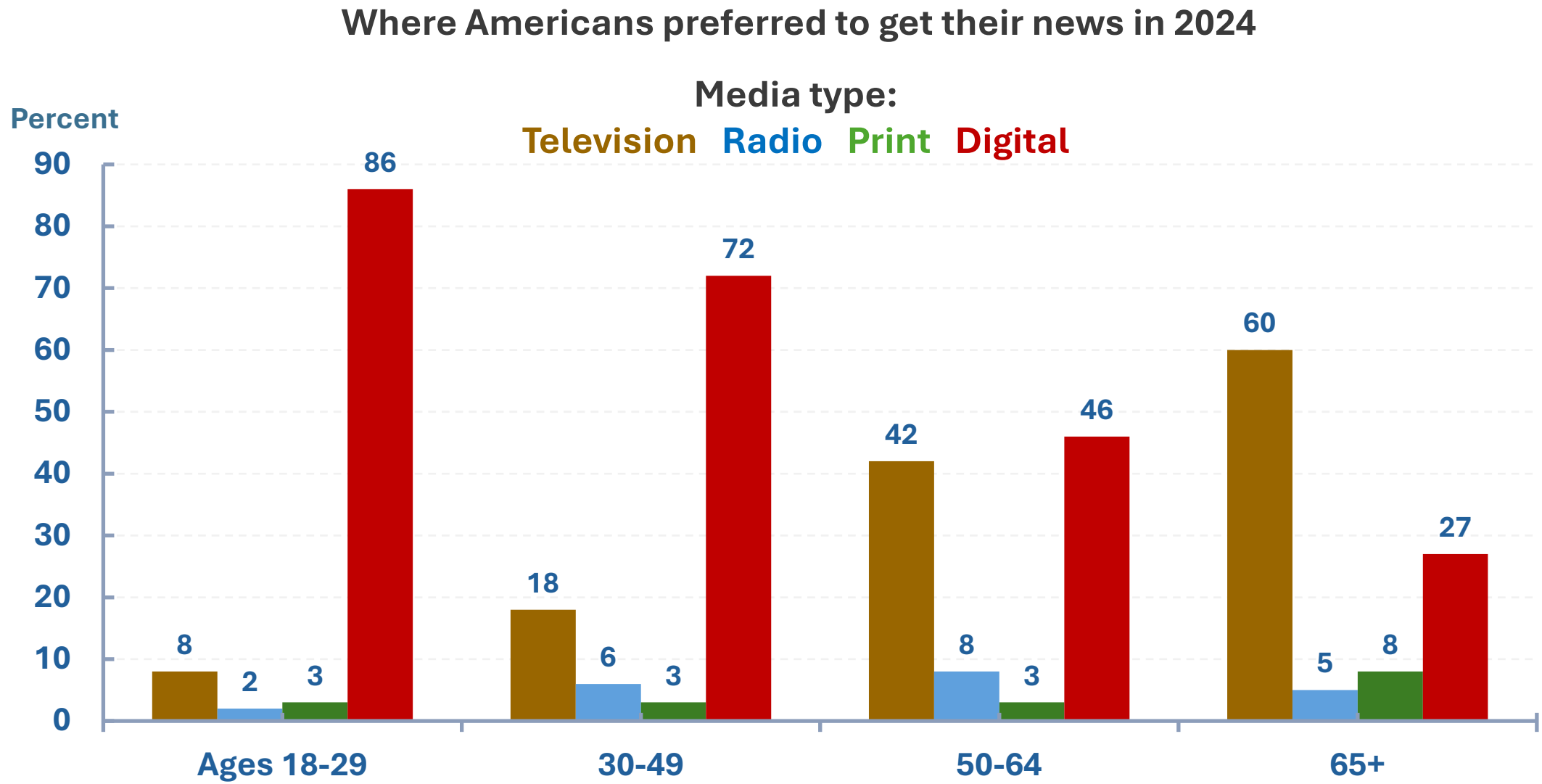


Figure 19. Younger Americans prefer to get their news digitally and older Americans prefer TV



Source: Pew Research Center (2024)

Figure 20: Bank of Jamaica: Inflation Targeting Music Video (<https://www.youtube.com/watch?v=UqDvv-1X3ms>)



Monetary Policy Independence and Building Trust in an Uncertain World

Loretta J. Mester

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and Former President and CEO, Federal Reserve Bank of Cleveland**

**Sir Leslie Melville Public Lecture
The Australian National University**

**Canberra, ACT
Australia
July 10, 2025**