Disciplined Judgment in Monetary Policymaking

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Remarks for the Panel on John Taylor and Taylor Rules in Policy
Hoover Annual Monetary Policy Conference: "Finishing the Job and New Challenges"
The Hoover Institution, Stanford University
Stanford, CA

May 9, 2025

Introduction

I never had the opportunity to take a course from John Taylor, but I consider myself one of his students because I learned so much about monetary policymaking from his papers, presentations, and discussions. I am honored to be here to thank John for his many significant contributions to macroeconomics and to the practice of monetary policy.

Every macroeconomic model incorporates some type of Taylor rule relating the central bank's policy rate to a set of economic conditions. The Taylor principle, which holds that the nominal policy rate should increase more than one-for-one in response to a sustained rise in inflation, is now accepted as appropriate monetary policy. The economics profession has not determined that there is a single policy rule that is optimal across a variety of economic models and in a variety of economic circumstances. Different rules can imply different paths for the monetary policy interest rate. I would not argue that a central bank should set policy simply by following the prescriptions from a single rule. But that is a strawman. A more general significant idea I take from John Taylor's body of work is that a consistent, systematic approach to setting monetary policy can make the policy more effective at achieving its economic goals. While judgment must be brought to bear in policymaking, I believe it should be *disciplined judgment*, informed by rules and models, rather than discretionary opinion that is not necessarily consistent with the underlying structure of the economy.[1]

Policy rules are useful in internal policy deliberations as a way to discipline judgment. Rules can also help policymakers explain their decisions to the public. Doing a better job at conveying the policy reaction function improves transparency, accountability, and credibility, all which support monetary policy independence. The conference organizers have limited our time for prepared remarks, so I'll focus mine first on internal deliberations and then on external communications.

Policy Rules and Internal Deliberations

Policy rules are used at the Fed, both internally and externally. The Board of Governor's semi-annual Monetary Policy Report began including prescriptions from a set of monetary policy rules in July 2017. And except for the June 2020 and February 2022 reports, rules have appeared in each report since then.[2] The Board staff's baseline forecast in Tealbook Part A, which helps to coordinate FOMC policy deliberations, incorporates a policy rule. The Tealbook's section on monetary policy strategies shows the policy prescriptions from several rules.[3] Various policymakers have used rules to help explain their own policy views.[4] Yet rules could be used more consistently in materials provided to the FOMC prior to meetings to help guide internal deliberations.

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[1] In a provocative recent paper, Hoenig (2024) discusses the costs of discretion and presents a proposal to significantly limit discretion in the Fed's monetary policymaking by restricting the fed funds rate to remain withing a predetermined range around an estimate of r^*, and restricting changes in the quantity of reserves available to banks to be less than 1 percentage point of the average 5- or 10- year growth rate of real GDP. Actions beyond these limits would need Congressional approval.

[2] Board of Governors of the Federal Reserve System (2025).

[3] Staff of the Board of Governors of the Federal Reserve System (2019).

[4] In some cases, the policymaker points out the challenges in using rules. See, e.g., Yellen (2017). In other cases, the policymaker is more positive about the guidance provided by rules. See, e.g., Bullard (2022).

When I was a policymaker at the Federal Reserve Bank of Cleveland, I found that looking at the prescriptions from a set of simple, robust policy rules across different economic forecasts helped me formulate my policy views. In 2016, the Cleveland Fed began publishing current readings from a set of policy rules and a tool that allows users to customize the rules to generate alternative policy paths.[5]

Intuition can lead you astray. The economy encompasses a vast array of interactions and general equilibrium dynamics between various actors and sectors. Economic models and policy rules discipline one's thinking about the relationship between incoming data, forecasts, risks, and policy decisions. They help to ensure that judgment is consistent with how the economy really works. When the Fed's policy stance was different from what the rules suggested, I had to carefully consider whether there were factors or alternative model assumptions that could support that deviation. Seeing the types of variation in prescriptions from different rules also helped me assess what the salient risks were to the outlook.

I used simple rules to help me construct my submission to Summary of Economic Projections (SEP).[6] And I also found rules helpful in understanding the SEP results across participants. In the September 2018 meeting (whose transcript is now public), I discussed the type of policy rule that could fit the SEP projections and compared that rule to the policy rule in the staff's Tealbook forecast.[7] The derived FOMC participants' rule was a little less inertial than the Tealbook baseline rule but the main difference was that the SEP rule put little weight on the unemployment gap and a high weight on the inflation gap. Given that the Tealbook's baseline rule was a fairly good description of the past behavior of the FOMC, I found

[5] The Cleveland Fed website includes current outcomes of the federal funds rate paths from a set of seven simple policy rules across three different publicly available forecasts, which are from the Cleveland Fed's BVAR model, the Congressional Budget Office, and the Survey of Professional Forecasters.

[6] Four times a year the FOMC releases the SEP, which provides information on the range of projections of real output growth, the unemployment rate, and inflation across FOMC participants, as well as the policy paths that individual participants view as appropriate in achieving those projections. The latest SEP was released on March 19, 2025.

[7] Federal Open Market Committee (2018).

this to be a cautionary tale. It meant that the Committee was planning to react differently to incoming data than it had in the past. In particular, it was reacting much less to tightness in the labor market as summarized by the undershoot of unemployment from its estimate of the natural rate of unemployment, U^*, than it had in the past.

I believe that framing an internal policy discussion like this at the four SEP meetings would help participants have a better understanding of what their SEP submissions imply about the Committee's reaction function. The Committee could go a step further and ask FOMC participants to submit two sets of projections, one based on their current view of appropriate policy, as is currently done, and one based on a benchmark policy rule. In this exercise, it is less important what particular rule is chosen than the fact that it would force some consistency across the forecasts. Committee participants would get a better sense of the assumptions each colleague was making about the underlying economic dynamics in constructing their forecast.

In addition, if the prescriptions from a set of rules applied to different forecasts were given more emphasis in internal deliberations, it would help illuminate for participants the type of variation one could expect in the policy path if the economy were to evolve differently than the modal forecast. Putting too much weight on a particular forecast can lead to policy mistakes. Looking at various scenarios and the variation in policy prescriptions across these scenarios helps to mitigate this risk, and the Tealbook includes alternative scenarios. It is particularly useful to analyze these alternatives when the level of uncertainty is high and there are several plausible scenarios that are nearly equally likely. Arguably, during the pandemic, the FOMC put too much weight on the scenario in which inflation driven by supply-side shocks would prove to be transitory rather than the alternative scenario in which demand-side accommodation was also an important contributor to persistent high inflation.[8,9]

Had FOMC meeting deliberations routinely included a discussion comparing proposed policy paths with prescriptions from rules, the discussion would have highlighted that policy was increasingly deviating from the Taylor principle. While it is not clear that having this insight would have changed Fed policy decisions, we cannot rule out that it might have resulted in the FOMC's moving rates up sooner. Policy tightening may have been able to be more gradual, which would have posed less risk of financial instability of the kind we saw in March 2023.

Rules and Monetary Policy Communications

Let me turn now to external communications. The benefits of clear communication and systematic 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.[10] When monetary policymakers set policy in a systematic way and clearly communicate this, their actions are more predictable. This predictability enhances the transmission of monetary policy to longer-term interest rates. Lower policy uncertainty reduces term premia and better aligns longer-term interest rates to the expected path of short-term rates. The public gets a better sense of how monetary policy is likely to change as economic conditions evolve and with such knowledge, households and firms can plan better; they can make better saving, borrowing, investment, and employment decisions.

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[8] Wieland and Hegemann (2025) have shown that as inflation surged in 2021, both the Fed and the European Central Bank deviated from the Taylor principle, which had characterized their past behavior.

[9] Analysis in a report published by the Group of 30 indicates that four benchmark policy rules called for the Fed to move rates up about a year before the FOMC acted in 2022. See Group of 30 Working Group on the 2025 Federal Reserve Monetary Policy Framework Review (2025).

[10] Many policymakers and academics have written about the benefits of systematic policymaking. See, e.g., Lacker and Plosser (2024).

In addition, when the public understands the usual strategy for setting policy, it will understand the policymaker's reasons for deviating from that approach in extreme circumstances, such as the Global Financial Crisis or pandemic, and those deviations will be more successful. Instead of limiting options, being consistent and communicating the rationale for decisions can expand policy options.

Of course, the communications challenge for monetary policymakers is to give the public a good sense of the usual reaction function: 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. It would not be a large leap to start using the prescriptions from the policy rules published in the Fed's monetary policy report as a reference point in policy communications. They would provide a good illustration of conditionality and better link up the changes in economic conditions to changes in policy. When actual policy differs from the prescription from the rules, policymakers would explain why.

In an uncertain environment, more communication is better than less. But it often seems that in uncertain times policymakers want to explain less because the uncertainty around the outlook and the risks make them fear being locked in or being perceived as making promises they may not want to keep. 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 FOMC statement. At my last meeting in June 2024, there were only 295 words. Research by McMahon and Naylor (2023) indicates that shorter does not necessarily mean more easily understood by regular people.[11] Others, including the media and Fed commentators, will fill the void in communications with their own interpretations, which may differ from what policymakers intended.[12] I think it is better for policymakers to take control of the narrative.

[11] See McMahon and Naylor (2023).

[12] See Mester (2024).

If policy communications routinely included a discussion of a consistent set of data that inform the outlook, the policymaker's outlook and risks around the outlook, some alternative ways the economy might evolve, and how the policymaker plans to balance the risks to its dual mandate goals, the public would have a better sense of what "data dependent" means. These communications should not be technical. Instead, they should strive to convey complex ideas in an accessible manner, without jargon, as the recent research by McMahon and Naylor suggests can be done.[13]

Finally, we live in a time of rising public skepticism about "experts" and declining public trust in institutions. Probably the number one way an institution can build trust is to be excellent at what it does; that is, to reach the goals that it has been charged to achieve. That means having a very well-qualified staff and making decisions informed by the best information and analysis available. But regardless of how good the policymaking foundation is, we have to recognize that a high degree of economic uncertainty often clouds the outlook and increases the number of plausible scenarios that could play out, raising the risk that even the best formulated decisions do not produce the intended results.

A central bank needs to constantly build its credibility with the public. It can do so by explaining its policy goals; taking a consistent approach to policy decisions rather than a discretionary one; communicating in a transparent way so that the general public understands the rationale for its decisions; and holding itself accountable, taking ownership of any deficiencies and making improvements to its policy strategy. In other words, practicing disciplined judgment when setting monetary policy. In an uncertain world, economic conditions can evolve in an unexpected way that requires a change in policy. If the public understands the reason for the change, it will be less likely to interpret the change as evidence that the past policy stance was in error or that the institution is succumbing to outside influences. Instead, the public would understand that if there is a material change in the economy, it is appropriate for

[13] McMahon and Naylor (2023).

monetary policy to evolve, too. This is a simple concept, but one that is worth explaining to the public because as much as one may wish it to be true, merely saying “trust me” is not good monetary policy communication.

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