



Making Monetary Policy Transparent

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The monetary arrangements of the United States, created and managed by the Federal Open Market Committee (FOMC), are fragile. The behavior of the FOMC influences the economy, and the behavior of the economy influences the FOMC. The problem is that the FOMC does not provide a framework that distinguishes the one-way causation running from its behavior to the behavior of the economy. It does not make forecasts showing how its behavior will affect the economy in a form that can be falsified ex post. Consequently, it is difficult to distinguish the effects of FOMC actions from the effects of external shocks. Such explicitness would require a conceptually simple model of the economy.

As a result, the FOMC does not transparently articulate its monetary standard—the rule that connects its policy actions to its objectives—and therefore cannot be held accountable for mistaken policy. The language of discretion used by the FOMC is merely a promise that it will act to stabilize the economy. The FOMC needs to be challenged to become more transparent about the nature of the monetary standard it has created. Such transparency is necessary if Congress, financial markets, and the public are to hold the FOMC accountable for whether its procedures stabilize the economy and prices or instead destabilize it and create inflation. The policy implication is that the FOMC should state the rule that constrains its individual policy actions so that mistakes can be identified ex post rather than explained away as external shocks.

The argument in this paper proceeds in three steps. First, it considers the nature of the monetary standard created by the FOMC and the role of its reaction function—that is, how the FOMC responds to incoming information about the economy. Second, it uses the pandemic and its aftermath to test whether inflation is best understood as a monetary or nonmonetary phenomenon. Third, it argues that the Fed can be made accountable only if it transparently states the rule that constrains its individual policy actions.

What Is the Nature of the Monetary Standard the FOMC Has Created?

This section asks what kind of monetary standard is implied by the FOMC's own statements and communications. It starts with the distinction between commercial banks and the Federal Reserve System, which is a central bank; turns to the FOMC's shift from the 2012 preemptive inflation control consensus toward the 2020 framework that treats maximum employment as a goal independent of price stability; and then asks whether the FOMC's meeting-by-meeting explanations make that standard transparent enough for accountability.

Central banks and the source of inflation

The place to start in addressing the question of the monetary standard created by the FOMC is to ask what is unique about a central bank like the Federal Reserve System. A commercial bank must attract deposits to obtain the resources the public has made available by refraining from consumption and enabling the bank to extend credit to firms that can put those resources to productive use. In contrast, a central bank can create bank deposits—that is, money—through open-market operations, a costless bookkeeping process. Over the centuries, an association has existed between a country's monetary arrangements, especially its procedures for controlling money creation, and the behavior of prices. A good question to start with when trying to understand the nature of a central bank is, What is the direction of causation between money creation and inflation? In other words, is inflation a monetary or a nonmonetary phenomenon? Does price stability require procedures that control money creation? Alternatively, do real shocks—that is, changes in relative prices—drive inflation, so that controlling inflation requires a real response in the form of increases in employment? If so, such control is summarized in the behavior of the Phillips curve, which models an inverse relationship between unemployment and inflation.

Monetary policy during the COVID-19 pandemic and its aftermath offers an important laboratory for sorting out these issues. This review does not ask whether the FOMC set the funds rate appropriately in light of what is now known. Instead, the idea in this paper is to summarize the FOMC's strategic plan as embodied in the consistency in its behavior—its implicit rule—and then to examine how changes in that behavior provide a natural experiment for sorting out the relevant issues. The FOMC's routine communications accompanying announcements of its policy decisions are of little help. More useful, however, is that on two occasions the FOMC explicitly sought to shape financial markets' understanding of how the FOMC would respond to incoming information about the economy—in other words, understanding of the FOMC's reaction function.

The FOMC's shift from preemptive inflation control (2012) to a Phillips curve framework (2020)

The FOMC's systematic response to new incoming information is important because there is no structural model of the economy that can identify the impact on the economy of a single policy

action such as a change in the funds rate. The goal must therefore be to identify a reaction function that explains how the FOMC responds to incoming economic information and how and when that reaction function changes. Given a conceptually simple model, one can then evaluate the success or failure of the FOMC's strategy for achieving its objectives by examining the resulting changes in the economy's behavior. The 2012 consensus document, "Statement on Longer-Run Goals and Monetary Policy Strategy,"¹ and its 2020 revision are central in this regard.

In the spirit of economist Milton Friedman's exposition² of how the price system determines the unique values of real variables—their "natural" values—the 2012 statement included the following language:

The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. . . . The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market. These factors may change over time and may not be directly measurable. Consequently, it would not be appropriate to specify a fixed goal for employment.³

In 2012, FOMC Chairman Ben Bernanke wanted to renew quantitative easing (QE) while some FOMC participants wanted to ensure that QE would not result in inflation. The FOMC consensus provided that assurance by implicitly reaffirming the Volcker–Greenspan practice of preemptive increases in the funds rate to prevent the emergence of inflation, a practice known as "lean against the wind" (LAW). That commitment was implied by the FOMC's rejection of the idea that maximum employment is a target independent of stable prices. The 2012 consensus statement ruled out any attempt to exploit a Phillips curve relationship.

In contrast, the 2020 consensus statement, as summarized in an August 27 press release from the Board of Governors of the Federal Reserve System, included language establishing maximum employment (low unemployment) as a goal independent of stable prices:

"The economy is always evolving, and the FOMC's strategy for achieving its goals must adapt to meet the new challenges that arise," said Federal Reserve Chairman Jerome H. Powell. "Our revised statement reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities, and that a robust job market can be sustained without causing an unwelcome increase in inflation." . . .

On maximum employment, the FOMC emphasized that maximum employment is a broad-based and inclusive goal and reports that its policy decision will be informed by its "assessments of the *shortfalls* of employment from its maximum level." The original document referred to "*deviations* from its maximum level."

On price stability, the FOMC adjusted its strategy for achieving its longer-run inflation goal of 2 percent by noting that it “seeks to achieve inflation that averages 2 percent over time.” To this end, the revised statement states that “following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time.”⁴

Although convoluted, the revised statement informed financial markets that the FOMC would no longer engage in preemptive increases in the funds rate to prevent the emergence of inflation. Instead, the FOMC would treat price stability and maximum employment as two independent goals related by a Phillips curve. Monetary policy would focus on moving the economy along a Phillips curve until inflation rose by some unspecified amount above 2 percent.

In January 2021, Powell expressed the belief that monetary policy could be highly stimulative without causing inflation:

We have a flat Phillips curve, meaning there’s still a small connection [between slack in the labor market and inflation] but you need a microscope to find it. We’ve also got low persistence of inflation, so that if inflation were to go up for any reason it . . . doesn’t stay up. . . . Remember, we’re a long way from maximum employment. There’s plenty of slack in the labor market.⁵

Powell was generalizing from the experience of the recovery from the 2008–2009 Great Recession. In doing so, he ignored the fact that unemployment and inflation would be unrelated if monetary policy stabilized inflation and allowed the price system to determine real variables. Powell’s assumption that monetary policy could manipulate a Phillips-curve relationship to produce a controlled increase in inflation did not work in practice. In the second quarter of 2022, headline personal consumption expenditures (PCE) inflation reached 6.9 percent, with core PCE inflation at 5.3 percent. Powell, however, dismissed any role for monetary policy in pandemic inflation.

Senior economist at Monetary Policy Analytics Kevin Burgett reported on Powell’s comments at the press conference after the April 2026 FOMC meeting:

Today, Powell simply reiterated his very different view: “I don’t think that anything that happened to create the global pandemic inflation was in any way related to overweighting the employment market. It was a global shock that happened essentially, very, very similarly, all over the world that had to do with closing, reopening, stimulus, and all that.”⁶

Powell, however, ignored the similarity of the monetary policies implemented by other central banks. In a 2023 assessment of the Bank of England’s monetary policy strategy, British monetary economist John Greenwood wrote, “Excessive money creation during the COVID pandemic has resulted in Britain’s worst episode of inflation since 1990–91.”⁷

A competing explanation to Chair Powell's places the emphasis on QE and money creation rather than global shocks. Kevin Warsh, the current FOMC chair, blamed QE for the inflation. QE does lead to direct money creation through banks' creation of deposits. In a 2025 interview, Warsh said the following:

[I]n the runup of the great inflation around the time of the COVID crisis, we saw a surge of money. . . . Because you have higher inflation caused by the bigger balance sheet, we want to shrink that. . . . We should be shrinking the Central Bank balance sheet, taking the Fed out of these markets unless and until there's a crisis. And in so doing, you'd have less inflation that way. You might call it practical monetarism.⁸

Does Warsh's "practical monetarism" offer an explanation for inflation superior to Powell's Phillips curve view? Unfortunately, the FOMC offers no guidelines for exploring this central issue. It does not offer a general framework for understanding the behavior of inflation supported by analysis of the historical relationship between inflation and monetary policy. Nowhere does the FOMC articulate the character of the optimal monetary standard and defend it by identifying past standards that have stabilized or destabilized the economy.

Why the Fed needs an explicit rule

But does not the FOMC already adequately explain its decisions? Consider the spirit of FOMC communication as inferred from Chair Powell's post-FOMC-meeting press conferences. The FOMC proceeds meeting by meeting, evaluating whether stable prices or maximum employment is the more pressing concern. It then adjusts the funds rate in a commonsense way, raising or lowering it to address that concern. How informative is the FOMC's narrative in characterizing the nature of the monetary standard it has established? The narrative addresses concerns of financial markets and the needs of newspaper reporters by offering information about the likely behavior of the funds rate and short-term interest rates. The relevant question is whether it makes monetary policy transparent in a way that holds the FOMC accountable for how well it achieves its congressionally mandated objectives.

To answer this question, the FOMC would need to explain how its decisions influence the behavior of households and firms in ways that meet FOMC objectives. An immediate puzzle arises from the need to address Milton Friedman's critique of discretionary monetary policy.⁹ Given the existence of long and variable lags, how can the FOMC predict the effect on the economy of an individual policy action? It cannot. A single funds-rate decision cannot be evaluated in isolation. What matters is the FOMC's reaction function: the rule markets expect it to follow as new information arrives. That rule shapes expectations about future interest rates, inflation, and economic activity. A more technical account of this transmission mechanism is explained below.

Modern macroeconomic dynamic stochastic general equilibrium (DSGE) models address the question of how monetary policy is transmitted by explaining how the FOMC's reaction function interacts with the structure of the economy, which in turn shapes public expectations about how the FOMC will respond in the future to new information about the economy. A model makes clear how the reaction function of the FOMC—its rule—shapes expectations, and how those expectations serve as a coordinating mechanism that makes the collective behavior of households and firms consistent with FOMC objectives.

For example, during a recession, the real yield curve must fall so that real aggregate demand rises—that is, so that saving falls—to keep it equal to potential real output, or full employment. To prevent inflation premia (extra yields demanded as compensation for expected inflation) from emerging in the yield curve, however, financial markets must believe that the FOMC will raise the funds rate in the future to prevent inflation—that is, it will raise the funds rate preemptively. In general, a conceptually simple model of the economy, with a reaction function that captures the character of monetary policy, is required to explain how monetary policy shapes the behavior of households and firms. Specifically, the funds rate, together with the yield curve, represents the intertemporal price of consumption—the relative price of current consumption in terms of future consumption—which equates supply and demand. In the contemporaneous period, supply is the full employment of resources. The yield curve then varies to adjust intertemporal demand so that it equals the full-employment supply.

In the FOMC's media-friendly narrative, the FOMC is *the* price system. The funds rate is a throttle, with pushes loosening policy and pulls making it tight. Why do FOMC spokespersons and their supporting economists not use the model-based framework required to discuss how the behavior of the price system coordinates the behavior of the public in a desirable way? One possibility is that the FOMC wants monetary policy to appear to be the *sine qua non* for stabilizing both prices and unemployment. A model for the FOMC to follow, in the spirit of economists Marvin Goodfriend and Robert King's neoclassical synthesis,¹⁰ would provide a stable nominal anchor and then pursue a LAW policy that allows the price system to control real variables by causing the funds rate to track the natural rate of interest, the rate that allows the price system to determine real output and employment without creating inflation. In such a model, employment is not an objective independent of inflation but rather an information variable. Its behavior indicates whether the funds rate needs to rise when the economy is growing unsustainably fast and, conversely, whether it needs to fall when the economy is growing unsustainably slowly. The FOMC is stabilizing the economy's rate of resource utilization rather than moving it around to exploit Phillips curve tradeoffs. Such a model of the optimal monetary standard, however, would never placate the FOMC's critics, who want the FOMC to target a socially desirable low rate of unemployment. The pandemic period provides a test of whether the FOMC's monetary standard was consistent with price stability or with a Phillips-curve effort to trade inflation for employment.

Causation Between Money Creation and Inflation: The Pandemic Test

To use the pandemic period as evidence, one must first specify what evidence would distinguish monetary from nonmonetary inflation. This section therefore begins with the rule required to provide for price stability if inflation is monetary, reviews why earlier monetarist and Keynesian approaches failed to provide a satisfactory test, and then explains why QE must be evaluated by whether the funds rate tracked the natural rate of interest.

The search for a model of inflation causation

If one assumes that inflation is a monetary phenomenon, it follows that to ensure price stability the FOMC must follow a rule that controls money creation. Specifically, because the FOMC's operating target is a short-term interest rate, and because money is therefore demand-determined by the public through banks' money creation, the rule must discipline money demand so that it is consistent with the expectation of price stability. The FOMC cannot disturb that expectation through incompatible, independent money creation. Such disturbances occur when FOMC procedures interfere with the price system by preventing the funds rate from tracking the natural rate of interest, which stabilizes the economy's rate of resource utilization. Such money creation, resulting from the monetization of an excess supply of bonds that arises when the funds rate is held below the natural rate of interest, is the counterpart of macroeconomic price fixing.

In practice, the rule should stabilize the inflation expectations built into firms' price setting for multiple periods—the “sticky price” sector—and should prescribe operating procedures that cause the funds rate to track the natural rate of interest.¹¹ The issue of whether inflation is monetary or nonmonetary lay at the heart of the monetarist–Keynesian debate of the 1970s. But neither side had a satisfactory model to organize a discussion of causation that could then be taken to the data for support or refutation. Keynesians accused monetarists of having only a “black box.” The Keynesian answer in the 1960s was the use of large-scale econometric models organized around a Phillips curve. Such models, however, failed to predict the breakdown in the forecasted unemployment–inflation tradeoffs of the 1970s.

The monetarists had the equation of exchange. Starting in the early 1980s, however, the monetary aggregates, M1 and M2, failed to predict the economy's short-term behavior. The failure arose when the cost of transferring funds between bank deposits and money market instruments began to decline in the early 1980s. Such transfers occurred because banks were slow to adjust the interest rates they paid on their deposits as money market interest rates changed. The behavior of the measured monetary aggregates then became countercyclical rather than procyclical, offering a misleading guide for setting the funds rate. That is, a weak economy and low money market interest rates caused funds to be transferred to bank deposits, thereby increasing money growth.

Monetarists offered no clear reason for treating money as exogenous within an equation-of-exchange framework in which the interest rate is the FOMC's policy variable. They lacked a model of the economy. Such a model had to be forward looking because the public holds money on the assumption that it will retain value in the future. Also, financial markets adjust the yield curve on the basis of economic forecasts and the FOMC's reaction function. DSGE models contain forward-looking agents, but the class is too general to clarify the nature of inflation. For example, economists Olivier Blanchard and Jordi Galí, in a 2007 paper, note that markup-driven inflation implies that price stability can be achieved only with periodically engineered increases in the unemployment rate.¹² The requirement that monetary policy be organized around Phillips curve tradeoffs then necessitates overriding the operation of the price system.

In contrast, Goodfriend and King's neoclassical synthesis has no inflation–unemployment tradeoffs.¹³ Blanchard and Galí termed this result “divine coincidence.” With divine coincidence, the optimal monetary policy is one of price stability, which leaves the determination of real variables—output and employment—to the unfettered operation of the price system's stabilizing properties.

The remainder of this paper addresses whether a model in the Goodfriend-King spirit offers a useful explanation for the inflation of the pandemic period and its subsidence without a recession.¹⁴ Why is this result different from the experience of the 1970s, when inflation was rising secularly?

QE and the natural rate of interest

Before examining the pandemic and its aftermath, it is important to understand the link between QE and the FOMC's procedures for implementing monetary policy that make the funds rate track the natural rate of interest. QE involves open-market purchases of long-term securities, replacing those securities in the public's asset portfolio with bank deposits and thereby making the portfolio more liquid. To rebalance the portfolio, individuals buy long-term illiquid assets such as equities, houses, and consumer durables, which makes monetary policy expansionary.¹⁵ With QE, the funds rate must rise to maintain equality with the natural rate of interest.

Initially, in fall 2008 and during the subsequent recovery from the 2008–2009 recession, the natural rate of interest was negative.¹⁶ When the economy recovered, the FOMC, under FOMC chair Janet Yellen, began raising the funds rate, with the initial increase occurring in December 2015. Weakness in the world economy delayed a sustained increase in the funds rate until December 2016. The initiation of a sustained recovery signaled a positive natural rate of interest. The preemptive increase in the funds rate by the Yellen FOMC, undertaken in the Volcker–Greenspan spirit, maintained the inflation rate in the prepandemic period at about 1.5 percent, a rate consistent with price stability properly measured. The situation was very different during the pandemic, when the FOMC began QE on a massive scale, combined with Odyssean forward guidance, which committed the FOMC to maintaining a zero funds rate until unemployment fell at least to its prepandemic level of 3.5 percent. Unlike the QE of the earlier period, the pandemic QE was not offset by

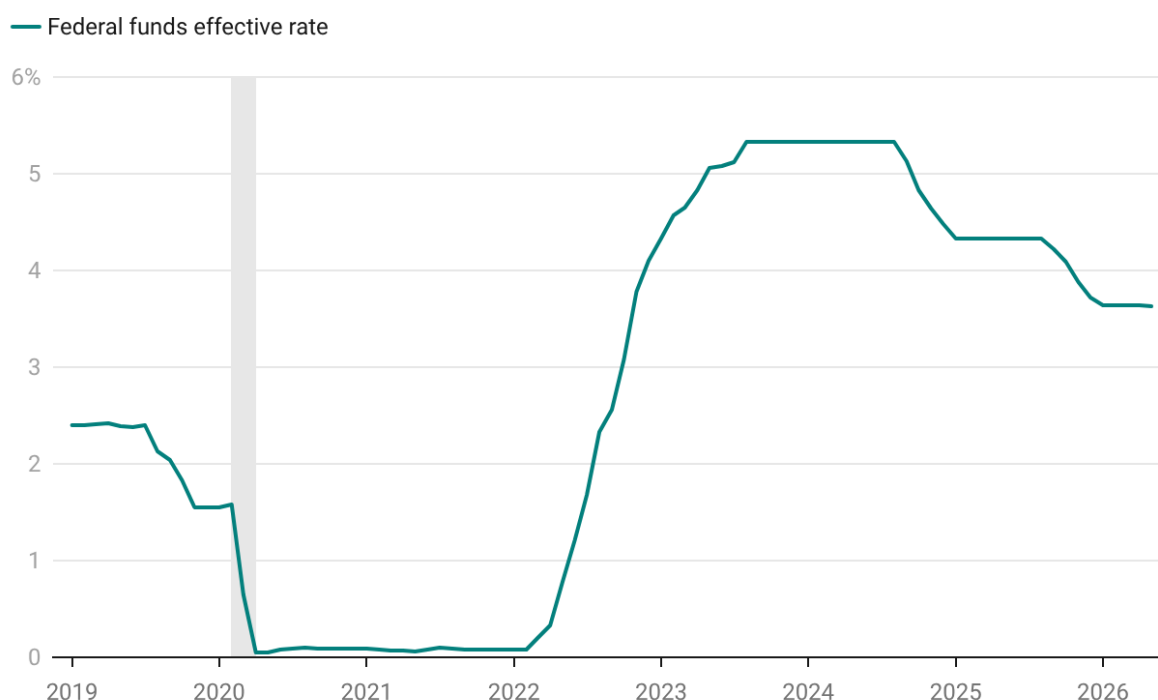
an increase in the funds rate, resulting in money creation similar in kind but not in magnitude to that in countries that had experienced hyperinflation.

A Graphical Overview: Evidence from the Pandemic and Its Aftermath

The following discussion examines the pandemic monetary policy and the policy that followed it using as a benchmark for the optimal monetary policy lean-against-the-wind with preemptive changes in the funds rate to maintain price stability. The figures provide the relevant information on the behavior of monetary policy and the economy.

Figure 1 shows the behavior of the funds rate. Out of concern for the possible impact of a weak world economy on the domestic economy, the Powell FOMC lowered the funds rate from 2.4 percent in July 2019 to 1.6 percent in February 2020. In March 2020, the FOMC lowered the funds rate to near zero and began to raise it in March 2022. The funds rate peaked at 5.3 percent in August 2023. The FOMC began lowering it again in August 2024, allowing it to fall to 4.3 percent by January 2025, and began lowering the rate again in August 2025, until it reached 3.6 percent in January 2026.

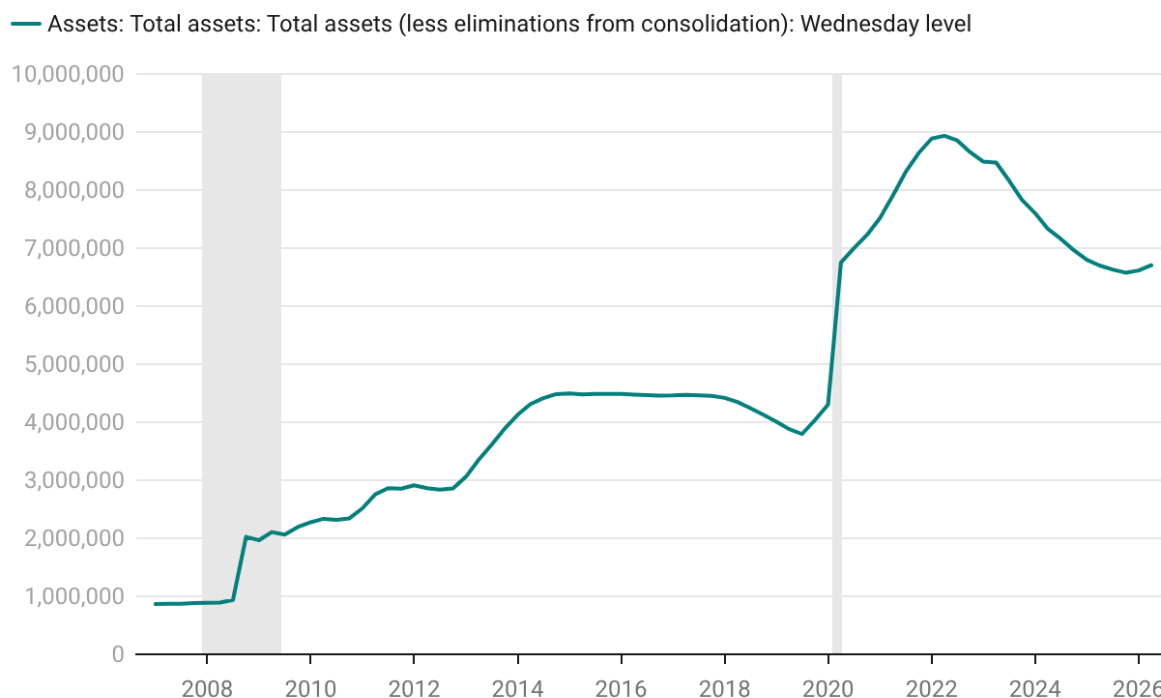
FIGURE 1. Federal funds effective rate, 2019–26



Source: Board of Governors of the Federal Reserve System (US), "Federal Funds Effective Rate [FEDFUNDS]," retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/FEDFUNDS>.

Note: Shaded area indicates US recession.

FIGURE 2. Total assets in the Fed’s portfolio, 2008–26 (US \$ millions)



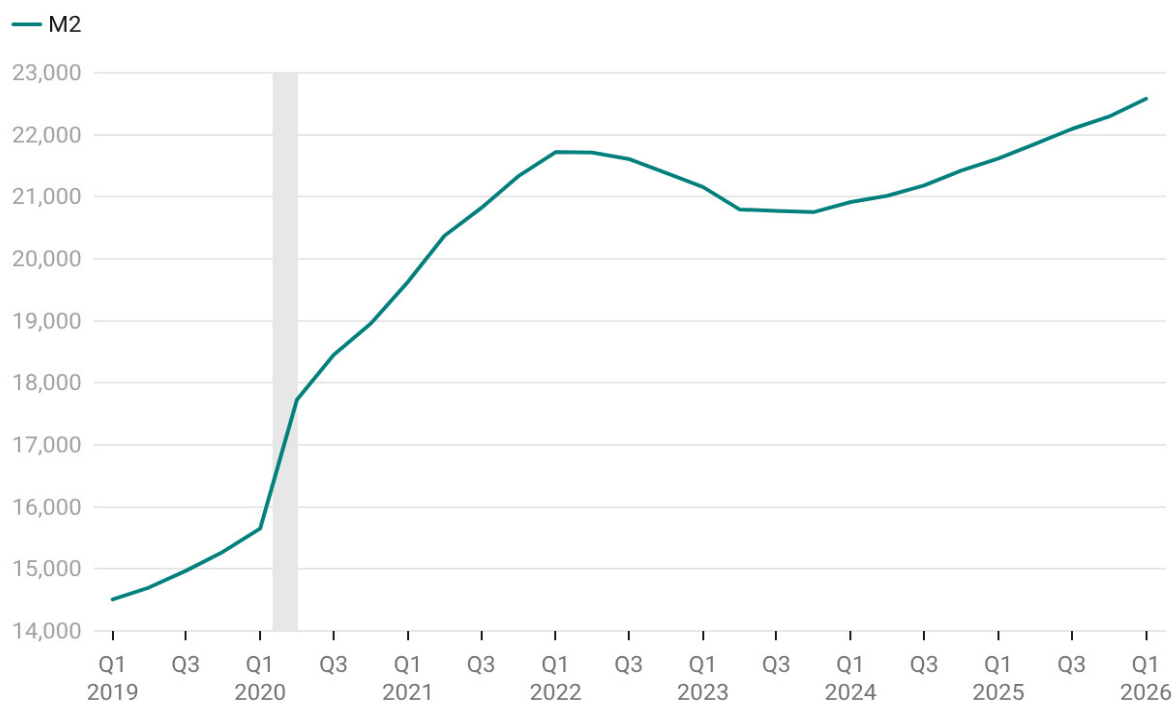
Source: Board of Governors of the Federal Reserve System (US), “Assets: Total Assets: Total Assets (Less Eliminations from Consolidation): Wednesday Level [WALCL],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/WALCL>.

Note: Shaded areas indicate US recessions.

Figure 2 shows the amount of assets in the Fed’s portfolio. In December 2007, assets amounted to \$0.9 trillion, with currency only slightly lower at \$0.8 trillion. That is, currency constituted the great majority of the monetary base. The QE prompted by the 2008–2009 Great Recession raised Fed assets to \$4.5 trillion in the fourth quarter of 2014. The subsequent QE prompted by the pandemic raised Fed assets from \$4.3 trillion in the first quarter of 2020 to \$6.8 trillion in the second quarter of 2020 and then to \$8.9 trillion in the second quarter of 2022. The resulting money creation raised M2 (figure 3). From the first quarter of 2020 to the second quarter of 2022, M2 increased by \$5.1 trillion, while assets in the Fed’s portfolio increased by \$4.6 trillion. The difference resulted from an increase in the currency supply of \$0.5 trillion, the demand for which was accommodated by the Fed.

As shown in figure 4, inflation rose with the increase in M2. With a four-quarter lag, inflation (four-quarter core PCE inflation) rose above its first quarter 2020 value of 1.6 percent to just less than 1.9 percent in the first quarter of 2021. It then rose to 5.3 percent in the second quarter of 2022 with headline inflation rising to 6.9 percent. This inflation behavior had all the hallmarks of a one-and-done “helicopter drop” of money, with the initial value of real M2 restored by inflation. Real M2

FIGURE 3. M2, 2019–26 (US \$ billions)



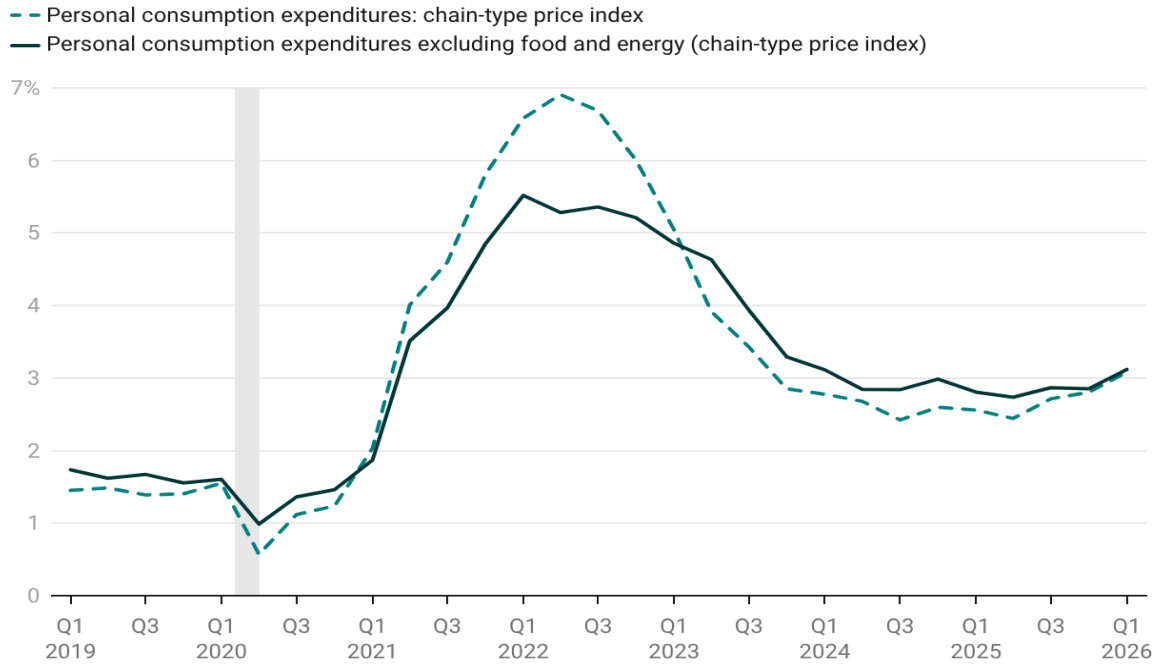
Source: Board of Governors of the Federal Reserve System (US), "M2 [M2SL]," retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/M2SL>.

Note: Shaded area indicates US recession.

balances (1982–84 dollars) increased from \$6.0 trillion in the first quarter of 2020 to \$7.7 trillion in the fourth quarter of 2021 before falling to 6.7\$ trillion in the fourth quarter of 2023 (figure 5). The somewhat higher figure for the fourth quarter of 2023 than for the first quarter of 2020 can be attributed to the secular increase in the demand for real money balances.

Figure 6 provides evidence that QE was inflationary, unlike the QE during the recovery from the 2008–2009 Great Recession. From the fourth quarter of 2020 to the second quarter of 2021, real final sales to private domestic purchasers (four-quarter changes) rose from near zero (–0.4 percent) to 16.3 percent, with the increase in real growth more than compensating for the prior negative growth. The rapid growth in real output is consistent with a positive natural rate of interest in DSGE models. Monetary policy was expansionary and ultimately inflationary because the FOMC kept the funds rate at the zero lower bound rather than letting it rise with the increase in the natural rate of interest, as it had done starting in December 2015. As shown in figure 6, over the interval between the second quarter of 2022 and the first quarter of 2026, at 2.7 percent, real final sales to private domestic purchasers (four-quarter changes) returned to a figure close to the average for the period between the second quarter of 2010 and the fourth quarter of 2019 of 2.9 percent.

FIGURE 4. Core and headline personal consumption expenditures inflation (4-quarter), 2019–26, % change from year ago



Source: US Bureau of Economic Analysis, “Personal Consumption Expenditures [PCE],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/PCE>; US Bureau of Economic Analysis, “Personal Consumption Expenditures Excluding Food and Energy (Chain-Type Price Index) [PCEPILFE],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/PCEPILFE>.

Note: Shaded area indicates US recession.

FIGURE 5. Real M2, 2019–26 (US \$ billions, 1982–84 dollars)

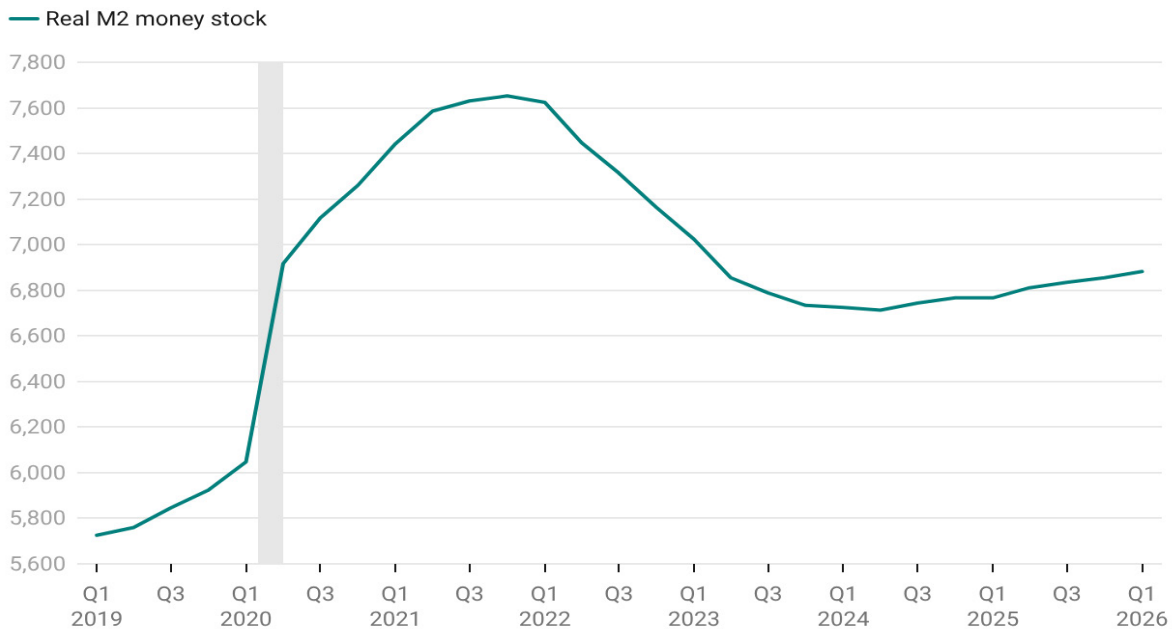
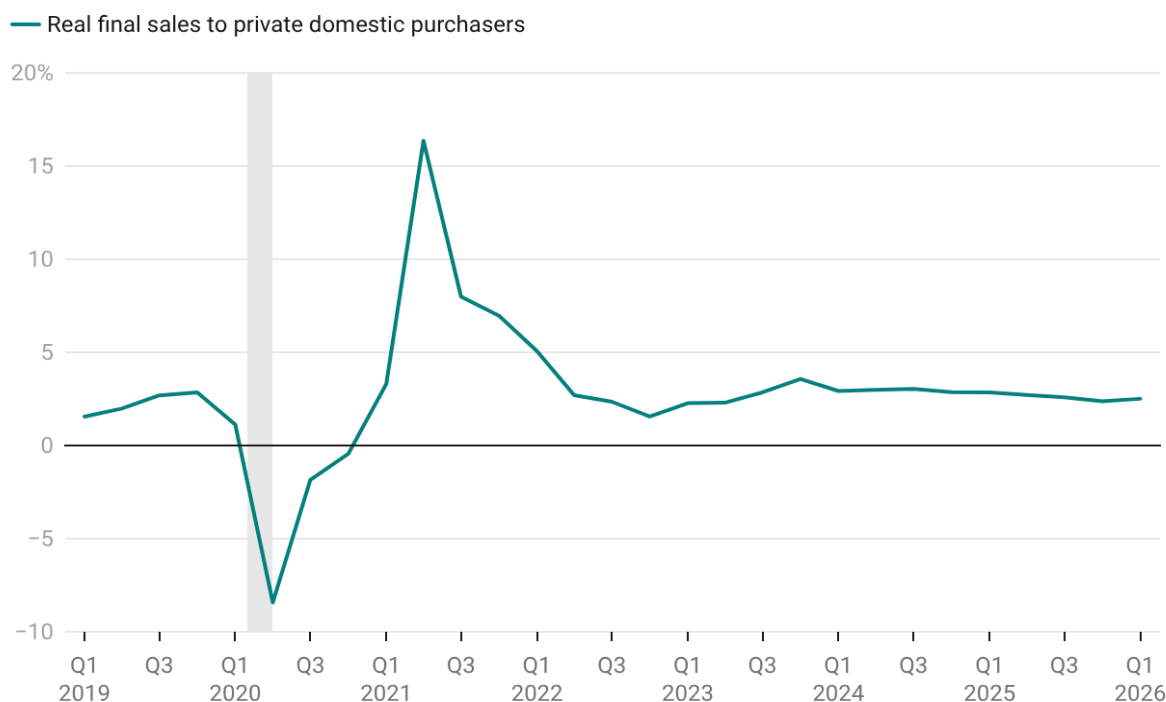


FIGURE 6. Real final sales to private domestic purchasers (4-quarter), 2019–26, % change from year ago

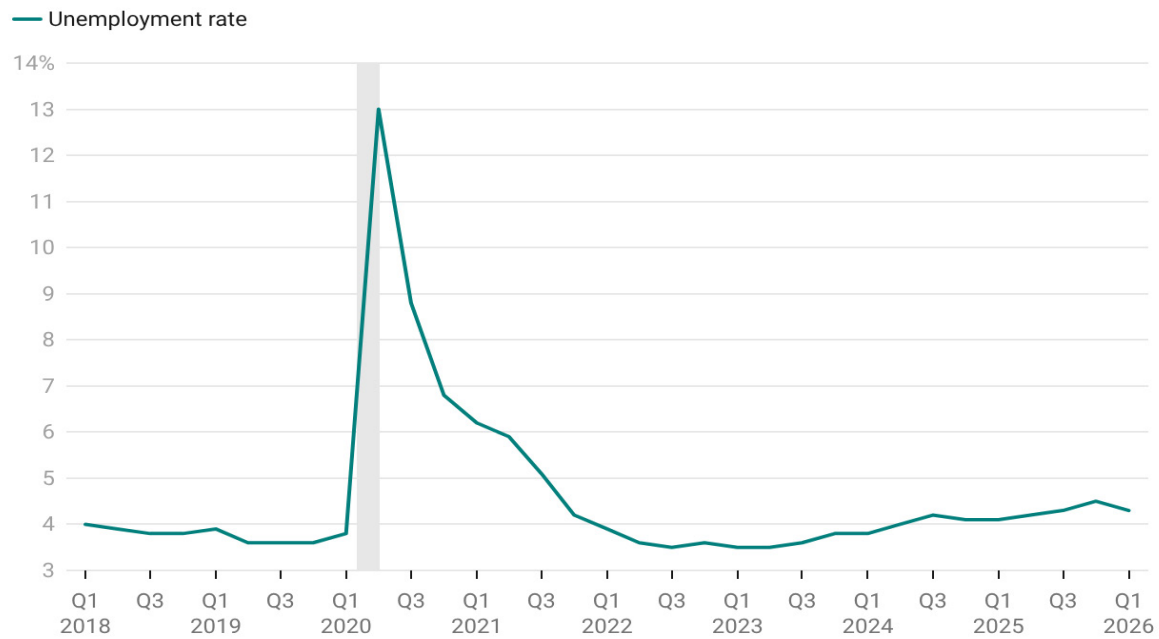


Source: US Bureau of Economic Analysis, “Real final sales to private domestic purchasers [PB0000031Q225SBEA],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/PB0000031Q225SBEA>.

Note: Shaded area indicates US recession.

After the second quarter of 2022, steady growth in real final sales to private domestic purchasers and a stable unemployment rate (figure 7) indicate that the economy returned to balanced growth after the FOMC ended QE in March 2022 and began to raise the funds rate. The key to understanding this is the credibility of the FOMC’s stabilizing rule. Core PCE inflation began to decline after the fourth quarter of 2022, as expected inflation returned to a lower, stable value. As shown in figure 8, expected inflation began to decline after the second quarter of 2022, as measured by the five-year breakeven inflation rate calculated using TIPS (Treasury Inflation-Protection Securities) yields. Figure 9 uses the market yield on constant-maturity Treasury securities as a measure of the stance of monetary policy. As shown, the 10-year yield began to rise in the fourth quarter of 2021 with communication that the FOMC would end QE and begin raising the funds rate. After reaching 4.5 percent in the fourth quarter of 2023, the 10-year bond rate stabilized close to that level. The stability in real final sales to domestic purchasers (figure 6) and in core inflation (figure 4) indicates that financial markets expected the FOMC to pursue a stabilizing monetary policy in the future and set the yield curve accordingly.

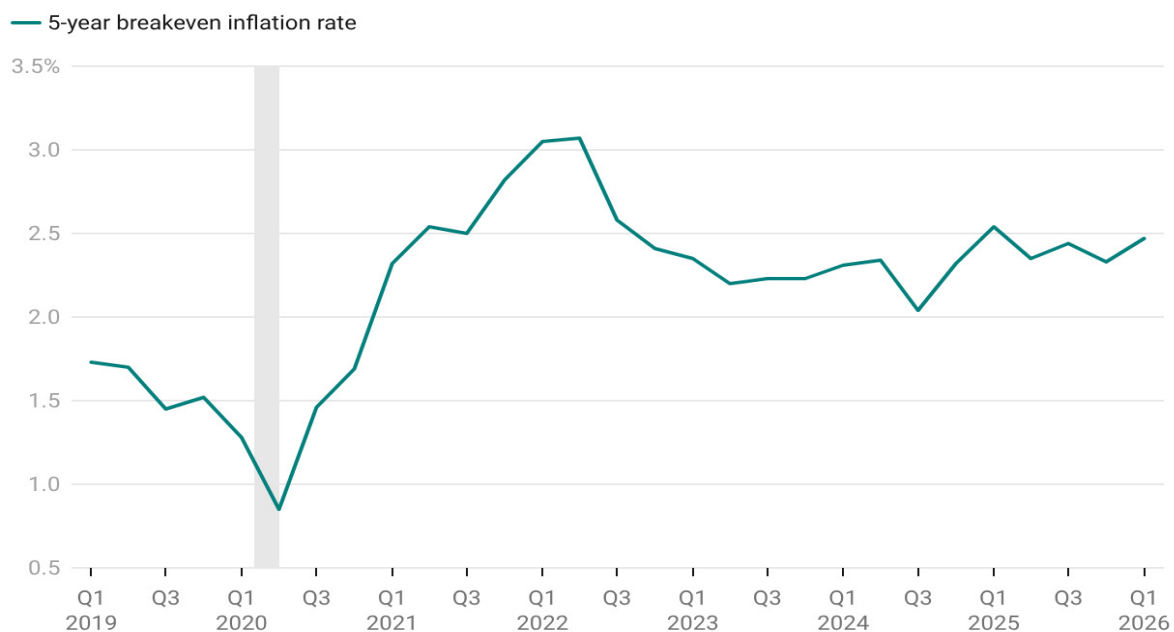
FIGURE 7. Unemployment rate, 2018–26



Source: US Bureau of Labor Statistics, “Unemployment Rate [UNRATE],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/UNRATE>.

Note: Shaded area indicates US recession.

FIGURE 8. Five-year breakeven inflation rate, 2019–26



Source: Federal Reserve Bank of St. Louis, “5-Year Breakeven Inflation Rate [T5YIE],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/T5YIE>.

Note: Shaded area indicates US recession.

FIGURE 9. Yield on 10-year Treasury securities (constant maturity), 2019–26



Source: Board of Governors of the Federal Reserve System (US), “Market Yield on US Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/DGS10>.

Note: Shaded area indicates US recession.

This interpretation is consistent with forward-looking models of monetary policy, in which expectations about the FOMC’s future rule matter as much as the current funds rate. Such an implication accords with economist Michael Woodford’s characterization of the transmission process for monetary policy in DSGE models. Woodford wrote:

Because the key decisionmakers in an economy are forward-looking, central banks affect the economy as much through their influence on *expectations* as through any direct, mechanical effects of central bank trading in the market for overnight cash. As a consequence, there is good reason for a central bank to commit itself to a systematic approach to policy, that not only provides an explicit framework for decision making within the bank, but that is also used to explain the bank’s decisions to the public. . . . [N]ot only do expectations about policy matter, but, at least under current conditions, very little *else* matters.¹⁷

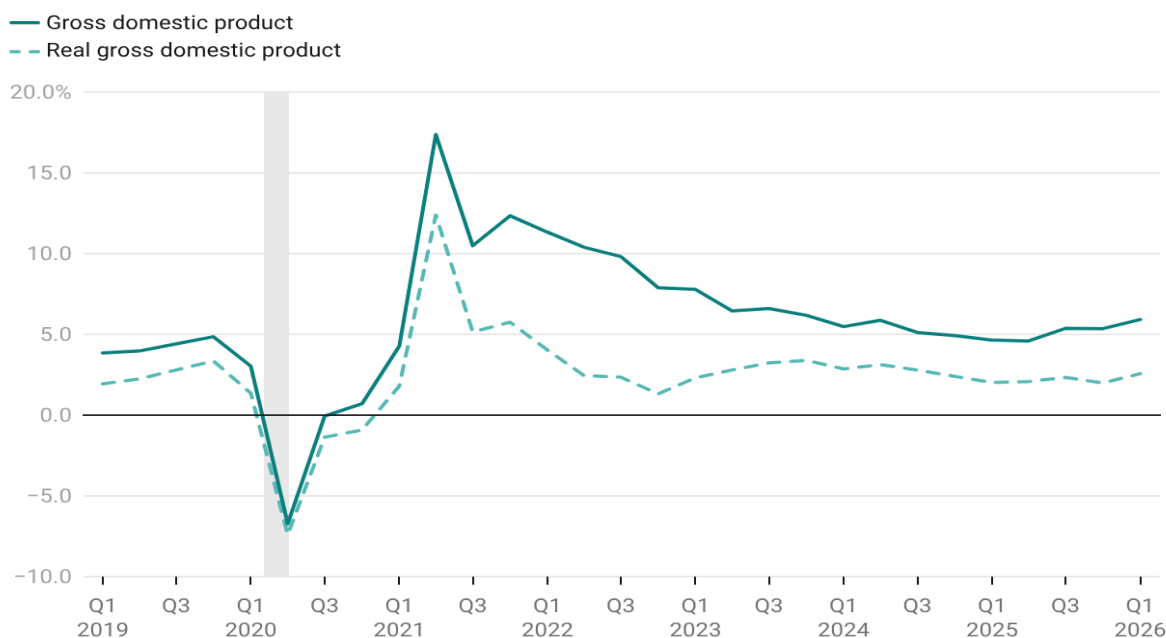
In their 2014 exposition of the New Keynesian DSGE model, economists Robert Barsky and his colleagues showed that the output gap, the difference between actual and natural output, “is the sum of all future real interest rate gaps, defined as deviations of the ex-ante real rate . . . from the

natural rate” [of interest]. They further state, “An interest rate path in which the actual real rate is always equal to the natural rate achieves both an output gap of zero (in the sense that output is at natural, i.e., flexible price equilibrium level) and zero inflation.”¹⁸ The contemporaneous term in the interest rate path is only one of many future expected values. Moving to an enduringly stable monetary standard would require the FOMC to make this stabilizing monetary policy rule explicit.

What Comes Next? Making the Fed’s Rule Explicit

Although the economy has returned to its prepandemic stability, it has done so with an apparent increase in underlying inflation of about a percentage point. Figure 8, showing expected inflation over the next five years, exhibits an increase from 1.5 percent in the fourth quarter of 2019 to 2.5 percent in the first quarter of 2026. Figure 10, which shows four-quarter percentage changes in nominal and real GDP, exhibits a difference in the series of 1 percentage point in the fourth quarter of 2019 and 3.3 percentage points in the first quarter of 2026. The April 2026 Federal Reserve Bank of New York Survey of Consumer Expectations reported an expected one-year-ahead inflation rate of 3.6 percent.¹⁹ At some point, monetary policy will have to tighten, but in a credible, measured way. Credibility would be enhanced by an explicit statement of the FOMC’s rule as lean-against-the-wind with preemptive changes in the funds rate. To provide such a statement,

FIGURE 10. Nominal and real GDP (4-quarter), 2019–26, % change from year ago, US \$ billions



Source: US Bureau of Economic Analysis, “Gross Domestic Product [GDP],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/GDP>; US Bureau of Economic Analysis, “Real Gross Domestic Product [GDPC1],” retrieved from FRED, Federal Reserve Bank of St. Louis, July 14, 2026, <https://fred.stlouisfed.org/series/GDPC1>.

Note: Shaded area indicates US recession.

the FOMC would have to return to the spirit of its 2012 consensus statement, making clear that the unemployment rate is an informational variable, not an independent objective.

What did the FOMC learn from its pandemic monetary policy and its policy during the aftermath? The question is difficult to answer for an institution that rarely identifies its own policy decisions as mistakes and therefore has limited incentive to revise its framework publicly. A fundamental change in culture would be for the FOMC to state the rule it follows that constrains individual policy actions at its meetings. It would then evaluate publicly over time how well the rule works

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Notes

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