

# **By Embracing Uncertainty and Accountability Monetary Policymakers Can Rebuild Credibility with the Public**

**Loretta J. Mester**

**Adjunct Professor of Finance, The Wharton School, University of Pennsylvania,  
Senior Scholar, Griswold Center for Economic Policy Studies, Princeton University,  
and Former Chief Executive Officer, Federal Reserve Bank of Cleveland**

**Remarks for the Panel Session “The Future of the Fed”**

**American Economic Association**

**Allied Social Sciences Associations Annual Meeting**

**Philadelphia, PA  
January 4, 2026**

## **Introduction**

The last few years have been challenging times for central banks and for all institutions. Public trust in institutions tends to fall quickly during a crisis, such as the Global Financial Crisis in 2008-2009 or the pandemic in 2020. And once trust declines, it takes time to rebuild.<sup>1</sup> In recent years, the public has lost confidence in the Federal Reserve and other central banks.<sup>2</sup>

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. Equally important, inflation moved up much faster and remained high for longer than many central banks anticipated. I was on the Federal Open Market Committee (FOMC) through this period. The evolution of our inflation forecasts over 2021 and 2022 showed that we kept revising up our forecasts, but inflation still came in higher than anticipated.<sup>3,4</sup>

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<sup>1</sup> Ehrmann (2024) and Bergbauer, et al. (2020).

<sup>2</sup> See the Gallup poll data discussed in Brennan (2024, 2025).

<sup>3</sup> Four times a year the FOMC releases the Summary of Economic Projections (SEP), which summarizes the individual FOMC policymakers' projections of real GDP growth, the unemployment rate, total PCE inflation, and core PCE inflation conditional on the path of monetary policy each participant sees as appropriate for promoting the FOMC's goals of price stability and maximum employment. 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, e.g., Federal Open Market Committee (2025b).

<sup>4</sup> The median of the FOMC's March 2021 forecasts showed inflation at 2.4 percent for the end of that year. FOMC

Contributing to the loss of credibility is the fact that people are still feeling the sting of higher prices even though the level of inflation has come down from its peak. While many people's wages increased over the past several years, their wages have not risen as much as prices by some measures. So people are not as well off as they were before the pandemic.<sup>5</sup>

The Fed's poor performance with respect to actual and forecasted inflation and the continued burden on households and businesses of the rise in inflation helps to explain part of the fall in the public's trust in the Fed. Given that credibility plays an important role in the effectiveness of monetary policy, it is important to consider what the Fed can do to rebuild trust.

I believe that if the Fed were to embrace economic uncertainty and accountability, rather than shrink from them, it would lead to improvements in the policymaking process and policy communications and help the Fed rebuild its credibility with the public.

### **Uncertainty and Accountability**

Uncertainty and accountability are interrelated. People prefer certainty but the world is an uncertain place. Several forms of uncertainty affect monetary policymaking.<sup>6</sup> There is data uncertainty. The U.S. statistical agencies have provided excellent service using best-practice techniques to gather large volumes of high-quality data on numerous aspects of the economy. But even the highest quality data are inevitably measured with some error and are subject to revision as more information is gathered.

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forecasts were revised up all year but inflation ended up even higher, at 5.8 percent. By March 2022, the median inflation forecast among Fed policymakers was 4.3 percent for the end of that year. Instead, inflation wound up being 6 percent.

<sup>5</sup> On average from 2021Q1 (when inflation started to take off) through 2025Q3, the CPI price index has risen 4.63 percent per year while average hourly earnings has risen less, at 4.48 percent per year. That is an average gap of 0.15 percent per year.

<sup>6</sup> Mester (2016) discusses uncertainty in monetary policymaking.

There is uncertainty about some of the structural aspects of the economy, including the natural rate of unemployment, potential output growth, structural productivity growth, and the equilibrium interest rate.

There is model uncertainty. Even if everyone agreed on one model of the economy, the parameters governing how economic agents interact with one another are estimated from the data and are not precisely known. The situation is even more complicated because economists do not agree on a single model or a single set of assumptions within a general class of models, and often, multiple models are consistent with the observable data.<sup>7</sup>

These types of uncertainty complicate tracking the evolution of the economy in real time, formulating an outlook, and determining appropriate monetary policy. As former Federal Reserve Chair Alan Greenspan pointed out: "... uncertainty is not just a pervasive feature of the monetary policy landscape; it is the defining characteristic of that landscape."<sup>8</sup>

The Fed is accountable to the public for its policy decisions made in the uncertain economic environment. Without that accountability the Fed will not be able to maintain its ability to set monetary policy focused solely on what it views as best to achieve maximum employment and price stability, independently of short-run political considerations. But Fed policymakers are not prescient – they do not know with certainty how the economy will evolve nor should they be held accountable for that. So the communications challenge for the Fed is to avoid overstating its knowledge and give the public a good sense of how policy is likely to respond *conditional* on how the economy evolves without implying that policy is pre-committed to a particular path *regardless* of how the economy evolves.

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<sup>7</sup> Manski (2011) calls different assumptions generating different projections "dueling certitudes." He posits a "Law of Decreasing Credibility: The credibility of inference decreases with the strength of the assumptions maintained." Strong assumptions can yield more definitive conclusions, but if the assumptions are questionable, then those definitive conclusions will be questionable as well.

<sup>8</sup> See Greenspan (2004).

## Recommendations

Accepting that uncertainty and accountability are essential parts of policymaking leads me to several recommendations to improve the monetary policy process and outcomes.

### **(1) Be more systematic in setting monetary policy**

First, the Fed could improve its performance and credibility if it were more consistent and systematic in setting monetary policy and less discretionary. Systematic policymaking does not mean strict adherence to a rule; judgment needs to be brought to bear since economic circumstances can differ over time. But incorporating rules more into monetary policy deliberations can help *discipline* the judgment and thereby help policymakers avoid large policy mistakes in an uncertain world.

Some argue against systematic policy because the world is uncertain. But in my view, in an uncertain world, consistency has value. Ironically, being systematic will give policymakers more flexibility, because market participants and the general public will better understand the Fed's reaction function. While policy needs to be flexible to respond to changes in economic and financial developments that inform the outlook, the response should be fairly predictable and not a surprise if those developments occur.

The post-pandemic high inflation episode is a case in point. As inflation rose in 2021, policy rules began indicating that Fed policy was moving further out of position. It took some time for the Fed to react to the increase in inflation.<sup>9</sup> As inflation and inflation expectations rose, real interest rates (ex post and ex ante) were falling and policy was getting further out of position.<sup>10</sup>

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<sup>9</sup> The initial release on January 28, 2022 of the December 2021 PCE inflation report, showed a year-over-year increase of 5.8 percent for total PCE inflation and 4.9 percent for core PCE inflation. Yet the FOMC did not increase the target range of the fed funds rate from 0 to  $\frac{1}{4}$  percent until March 2022. (The readings have since been revised up to 6.1 percent for total and 5.2 percent for core.)

<sup>10</sup> Wieland and Hegemann (2025) discuss both the Fed's and ECB's delay in raising policy rates in response to high inflation.

Had FOMC meeting deliberations routinely been framed around a comparison of proposed policy paths with prescriptions from rules, the discussion would have highlighted that policy was increasingly deviating from the Taylor principle. It is not clear that having this insight would have changed Fed policy decisions. But it might have led us to react sooner and we might have been able to avoid having to raise rates as forcefully as we did, which posed the risk of financial instability of the kind we saw in March 2023.

This is not to say that the FOMC does not look at policy rules. They are included in the Tealbook.<sup>11</sup> Yet rules and the potential deviations from the rules do not play a regular role in coordinating the FOMC discussion.

Rules could also be productively used in the SEP. Once the projections are in before the meeting, staff could provide the FOMC with an analysis of what type of policy rule would fit the SEP projections and compare that rule to the policy rule in the staff's Tealbook forecast.<sup>12</sup> The FOMC would get some insight into what their SEP submissions imply about the FOMC's reaction function.

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<sup>11</sup> 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. See, e.g., Board of Governors of the Federal Reserve System (2025).

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. See, e.g., Staff of the Board of Governors of the Federal Reserve System (2019).

<sup>12</sup> 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. 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 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. See Federal Open Market Committee (2018).

In addition, FOMC participants could be asked 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, which the FOMC would agree to use at the beginning of the year and around which policy deliberations could be focused. This 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 his or her forecast.<sup>13</sup>

Another useful step would be if at the beginning of each year, the FOMC agreed on and communicated a consensus on what they will be assuming for the potential growth rate, the natural rate of unemployment, and the neutral policy rate for that year as they set monetary policy. These structural aspects of the economy are measured with considerable error, but it would be better if the policymakers agreed on values at the start of the year rather than having them vary from meeting to meeting depending on which set of participants held the majority view at the particular meeting. These values would be a component of a consistent economic narrative and rationale for policy decisions.

These might be good steps to enable the development of an FOMC consensus forecast. This was attempted under Chair Ben Bernanke in 2012 and proved to be difficult.<sup>14,15</sup> But other central banks have been able to do it and the benefits in terms of communicating the Committee's outlook would be worth the effort.

## **(2) Incorporate scenarios into monetary policy deliberations and communications**

A second improvement driven by embracing uncertainty and accountability is incorporating scenario analysis more centrally into FOMC policy deliberations. The FOMC tends to focus on the modal outlook

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<sup>13</sup> See Mester (forthcoming).

<sup>14</sup> See the transcripts of the FOMC meetings from July-August, September, and October 2012. (Federal Open Market Committee, July 31-August 1, 2012; September 12-13, 2012; and October 23-24, 2012).

<sup>15</sup> Hetzel (2017) provides one proposal for how this might be implemented.

for the economy, with a discussion of risks to that outlook. But in times of uncertainty when the underlying structural aspects of the economy are potentially changing and the shocks hitting the economy are both on the demand and supply sides, as is the case today, alternative scenarios are plausible and could be nearly as probable as the modal outlook. A discussion of alternative scenarios and the associated appropriate policy could illuminate salient risks to the modal outlook and give the FOMC better insight into the implications of uncertainty for policy. Having had such discussions, the FOMC would be more nimble; they would be better prepared and less prone to delay action should the economy evolve more in line with one of these alternative scenarios. Policy would be kept better calibrated to how the economy was actually evolving.<sup>16</sup>

Scenario analysis would also help the Fed communicate the risks and uncertainty around their modal forecast and the future path of monetary policy.<sup>17</sup> The public would understand the contingent nature of policymaking -- that if certain risks are realized, policy may have to deviate from the previously communicated modal path. This understanding would raise the central bank's credibility in that a change in policy would not be viewed as a breach of promise.

The Bank of England has recently incorporated scenarios into their communications. Their November 2025 Monetary Policy Report included a section describing two alternative scenarios to the Bank's central projection.<sup>18</sup> The first scenario involved more inflation persistence and the second involved weaker demand. As indicated in the report, the scenarios included were based on those that were relevant to the

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<sup>16</sup> Consider the post-pandemic high inflation episode. As a Committee, we put too much weight on the modal outlook in which high inflation would be transitory because supply shocks would be transitory and too little weight on an alternative scenario in which inflation would be more persistent. It turned out that the usual prescription to look through supply shocks did not apply because even as supply began to normalize, aggregate demand was outpacing supply in an environment of very accommodative fiscal and monetary policy. Inflation would remain persistently elevated until monetary policy was recalibrated to reduce accommodation to moderate demand so that it came more into balance with supply.

<sup>17</sup> I discussed this recommendation in Mester (2023). Also, in his review of the Bank of England's forecasting and communications, Bernanke (2024) suggests including analyses of alternative scenarios in both internal discussions and as part of communications to the public.

<sup>18</sup> Bank of England (2025).

current policy discussion and not necessarily those viewed as the most likely alternatives. The report provides a brief summary of the scenario's assumptions, illustrates how the economy would evolve, the projected policy paths based on two policy rules, and compares the paths to the central projection. This is a promising way to communicate alternative ways the economy could evolve and the implications for monetary policy. Given that the Fed already includes alternative scenarios in its Tealbook, it would not be too much of a leap for the Fed to develop a similar type of communication.

**(3) Own the monetary policy narrative, proactively communicate, acknowledge policy errors and hold itself accountable**

My third recommendation is for the Fed to own the narrative, including communicating proactively about policy issues and holding itself accountable whenever there are policy errors. Research suggests that effective policy communication can enhance the general public's belief that the central bank will maintain price stability, and therefore its credibility.<sup>19</sup>

***(a) Control the narrative***

First, after each meeting policymakers should provide more narrative, describing their current assessment of economic developments, how those developments have influenced the outlook, the risks to that outlook, other plausible ways the economy could evolve, and the implications for monetary policy.<sup>20</sup>

This Fed is not doing this now. FOMC post-meeting statements have become very short.<sup>21</sup> Relying on catch phrases is not enough. Consider "data dependent." This term was useful when it was first used by the FOMC to describe its policymaking approach after the Great Recession when it was transitioning

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<sup>19</sup> In a study using randomized information treatments in the six largest euro area countries, Ehrmann, Georgarakos, and Kenny (2023) find that communicating information about the inflation target can increase the central bank's credibility to maintain price stability over the medium term, even in periods in which inflation has risen.

<sup>20</sup> See Mester (2024) for further discussion.

<sup>21</sup> 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. (See Federal Open Market Committee, 2014 and 2024.)

policy from a period of explicit forward guidance to more normal times.<sup>22,23</sup> But today there is confusion about what the Fed actually means by “data dependent.” This was illuminated recently when the official government statistics were delayed and Fed watchers and the general public did not understand how a data-dependent Federal Reserve would conduct policy without the official data. “Data dependent” is being interpreted as “data-point dependent,” which is counterproductive.

So, while simpler and shorter is often seen as a virtue, it can also be a detriment if the language is open to interpretation. Rather than speaking less because of uncertainty and fear of being locked in, the Fed should explain more, with policy statements that provide more information. When the public understands the rationale for the Fed’s decisions it will be in a better position to hold the Fed accountable appropriately.

***(b) Communicate proactively***

The Fed should also be more proactive in addressing issues that may be on the horizon. For example, the Fed announced in December that it was going to resume purchases of Treasury bills to manage reserves on its balance sheet. While the chair’s press conference statement said that these purchases pertained to monetary policy implementation and “are separate from and have no implications for the stance of monetary policy,” the prepared remarks should have explained why the FOMC does not view this as a resumption of quantitative easing or as a support for increased Treasury issuance. It could be that the chair was anticipating a question and would take that opportunity to elaborate. But in my view, if there is ever a question that the chair hopes will be asked, then this question should be addressed in the prepared press conference remarks.

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<sup>22</sup> See Mester (2014) for an overview of the use and evolution of forward guidance during the Great Recession and its aftermath.

<sup>23</sup> Then Fed Chair Ben used “data dependent” in the press briefing after the December 2013 FOMC meeting. See Federal Open Market Committee (2013).

*(c) Admit policy errors*

Finally, to build trust with the public, an institution has to be willing to hold itself accountable. The Fed should do an annual evaluation of its policy effectiveness and communicate the results to Congress and the public. The Fed recently made changes to its monetary policy strategy; this suggests that the Fed did a critical assessment of its performance in the post-pandemic period as part of its framework review.<sup>24</sup> The Fed should share its assessment with the public. Admitting when there have been policy and forecast errors, identifying potential causes, and making changes to address them would improve the central bank's credibility with the public.

In summary, a central bank needs to constantly build its credibility with the public. It is not enough to merely tell the public, “trust me.” If the Fed were to embrace uncertainty and accountability, it would lead to improvements in its policymaking process and communications that will help rebuild the public’s trust in the institution.

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<sup>24</sup> Federal Open Market Committee (2025b).

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