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Is Current FOMC Policy Robust to Mismeasurement of Key Variables?

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Any views expressed here are my own and do not necessarily reflect those of Purdue University.

Data and measurement

- One task force topic is **data**.
- One of the issues is the **measurement of inflation**, a topic that has not been revisited officially by the Fed since the Greenspan era.
  - During the 1990s, the FOMC committed to PCE inflation as its **preferred metric**, and especially core PCE inflation.
  - There are many well-known issues around this choice, including the treatment of housing services, market versus non-market pricing, and hedonics.
- Other key variables also have measurement issues, such as the real rate of interest and the output gap.
- A charge to the task force is to ask whether and how **better measurement might lead to better monetary policy**.

Is current FOMC policy robust?

- In this talk I will address the issue of whether current policy is **robust** to measurement issues.
- Via simple calculations, I will **conclude that the current policy stance is only modestly robust**.
  - This means **rhetorically hawkish** policy is only partially being matched by an **actually hawkish** policy stance, considering that variables may be mismeasured.
- **Paths to more widely accepted and accurate measurement** may mean that future Committee policy would not have to go quite as far to achieve a credible policy stance.
  - The data task force might be able to help.

A SIMPLE ROBUSTNESS EXERCISE

- A compact and simple method of understanding the **recommended** current stance of policy is through a Taylor-type rule.
- We can compare this recommended policy to actual policy measures to see if the current stance is **hawkish or dovish**.
- But we can **go further** and discern the extent to which such a conclusion depends on measurement issues.
  - Different combinations of measures of inflation, the real interest rate, and the output gap will **yield different conclusions**.
  - The Committee may wish to take a hawkish stance, but **may not be credibly hawkish** when assessed against some plausible interpretations of the data.
  - To be fully robust, the Committee would have to adopt satisfactory policy **even for the worst combination**.

A MODEL-RECOMMENDED POLICY

- I will use a **well understood** Taylor-type monetary policy rule:

$$r(t) = \pi^{\star} + r^{\star} + \varphi_{\pi}\left[\pi(t) - \pi^{\star}\right] + \varphi_{x}\left[x(t) - x^{\star}\right] \tag{1}$$

  where $r(t)$ is the current policy rate recommended by the rule, $r^{\star}$ is an underlying real rate of return, $\varphi_{\pi} = 1.25$ is a parameter for which I am using a low value, $\pi(t)$ is the current inflation rate, $\pi^{\star} = 200$ is the inflation target, $\varphi_{x} = 0.25$ is a parameter for which I am using a low value, and $x(t) - x^{\star}$ is the current output gap or the negative of the current unemployment gap.
- I will consider **different ways to measure** $r^{\star}$, $\pi(t)$, and $x(t) - x^{\star}$, but leave everything else as is.
- This means I do not explore parameter uncertainty or model uncertainty here.

Data

- I express all values in **basis points**.
- All data is as of October 26, 2026.
- The various measures of inflation are the most recent 12-month readings.
- The real rate $r^\star$ is either the Holston, Laubach, Williams (2023) most recent estimate from the NY Fed website, or the 10/26 value of the TIPS one year real yield.
- The $x\left(t\right) - x^\star$ term is either 0 interpreted as unemployment or 140 basis points based on the most recent FRED data on the output gap.

The actual policy stance

- I will use three measures:
  - The **current** policy rate.
  - The likely **future** policy rate as described in the Committee's "dot plot".
  - The current **two-year Treasury** yield.
- Of these, the two-year Treasury yield is an assessment of **both** the current level of the policy rate and the **likely future direction** as currently understood by financial markets.

Current FOMC policy and measurement

Inflation Measure	Inflation Target	R-Star HLW/1yrTIPS	Inflation Gap Contribution	Unempl/ Output Gap Contribution	Recommended Policy Rate		Actual Policy Rate	Likely Dec Policy Rate	Current 2yr Treas	Evaluation
core pce	200	101	138	0	**439**		388	413	**472**	hawkish
core cpi/tm	200	101	88	0	**389**		388	413	**472**	hawkish
dallas pce tm	200	101	25	0	**326**		388	413	**472**	hawkish
core pce	200	101	138	35	**474**		388	413	**472**	on target
core cpi/tm	200	101	88	35	**424**		388	413	**472**	hawkish
dallas pce tm	200	101	25	35	**361**		388	413	**472**	hawkish
core pce	200	185	138	0	**523**		388	413	**472**	dovish
core cpi/tm	200	185	88	0	**473**		388	413	**472**	on target
dallas pce tm	200	185	25	0	**410**		388	413	**472**	hawkish
core pce	200	185	138	35	**558**		388	413	**472**	dovish
core cpi/tm	200	185	88	35	**508**		388	413	**472**	dovish
dallas pce tm	200	185	25	35	**445**		388	413	**472**	hawkish

FIGURE: The current U.S. monetary policy stance could be interpreted as hawkish, dovish, or on target depending on the measurement of key variables.

What could better measurement accomplish?

- The Table suggests the **range of uncertainty** for the "correct" policy rate is 326 to 558, which is 232 basis points, based on measurement issues alone.
- Current rhetorically hawkish policy could be interpreted as **moderately robust**: hawkish in 7 of 12 cases, on target (within 25*bps*) in 2 cases, but also dovish in 3 cases.
- A fully robust hawkish policy would guard against the **worst case**, which is 558 in the Table.
  - That's 86 basis points higher than the 2-year yield in the Table.
  - The second worst case is 523, which is 51 basis points higher than the 2-year yield in the Table.
- The Committee could be interpreted as **probability-weighting** the various possibilities.

Some questions on measurement

- To the extent that there is an underlying truth, some of the measurements must be **incorrect**.
  - The robustness literature sometimes talks about a "ball" or "nest" of uncertainty.
- The need to demonstrate a credibly hawkish (or dovish) policy in certain circumstances means the Committee may have to "**go too far**" because of measurement issues.
- Current U.S. monetary policy could be interpreted as **modestly robust** against mismeasurement in the hawkish direction according to this analysis.
- Would it be possible to **limit some of the uncertainty** the Committee faces through better, more satisfactory measurement? If so, the task force could be **very helpful**.

- Thank-you!