US Rates Strategy

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Revising the dots

The Fed's policy framework review is due later this summer. Part of the review has focused ways to improve Fed communications. We think the Fed could make a few changes to the way it presents the fed funds dot plot to emphasize policy uncertainty.

- Markets expend significant effort dissecting the Fed's dot plot. But the median rate projections were never intended to be interpreted as a consensus policy forecast. Moreover, the dots do a poor job communicating the uncertainties and risks in the outlook.

- Former Fed Chair Bernanke recommends the Fed publish a quarterly Monetary Policy Report (MPR) that allows for a broader discussion of the risks and uncertainties in the outlook.[1]

- The Fed already has this information. It could release portions of the alternative growth and inflation forecasts included in the pre-FOMC Teal Book. These could be accompanied by summary rate paths using simple policy rules.

- **Similarly, the dot plot could be expanded to include written summaries of FOMC members' projections together with some discussion of their alternative scenarios**. These would help de-emphasize importance attached to the median dot plot.

- However, releasing data on alternative fed funds paths raises complications. How many and which scenarios should be published? When should these be published? **Is there a risk of "forecast overload" with markets overwhelmed by multiple, alternative paths?**

- **Other central banks provide scenario analyses in their public communications**.[2] And several current Fed officials appear to be warming to the concept of publishing alternative scenarios. **As a result, we think the Fed may be preparing to publish a descriptive summary of alternative scenarios with the SEP although their structure and timing is uncertain**.

Dot plot shortcomings

Markets obsessively focus on the dot plot of the fed funds rate in the Fed's quarterly Survey of Economic Projections (SEP). Because the dots are plotted without context, the market views them, and especially the median path as a consensus measure of the FOMC's expected monetary policy.[3] It also expends a lot of effort connecting a dot with a particular FOMC member. The dots suggest that while there are few dissents at FOMC meetings there is more variation across individuals' longer-term

[1] See, "Improving Fed Communications: A Proposal", B. Bernanke, Brookings Institute, Second Thomas Laubach Research Conference, May 16, 2025.
[2] For example, the ECB and the Swedish Riksbank.
[3] The Fed experimented unsuccessfully with trying to form an FOMC consensus in 2012.

forecasts. This may be because these longer-term projections reflect each FOMC members' scenario analysis. For the market, the median long-term dot has become the *de facto* expression of the Fed's forward guidance. This is not what the Fed intended when it introduced the dot plot in 2012. The dots are meant to be "nowcasts" reflecting each FOMC member's current snapshot of how policy might play out in the short and medium term assuming the economy's growth and inflation trajectory is as the member expects.[4]

The dot plot is a blunt communications tool. Graphically, it does not provide any additional information beyond the (anonymous) rate assumption of an individual FOMC member. There is no context around the participant's level of uncertainty or the risks the member sees to the growth or appropriate policy paths. Similarly, the dots do not allow FOMC participants to provide contingent guidance. Nor do they allow the member to emphasize any data dependency around the appropriate policy path.

That said, the SEP includes other charts that provide some sense of the funds rate's path uncertainty. It includes a plot of the distribution of fed funds projections across participants. And, in a separate plot, the SEP graphs a 70% confidence interval fan chart around the median fed funds projections. The interval is derived from 20y of historical fed funds survey forecast errors. But, like the dot plot, the median projection is not a forecast but rather a summary of the FOMC participants' assessments of appropriate policy. And fan charts "have not proved to be an effective way of communicating with the public about the risks".[5]

Revising communications

The Fed's current framework review will consider its communications strategy. The Fed appears to be looking for ways to communicate policy uncertainty while demoting the significance of the median dot plot. Former Fed Chair Bernanke recommends the Fed consider publishing a quarterly MPR that allows for a broad discussion of the risk and uncertainties in the outlook. This is matches the recommendation he made to the Bank of England last year.

The MPR would be based on forecasts provided by Board staff together with input from the district banks. **It would include a summary of alternative scenarios for growth and inflation which could then be plugged into model simulations of the fed funds rate**.[6] Rather than a single path, the Fed would be able to highlight a series of "state contingent" ones. Each expected rate path would allow the market to judge the FOMC's reaction function – that is, the sensitivity of the fed funds rate to specific combinations of unemployment and inflation. This strategy would also be useful to clarify the Fed's forward guidance as the FOMC could more carefully outline the set of conditions necessary, for say, ending QE or terminating rate hikes. Scenario analysis would allow the market to gauge the Fed's response to changes in fiscal policy.

Release the "altsims"

Much of this information already exists in the Fed Board's pre-meeting Teal Book that is provided to FOMC members. The Teal Book is divided into two parts. The first reviews the growth outlook along with risk summaries and financial conditions. This part includes what the Board describes

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[4] See "Why the Big Fuss about Little Dots?", C. Davidson, Federal Reserve Bank of Atlanta, December 5, 2019.
[5] See, "Response of the Bank of England to the Bernanke Review of Forecasting for Monetary Policy Making and Communication at the Bank of England", Bank of England, April 2024.
[6] See, "Could the Fed Replace the Dot Plot with Scenarios?", D. Wessel, Brookings Institute, August 1, 2024.

as “altsims” – simulations of the fed funds path under different growth assumptions.[7] The second part of the Teal Book includes different monetary alternatives. Each alternative is presented as an update to the FOMC’s previous statement together with discussions about each of the underlying assumptions, risks, and market expectations. **It might be possible for the Fed to publish a summary of both sections for the market**.

Similarly, the SEP includes unpublished data that might also be released. **Former Fed Chair Bernanke argues that the Fed could release summaries of the already-collected written commentary from participants**. These commentaries include information about their outlook, their views about the most likely alternative scenarios together with their views on the Board’s forecast and policy assumptions. Releasing this information would help to clarify the market’s interpretation of the dots while emphasizing path uncertainty.

Complications

But there are several complications with simply releasing more data from either the Teal Book or the SEP. First, alternative scenarios are most useful when compared against a central forecast. However, the Fed does not provide its own forecast. Second, whose forecasts and alternatives should be provided – the Board staff’s or the individual FOMC members? And which and how many alternative scenarios should be provided? The January 2019 Teal Book outlined seven different scenarios. The number of scenarios needs to be weighed against their detail. Simply publishing “high/low growth (inflation)” paths from meeting to meeting might not be very useful. To counter accusations of “groupthink” the alternative scenarios should create enough path divergence across FOMC members for the market to get a sense for the Fed’s overall reaction function. That said, overly detailed alternatives may be too specific or too closely tied to current events to have a useful shelf life. There is a risk of “forecast overload”. Markets may stop paying attention if the Fed provides too many versions of alternative policy paths. Finally, it is not clear when the Fed should provide these scenarios. Should they be published before the FOMC meeting or, later with a lag. And, should these discussions be limited to the longer term rate path rather than upcoming FOMC meetings.

Separately, there is a risk that the “altsims” or the descriptive summaries could increase political sensitivities.[8] The Fed’s policy decisions are already heavily scrutinized.[9] But this is *ex post* and usually only after there is more clarity about the outlook. Providing alternative future policy paths based on the potential implications of fiscal policy such as tariffs or changes in tax rates might open the Fed to criticism. The highlighted alternatives might be seen as interference – especially, if say, these involved leaning against fiscal expansion or might occur ahead of an election.

Nevertheless, other central banks provide scenario analyses in their public communications. And several Fed officials appear to be warming to the idea including Governor Cook and St. Louis Fed President Musalem.[10] Last year, Fed Governor Waller likened the Fed’s policy communication to commuting. While you may regularly take the same route home, “you need to think about alternative routes…and how long they will take if you are confronted with unexpected congestion. And most likely,

[7] See, for example, Part A of the January 2019 Teal Book, page 87.
[8] See, “Discussion of ‘Improving Fed Communication: A Proposal’ by B. Bernanke”, B. English, Yale University, May 16, 2025.
[9] See, for example, “Reform the Federal Reserve’s Governance to Deliver Better Monetary Outcomes”, D. Katz and S. Miran, Manhattan Institute, March 2024.
[10] See, “Common Inflation and Monetary Policy Challenges across Countries”, Fed Governor Cook, July 10, 2024 and “Remarks on the Economic Outlook and Monetary Policy”, St. Louis Fed President Musalem, June 18, 2024.

you will also have to communicate these alternative travel plans to family members".[11] **As a result, we think the Fed may be preparing to publish a descriptive summary of alternative scenarios with the SEP although their structure and timing is uncertain**.

[11] See, "Getting Closer", Federal Reserve Governor Waller, July 17, 2024

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