Discussion of

“Interventions and Inflation Expectations in an IT Economy”

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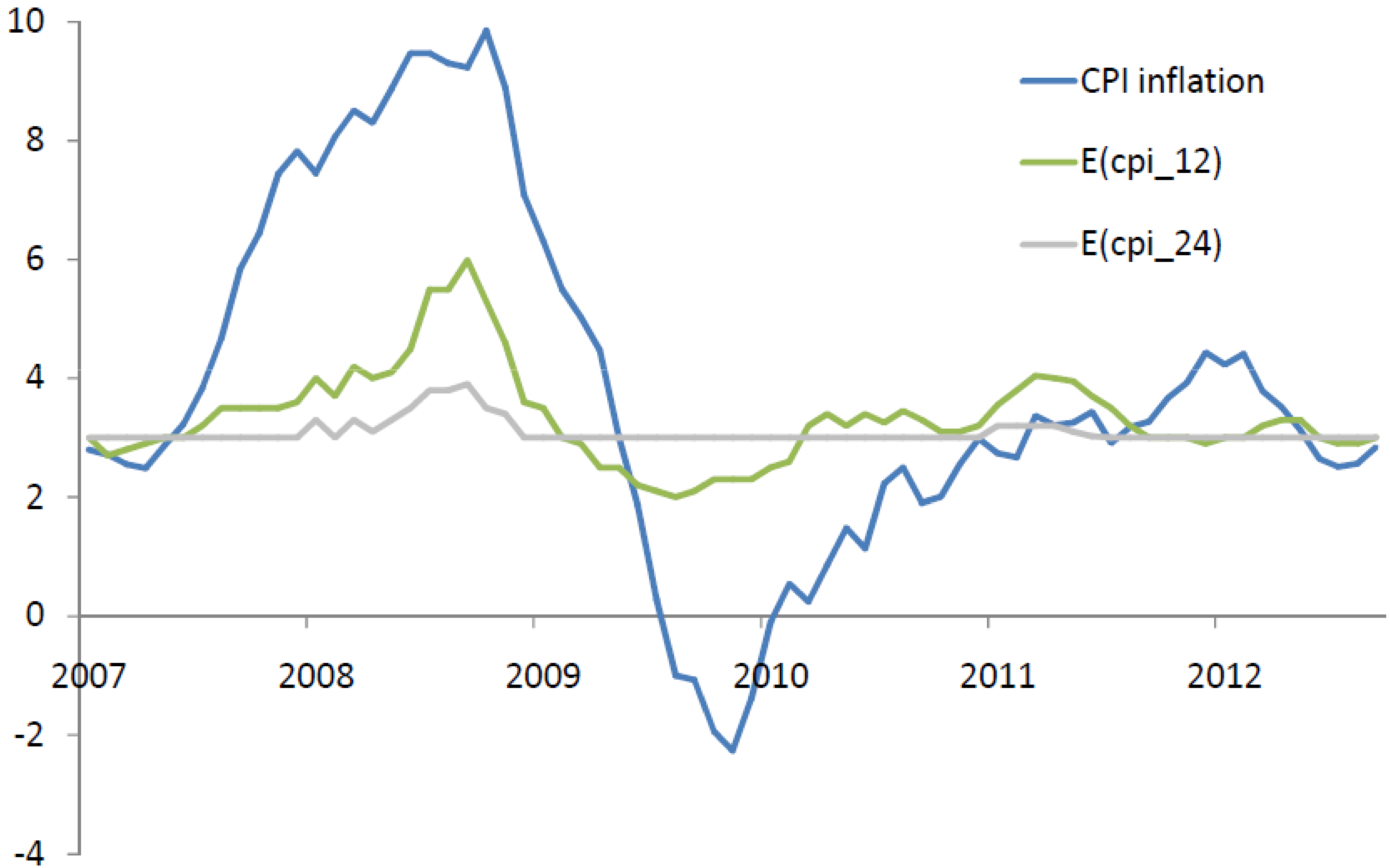
Inflation and Expectations in Chile



What the paper does

The paper posits that a purely floating exchange rate regime is needed for IT

bases the case on the *impossible trinity*

& on the effects of intervention on expectations

Describes 3 direct intervention episodes of the BCCh (and 1 indirect), since 2000

Attempts to estimate the effects of interventions on the distribution of inflation forecasts, at different horizons

(*a very relevant issue!*)

What the paper does

$$\Phi_{ih}(B)\Delta\left[\pi^{e}_{ti}(h)\right] = \delta_{it}\Delta\left[\pi^{e}_{ti-1}(h)\right] + \Delta X'_{t-1}\beta_{ih} + \gamma_{ih}\Delta M_{it-1} + \Theta_{ih}(B)u_{it}$$

Estimated for each decile as single equation or SUR

Attributes two episodes of deviations of expectations from target to the <u>two</u> intervention episodes (2008 & 2011)

> ”*1 bn dollar in purchases predicts a raise of 41.6 bp in inflation expectations one year ahead*”

Some conceptual issues

Interventions could increase expectations for inflation **if**

- they affect the exchange rate and the pass-through is non-negligible, **or**

- they signal an (unexpected) reduction in the weight put on inflation deviations in the objective function of the Central Bank

Paper dismisses the first mechanism (*"mixed evidence of effectiveness of interventions"*) and emphasizes the second.

While the second mechanism is <u>perfectly plausible</u> it cannot be taken for granted

Some doubts

$$\Phi_{ih}(B)\Delta\left[\pi^{e}_{ti}(h)\right] = \delta_{it}\Delta\left[\pi^{e}_{ti-1}(h)\right] + \Delta X'_{t-1}\beta_{ih} + \gamma_{ih}\Delta M_{it-1} + \Theta_{ih}(B)u_{it}$$

- not clear about $\Phi_{ih}(B)$ (??) and $\Theta_{ih}(B)$

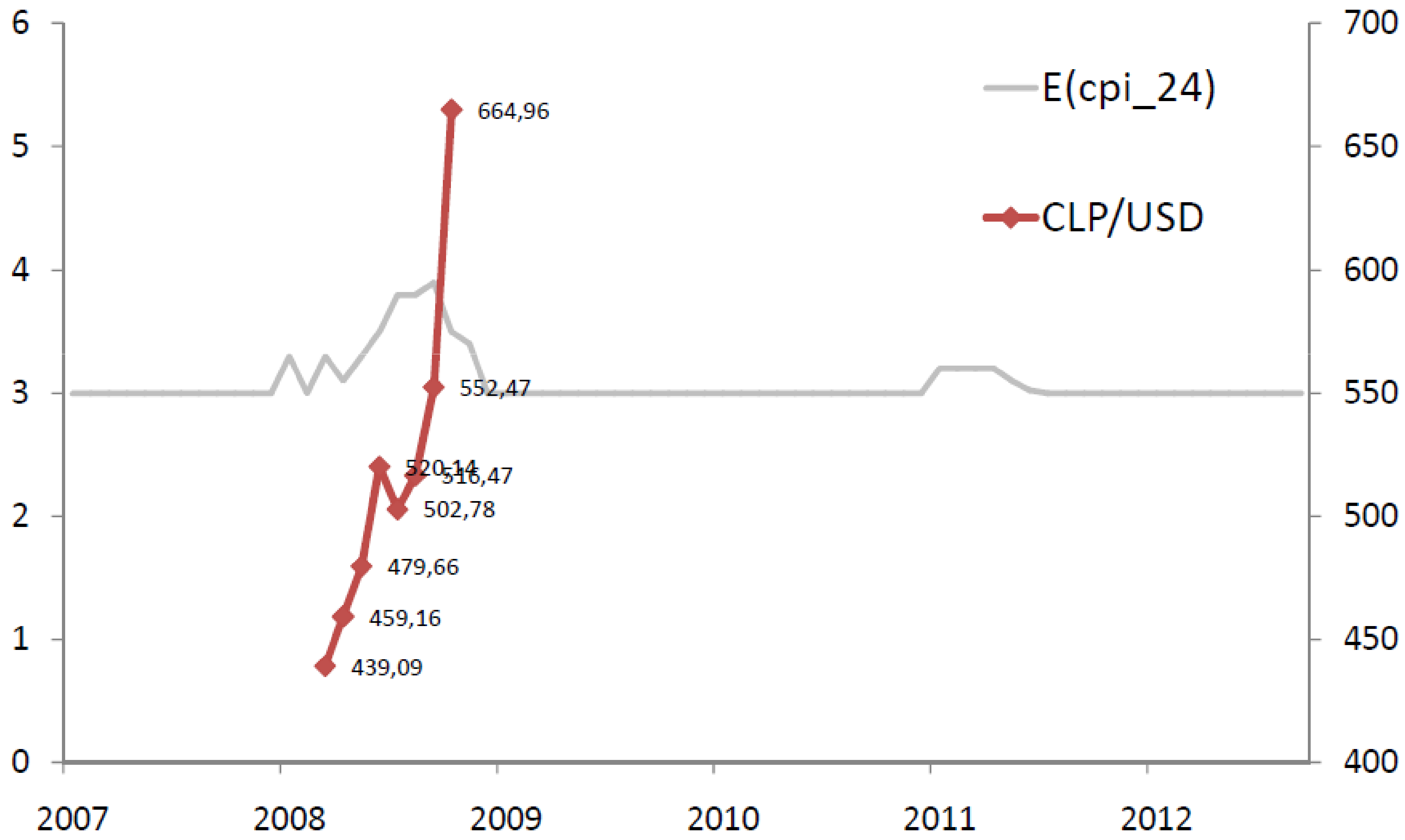
  Are they needed ?

- are AR and MA terms really used?

  (if yes, show at least the AR term)

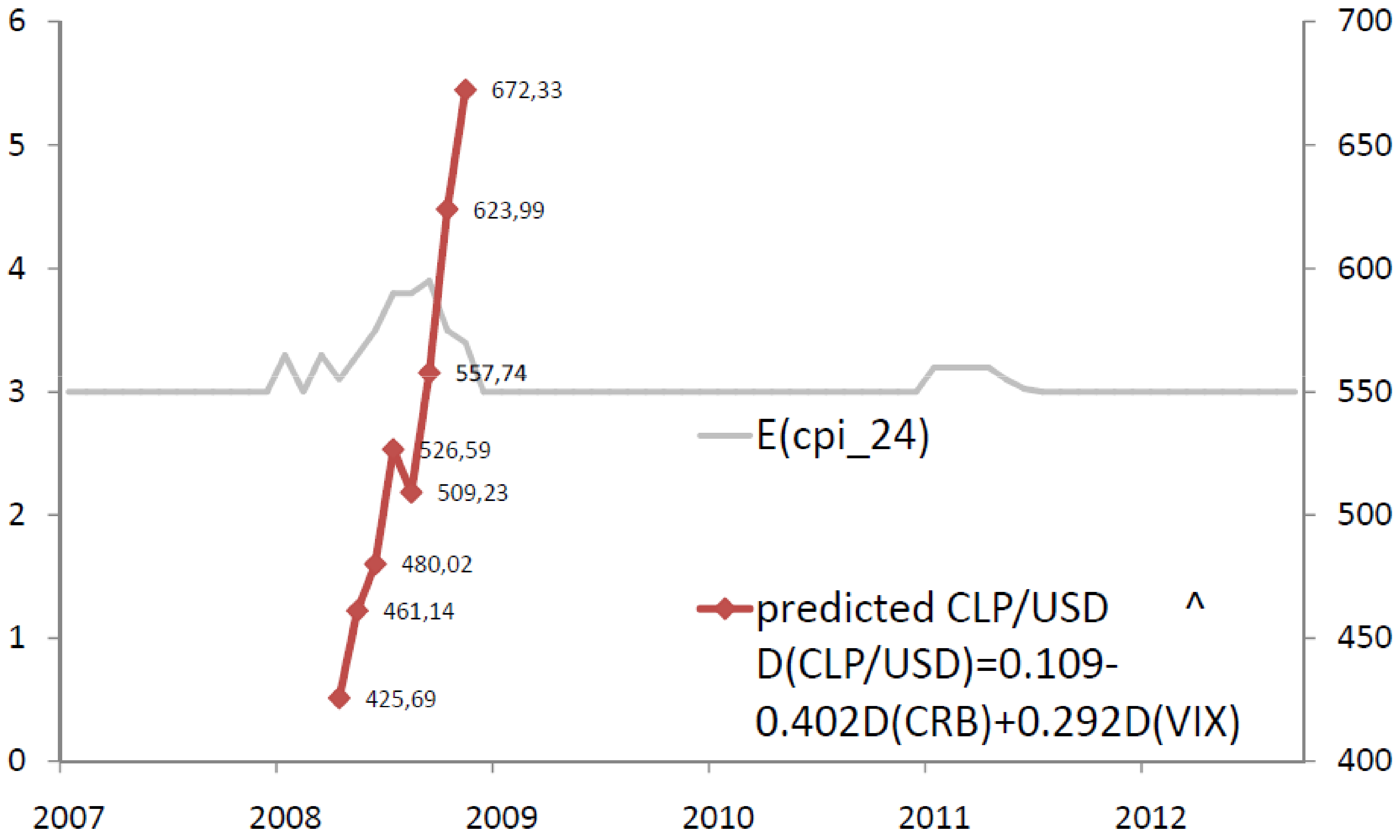
- intervention variable could be acting just as a *proxy* for (omitted) exchange rate variation

Wasn’t it just the (omitted) exchange rate ?



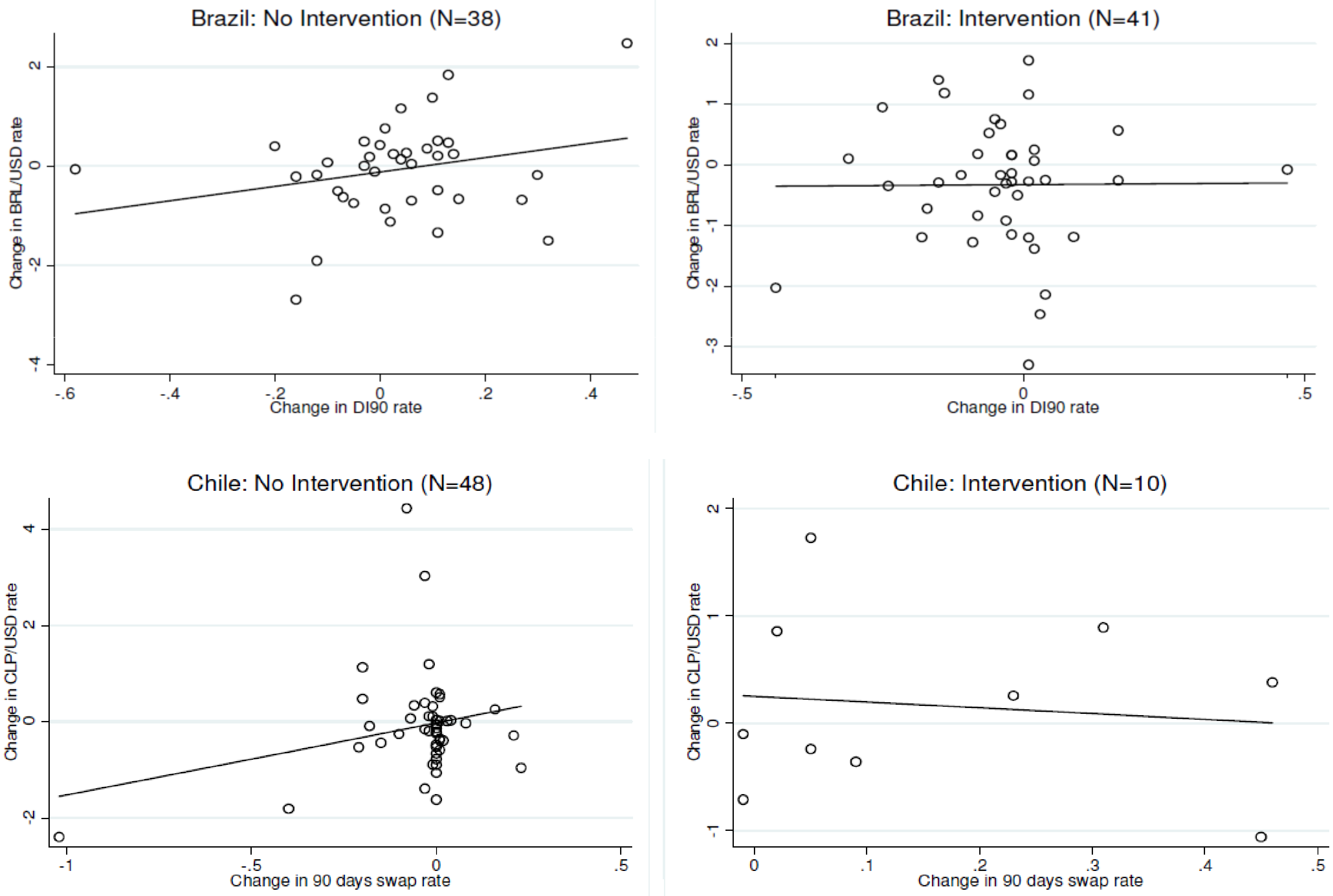
Wasn't it just the (omitted) exchange rate ?

predicted CLP/USD exchange rate, based on global variables alone



On the “Impossible Trinity”

Is the link between domestic *i* and *e* really as tight as we assume?



Is Flexible IT/Managed Float Inferior ?

✧ Two intermediate targets (the interest rate and the exchange rate) are not incompatible -- as long as they are consistent with eachother (Mishkin and Savastano (2001))

- could be intervening to contain devaluation, or

- to contain excessive e.r. volatility that, for instance, triggers coordinated price adjustments if agents follow *S-s* based pricing rules.

✧ The exchange rate may complement the interest rate as as an instrument, rather than substitute inflation as a target (see Parrado (IMF, 2004), Ostry, Ghosh and Chamon (IMF, 2012), Benes, Berg, Portillo and Vavra (IMF, forthcoming))