Discussion of

“Interventions and Inflation Expectations in an IT Economy”
by Pablo M. Pincheira B.

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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

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

Estimated for each decile as single equation or SUR

Attributes two episodes of deviations of expectations from target to the two 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 perfectly plausible it cannot be taken for granted
Some doubts

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

- 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 each other (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 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))