EUROPEAN CENTRAL BANK

EUROSYSTEM

Discussion of “Forward Guidance and Expectation Formation: A Narrative Approach” by Chris Sutherland

BIS-CCA Research Network on “Monetary policy frameworks and Communication”

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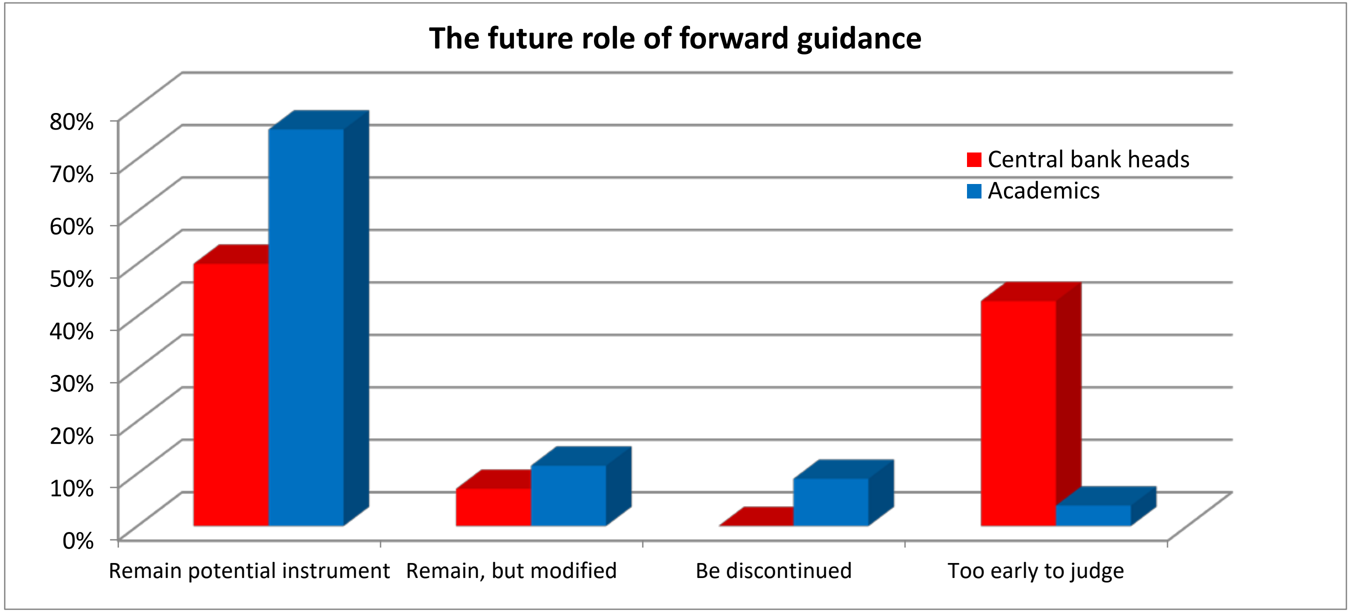
The views expressed here are my own and do not necessarily reflect those of the ECB or the Eurosystem.

Overall remarks

- An extremely careful study of a very important topic
  - 49-page paper, 45-page appendix
- Amazing data work
  - 12 countries, 30 years
  - Central bank measures (policy rate changes, FG, QE)
  - Classification of FG (Delphic/Odyssean, state-contingent/date-based/qualitative)
  - Expectations of FG announcements
  - Central bank projections
  - Matching forecasters in Consensus Economics
  - Careful matching

Why the paper is worth reading

- FG is there to stay, but we know little about how it works



Source: Blinder et al. (2017) survey among central bank governors (55 responses) and academic economists (159 responses). "Once conditions return to normal, do you think each of the following should remain a potential instrument of monetary policy, remain an instrument but in modified form, be discontinued, or that it is too early to judge?"

Why the paper is worth reading

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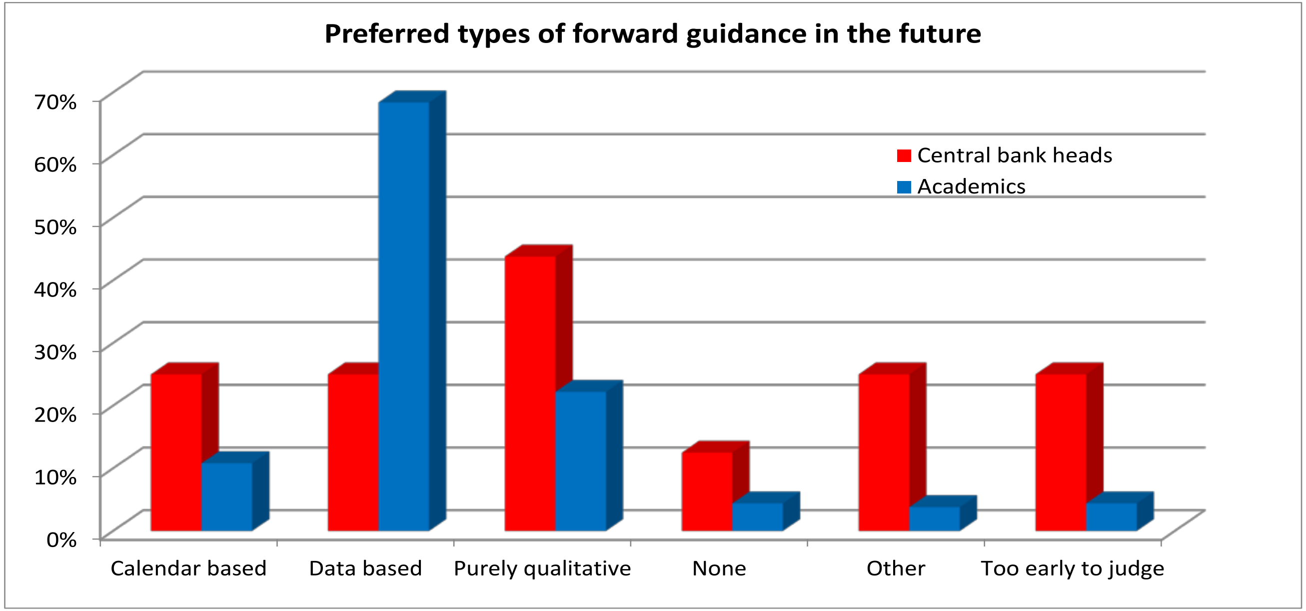


Source: Blinder et al. (2017) survey among central bank governors (55 responses) and academic economists (159 responses). "In the future, which type(s) of forward guidance do you believe would be most effective for your central bank?"

Why the paper is worth reading

- FG is there to stay, but we know little about how it works
- How do interest rate expectations change in response to changes in FG?
  - At and off the ELB
  - For different types of FG
  - Odyssean vs Delphic
  - At different maturities and forecast horizons
  - At different time periods
  - Across countries
- The paper is very well written and very advanced

Classification of FG

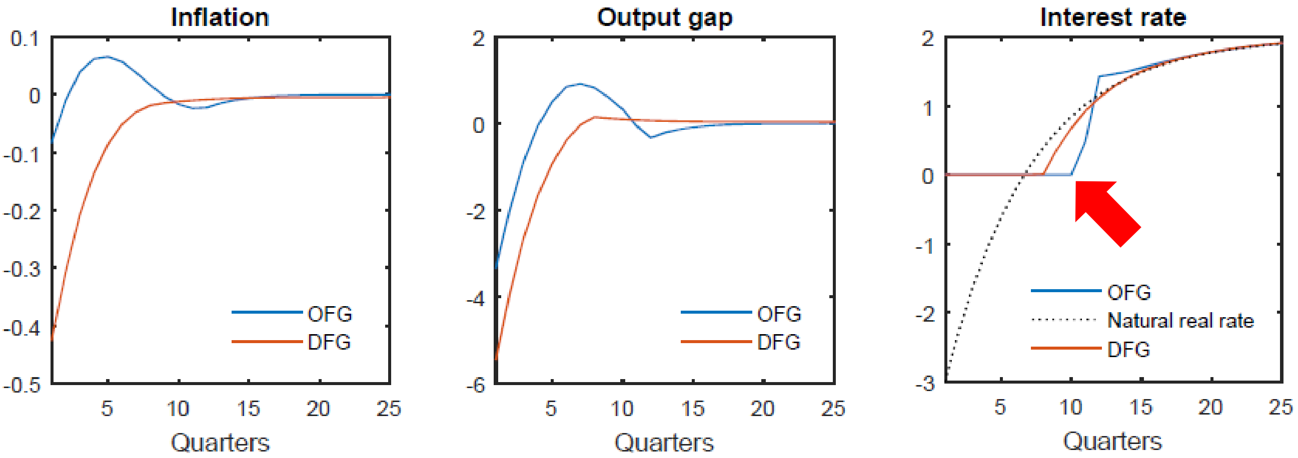
- Dovish, neutral and hawkish
  - Hawkish: next change in the policy rate is more likely to be up than down
    - Bank of Canada, 2009: “Bank of Canada lowers overnight rate target by 1/4 percentage point to 1/4 per cent and, conditional on the inflation outlook, commits to hold current policy rate until the end of the second quarter of 2010.”
    - Bank of Canada, current: “The Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved.”
  - Changes in FG: When a central bank significantly shifted the tone of its forward guidance, this change was recorded as either a -1 (a shift to a more dovish stance) or a +1 (a shift to a more hawkish stance)

Classification of FG

- Odyssean vs Delphic
  - Has any CB ever used Odyssean FG?
    - Chris identifies 5 episodes
    - 2009: “Bank of Canada lowers overnight rate target by 1/4 percentage point to 1/4 per cent and, conditional on the inflation outlook, commits to hold current policy rate until the end of the second quarter of 2010.”
    - 2020, RBNZ: “The Official Cash Rate (OCR) is 0.25 percent, reduced from 1.0 percent, and will remain at this level for at least the next 12 months.”

Classification of FG

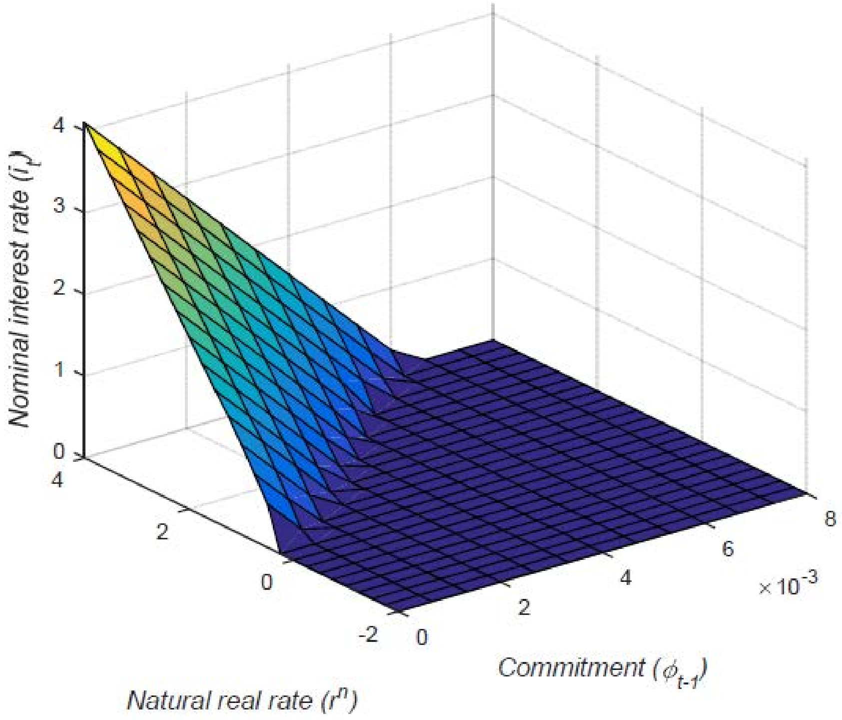
- Odyssean vs Delphic
  - Odyssean FG is to commit "to keep the rate at zero longer than required by economic conditions and thereby creating an economic boom in the future" (Campbell et al. 2012, referring to Woodford 2003)



Source: Coenen et al. (2017)

Classification of FG

- Odyssean vs Delphic
  - Odyssean FG is state-contingent



Source: Coenen et al. (2017)

The regressions – is everything considered?

- Enough controls, given multitude of monetary policy tools? E.g. ECB

First, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.50% respectively. The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics.

Second, the Governing Council will continue the purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion. The Governing Council will conduct net asset purchases under the PEPP until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over. The purchases under the PEPP will be conducted to preserve favourable financing conditions over the pandemic period. If favourable financing conditions can be maintained with asset purchase flows that do not exhaust the envelope over the net purchase horizon of the PEPP, the envelope need not be used in full. Equally, the envelope can be recalibrated if required to maintain favourable financing conditions to help counter the negative pandemic shock to the path of inflation.

The Governing Council will continue to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2023. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

Third, net purchases under the asset purchase programme (APP) will continue at a monthly pace of €20 billion. The Governing Council continues to expect monthly net asset purchases under the APP to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates.

The Governing Council also intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Finally, the Governing Council will continue to provide ample liquidity through its refinancing operations. In particular, the third series of targeted longer-term refinancing operations (TLTRO III) remains an attractive source of funding for banks, supporting bank lending to firms and households.

The Governing Council continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

The role of the central bank forecast

- Zero weight on the central bank forecast?
  - Timing might matter here
    - Central bank forecast presumably somewhere in between Consensus Economics
    - Own forecast revision contemporaneous to revision in interest rates
- Excludes central bank information effect?
  - Central bank communicates more than just its forecasts

	[1]	[2]
CB π revision (+25 bps)	0.78^{**}	0.15
	(0.27)	(0.16)
CB GDP g rev. (+25 bps)	0.39^{*}	-0.11
	(0.18)	(0.12)
Indiv. π rev. (+25 bps)		2.31^{***}
		(0.40)
Indiv. GDP g rev. (+25 bps)		4.50^{***}
		(0.52)
FG $\{-1, 0, 1\}$ change		5.72^{***}
		(1.03)
Adjusted R^2	0.00	0.22
N	26304	26304

Classification of ELB

- The perceived ELB was time varying
- All but one central bank have not communicated where they see the ELB
  - "The Bank is setting an effective lower bound of 25 basis points for the overnight rate" (April 2009 MPR)
  - "We now believe that the effective lower bound for Canada's policy rate is around minus 0.5 per cent, but it could be a little higher or lower" (Poloz, 2015)
  - "The Bank of Canada today held its target for the overnight rate at the effective lower bound of ¼ percent" (December 9, 2020)
- If the ELB is credible, then rate expectations can only go up
  - Either run regression separately, or interact all variables with the ELB dummy

Vagueness about the ELB

- Does communication about the ELB matter?
  - Bank of Canada: “The Governing Council will hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved.” (December 9, 2020)
  - FOMC: “The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.” (January 27, 2021)
  - ECB: The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics (January 21, 2021)

Let me reiterate…

- Important topic
- Amazing data work
- The analysis is carefully done, covers many aspects of the question at hand
- The paper is very well written

Thank you!