Discussion of

Monetary Policy Announcements and Expectations: The Case of Mexico

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BASIC IDEA OF PAPER

Using a novel survey of professional forecasters in Mexico, the authors study how these agents revise their expectations about inflation and monetary policy.

They exploit the relatively high frequency of this survey (every two weeks) and combine it with information on policy surprises and data releases to characterize how this new information is incorporated into the forecasts of professionals.

This is a great question and a great dataset to answer it!

STYLIZED BACKGROUND FACTS

- Professional forecasters are relatively attentive to monetary policy and recent data releases in advanced economies, though
    - o we can reject the null of full information in many cases,
    - o they display under-reaction to economic shocks,
    - o their inflation expectations are not fully anchored even in the U.S. or Euro-Area.

- Professional forecasters and financial markets are far more attentive to monetary policy and macroeconomic data than households and firms in advanced economies.

- Households and firms are more attentive to macroeconomic policy and conditions in countries where inflation and macroeconomic volatility have been more prevalent.

WHAT THIS PAPER BRINGS TO THE TABLE

Data on:

- Professional forecasters in Mexico
- Semi-monthly frequency
- Questions on both short run and long run inflation expectations
- Questions on expectations about monetary policy:
  - Expected policy rate at the end of calendar year
  - Will next monetary policy change be increase/decrease in rates?

This allows them to provide novel evidence on how professional forecasters revise their expectations after monetary policy announcements.

MAIN FINDINGS

After monetary policy announcements, professional forecasters immediately revise their views about end-of-year inflation and interest rates, but *not* about long-run inflation.

Their interpretation: Professionals are attentive ("listen" to the central bank) and have anchored expectations. This suggests that communication by the central bank of Mexico has been successful.

MAIN FINDINGS

After monetary policy announcements, professional forecasters immediately revise their views about end-of-year inflation and interest rates, but *not* about long-run inflation.

<u>Their interpretation</u>: Professionals are attentive ("listen" to the central bank) and have anchored expectations. This suggests that communication by the central bank of Mexico has been successful.

But…

the properties of these beliefs are hard to reconcile with this narrative. In fact, forecasters don't seem to think that the central bank responds strongly to inflation. So how can their expectations be anchored?

EVIDENCE 1

Tab. 1. Results from Fixed-Effect Estimations with Change in End-of-the-Year Inflation Expectations and t+2,t+6 Inflation Expectations as Dependent Variables with Monetary Policy Announcements

Dependent Variable:	$\Delta E_{it}\left(\pi^{\text{end y}}\right)$		$\Delta E_{it}\left(\pi^{\text{end y, t+2,t+6}}\right)$	
	(1)	(2)	(3)	(4)
Sample:	All	Latest	All	Latest
π_{t-1}^{surp}	0.3820***	0.3520**	0.0480	0.0264
	(0.0538)	(0.1610)	(0.0329)	(0.0632)
r_{t-1}^{surp}	0.0799**	0.1180***	-0.0227	-0.0200
	(0.0253)	(0.0364)	(0.0272)	(0.0331)
$\Delta E_{it}\left(\text{GDP}^{\text{end y}}\right)$	0.0436	-0.0981		
	(0.0268)	(0.0742)		
$\Delta E_{it}\left(\text{NER}^{\text{end y}}\right)$	0.0028	0.0073**		
	(0.0017)	(0.0028)		

Their first result is that after a contractionary policy surprise, short-run expectations respond while long-run expectations do not.

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But the sign of the response is a little suspect and is consistent with information effects in monetary policy rather than policy that is actively controlling inflation.
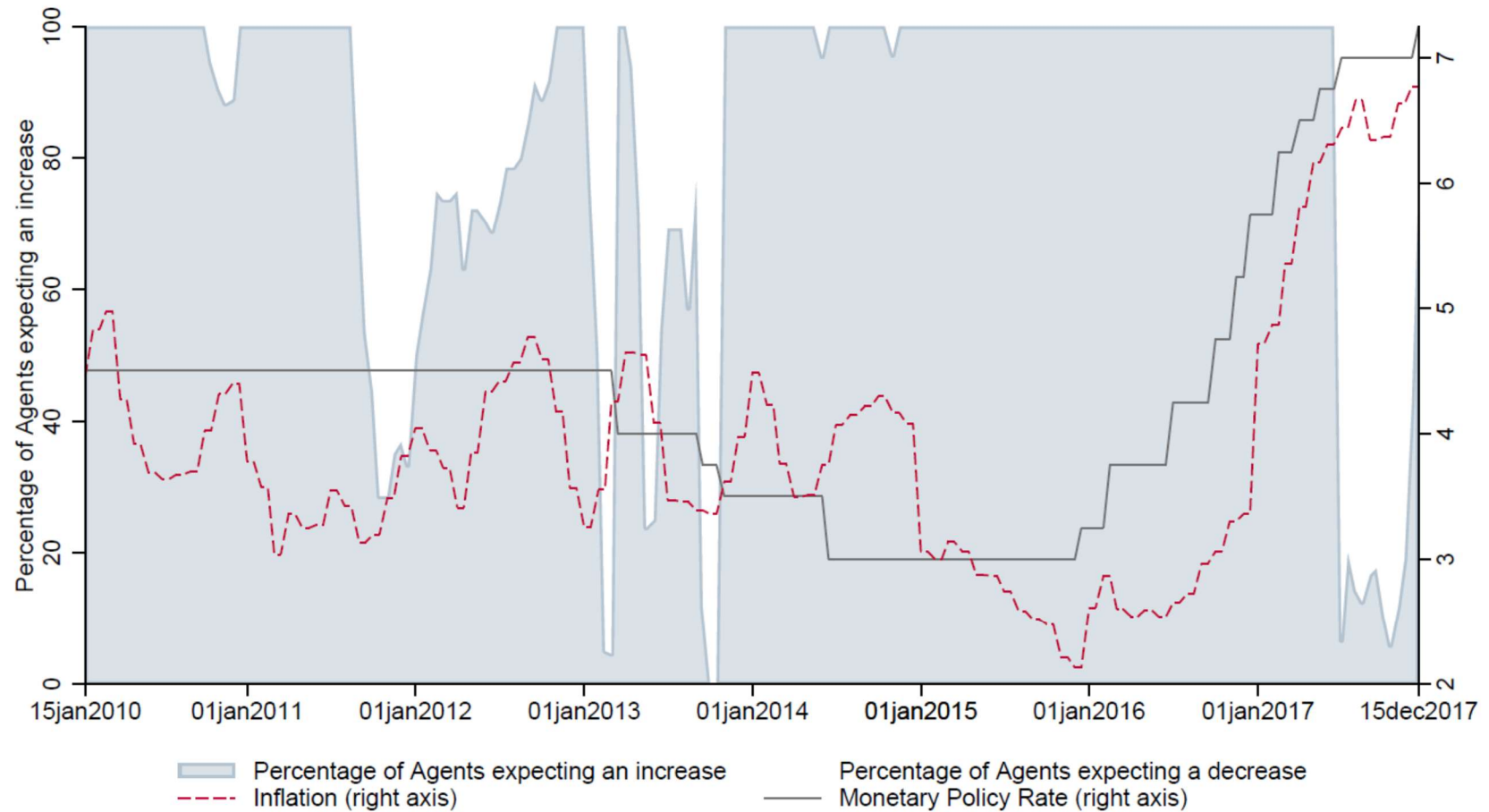
EVIDENCE 2

Tab. 3. Results from Fixed-Effect Estimations with Change in End-of-the-Year Monetary Policy Rate Expectations as Dependent Variable

Dependent Variable: $\Delta E_{it}\left(r^{\text{end y}}\right)$				
	(1)	(2)	(3)	(4)
	MPA		No MPA	
Sample:	All	Latest	All	Latest
π_{t-1}^{surp}	-0.0226	-0.343	-0.171***	-0.153**
	(0.0376)	(0.259)	(0.0344)	(0.0654)
r_{t-1}^{surp}	0.584***	0.529***		
	(0.0611)	(0.107)		
$\Delta E_{it}\left(\text{GDP}^{\text{end y}}\right)$	-0.0102	-0.0220	0.0248	-0.0966
	(0.0213)	(0.0873)	(0.0175)	(0.0976)
$\Delta E_{it}\left(\text{NER}^{\text{end y}}\right)$	0.0167***	0.0208***	0.00325	0.00996**
	(0.00227)	(0.00503)	(0.00215)	(0.00404)
$\Delta E_{it}\left(\pi^{\text{end y}}\right)$	0.131***	0.307***	0.274***	0.517***
	(0.0388)	(0.109)	(0.0506)	(0.0477)

When there is a positive inflation surprise, forecasters *reduce* their expectations of the future policy rate.

EVIDENCE 3

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When forecasters raise their inflation expectations by 1 percentage point, they increase their expectations about the policy rate by much less than 1% point (i.e. no Taylor principle).
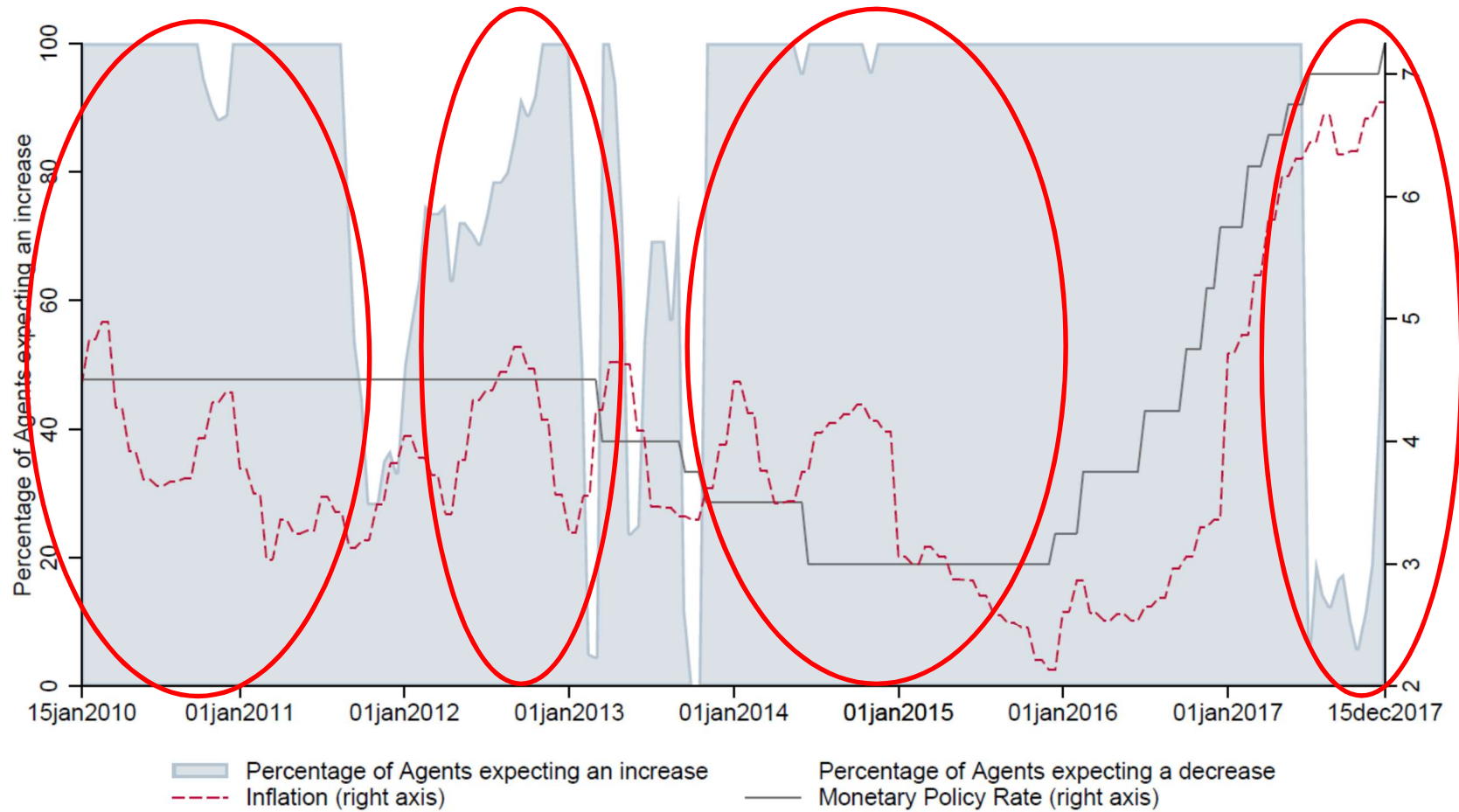
EVIDENCE 4

Fig. 2. Percentage of analysts that expect increase or decrease in the policy rate's next move

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Percentage of Agents expecting an increase
Inflation (right axis)

Percentage of Agents expecting a decrease
Monetary Policy Rate (right axis)

SUMMARY

Professional forecasters in Mexico:

- View contractionary policy surprises as indicating *higher* future inflation
- Anticipate *lower* future policy rates when inflation has been unexpectedly higher
- Do not seem to believe in the *Taylor principle*.
- Seem incapable of predicting whether policy rates will be increasing or decreasing in the future.

SUMMARY

Professional forecasters in Mexico:

- View contractionary policy surprises as indicating *higher* future inflation
- Anticipate *lower* future policy rates when inflation has been unexpectedly higher
- Do not seem to believe in the *Taylor principle*.
- Seem incapable of predicting whether policy rates will be increasing or decreasing in the future.

These are really hard to reconcile with the idea that inflation targeting in Mexico has convinced professionals that the central bank knows how to control inflation, or that the central bank is good at communicating about its policies and economic outlook.

TAKEAWAY

The paper explores an exciting dataset that includes not just standard macro expectations of professional forecasters *but also their expectations about future monetary policy*. This allows them to provide novel evidence on the effect of monetary policy communication on the beliefs of professional forecasters in Mexico.

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While it's true that the long-run inflation expectations of forecasters appear well-anchored, this does *not* seem to reflect a perception that the central bank is "hawkish" or very concerned about fighting inflation.

- Few worries about fiscal dominance?
- Reduced exposure to oil price variation?
- Other factors?