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Comments on "Quantitative Goals for Monetary Policy"

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What do they do?

Key question: ***How does the explicitness of policy goals affect economic outcomes?***

Annual data, 42 countries, 1960-2000

Cross sectional regressions

$$\pi_{i,t} = \beta_1 \text{target} + \beta_2 \text{success} + controls + e_{i,t}$$

$$\sigma(y)_{i,t} = \beta_1 \text{target} + \beta_2 \text{success} + controls + e_{i,t}$$

β_1

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What do they find?

Level of inflation

- ✓ β_1 **"remains economically large and statistically significant"**

- ✓ β_2 **is "generally significant"**

Volatility of output

- ✓ β_1 **"little evidence to support any claim on the effect of policy regimes on output volatility"**

- ✓ β_2 **is some modest support, at best**

Economic growth? No convincing evidence!

Strengths of the paper

Dataset: a wonderful effort to compile a monetary policy regime dataset which will set the standard going forward

Robustness checks: from a research perspective, a good example of solid empirical work of this type; the endogeneity issue is addressed (eg Ball and Sheridan)

Extends focus: the paper goes beyond inflation targeting to consider FX. Central banks have alternative means to establish a nominal anchor

Two caveats

1. Why should an explicit target lead to lower inflation?

- ✓ Case of the BOJ: the successful adoption of an IT framework would result in an increase in inflation! Hence results must be sample dependent

- ✓ A more unambiguous test would be about the volatility of inflation. Why didn't the authors do this?

Hence, strong statistical support for the inflation effect has to be taken with a grain of salt.

May suggest that authors did not adequately control for learning in the 1970s & 1980s (Cogley-Sargent).

Two caveats

2. Alternatively, evolving economic environment, namely the trend toward greater globalization, might account for the change.

- ✓ Rogoff (2003) argues globalization, deregulation and declining monopoly power led to greater competition and smaller mark-ups.

- ✓ Blanchard and Philippon (2003) show a secular reduction in quasi-rents. Should add variable.

Correlation between quasi-rents and inflation, not explicitness of regime, might be the important factor.

Technical quibbles

Incorporating data classification uncertainty?

US chronology from the Appendix

	Inflation target	Money target
1960-72	NO	NO
1973-1974	NO	NO
1975-95	NO	YES
1996-2000	NO	NO

- ✓ Should correct the standard errors for classification error in categorical variables (Lee)?
- ✓ Might try alternative chronologies as a robustness method (+ de jure versus de facto)

What do we learn about CB communication?

- Yes, the explicitness of the monetary regime matters in some broad sense.
- But, is the forest perspective is too broad?
  - Botswana and Mauritius versus the G10
  - 1970s versus current regime
- Is any explicit regime is as good as any other explicit regime, and better than implicit regimes?

What do we learn about CB communication?

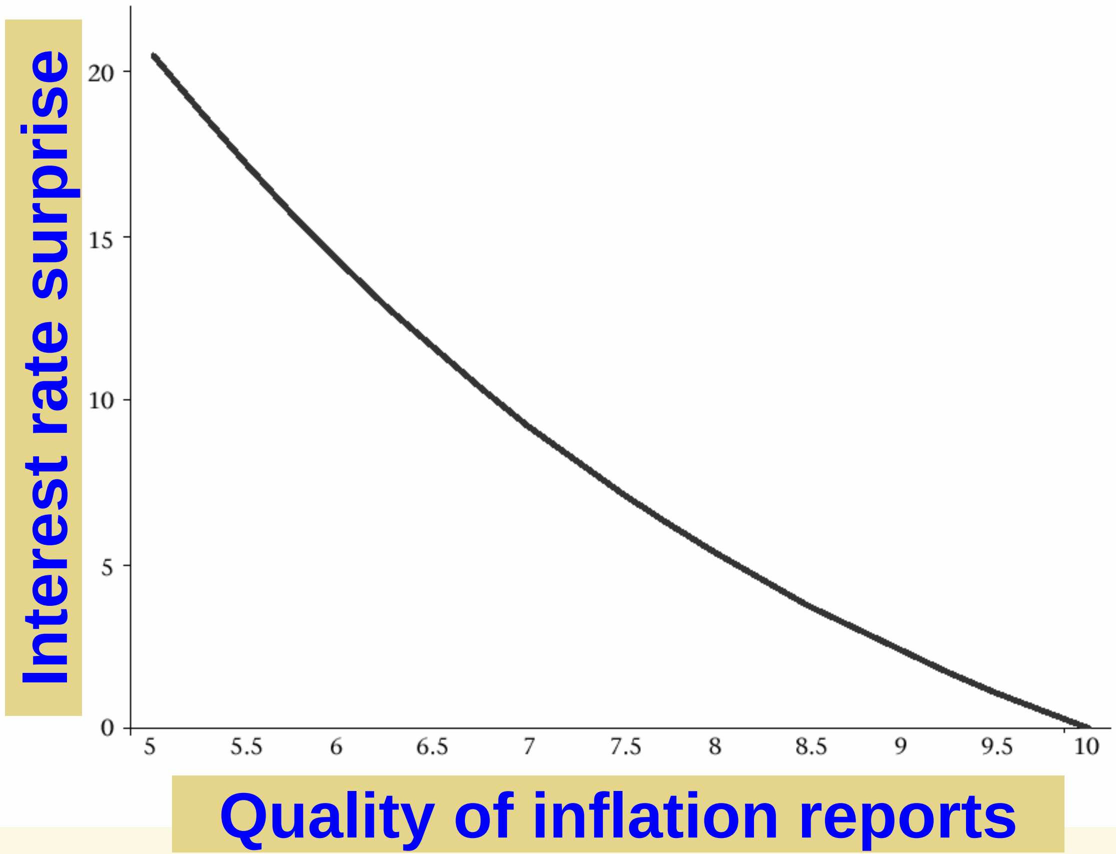
- ✓ On the one hand, illustrates that CBs can learn important facts about policy tradeoffs with cross sectional studies.

- ✓ On the other hand, the immediate policy relevance is fairly weak because too broad of a focus.

  - ✓ e.g. “How do central banks write? (CEPR, 2003)”

What do we learn about CB communication?

Figure 4.3 Reduction in interest-rate surprises due to the quality of the Inflation Report



Source: Fracasso et al (2003)

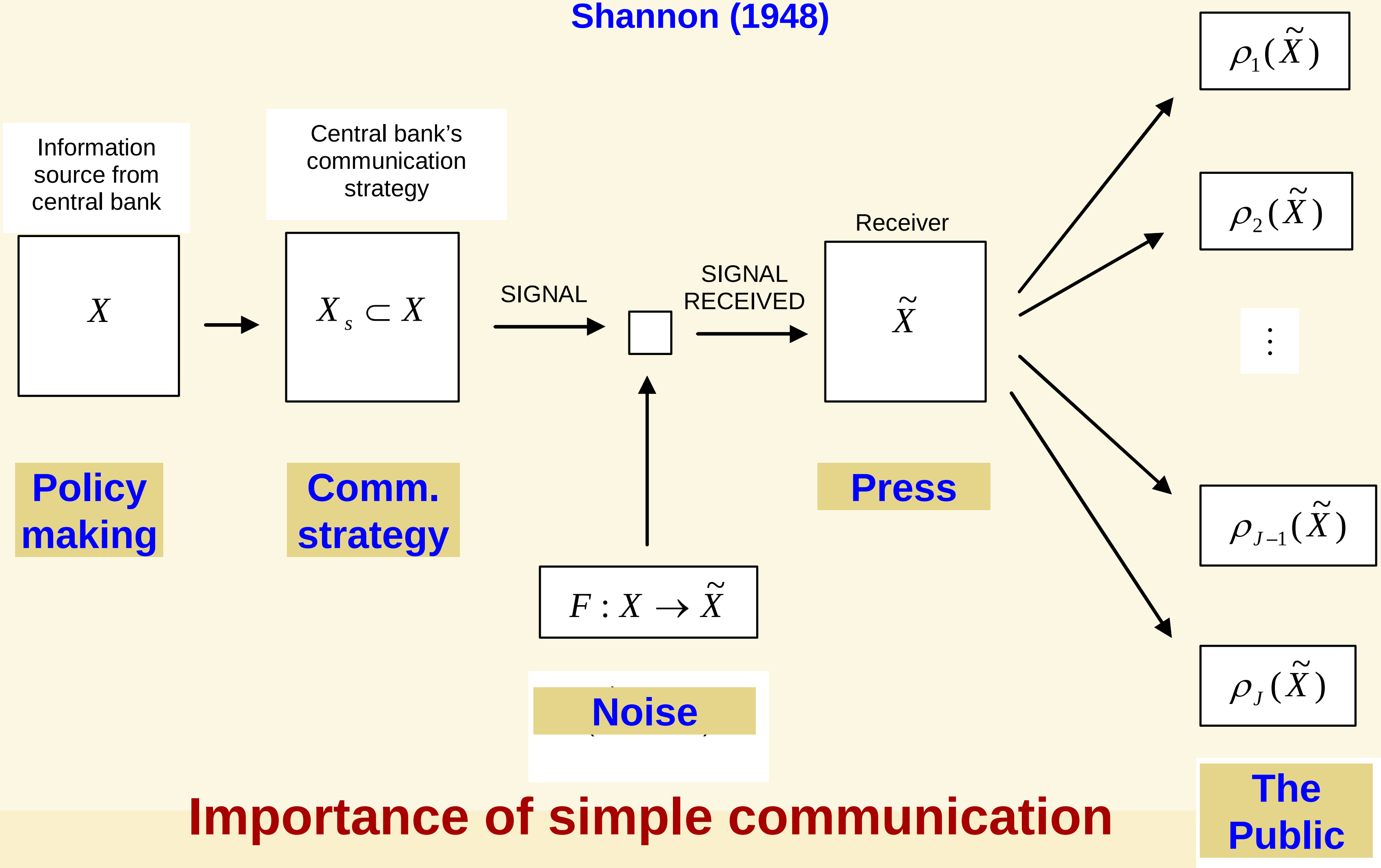
Transparency versus clarity

- ✓ **Transparency: the information**
- ✓ **Clarity: quality of the signal**

A simple illustrative model

Communication Technology

Shannon (1948)



Importance of simple communication

Transparency versus clarity: policy concerns

- ✓ More information – less clear but potentially more accurate (contingent statements)
- ✓ Less information – simpler and clearer messages but a smaller snapshot of policy process

Are current regimes too complex?

Are current regimes too simple?

Explicitness: a current policy issue

Should current regimes have an explicit monetary pillar?

1. BIS publications: the limits of conventional inflation targeting regimes in the presence of asset price booms and busts. See April 2005 ECB paper.

2. Bordo and Filardo (NBER, 2004)

   From a historical view, a monetary pillar may be important for policymakers pursuing price stability, especially as risks of the ZLB for the policy rate arise

“Quantitative targets”, not just numerical goals

Thank You