Discussion of "*What Does Anticipated Monetary Policy Do?*" by D'Amico and King

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Usual disclaimer applies

Summary of methodology

- NK model to study shocks to policy expectations

- Standard VAR + expectation variables

- Shocks identified with zero/sign restrictions

- Compare conventional policy shocks with shocks to expectations of future policy rate
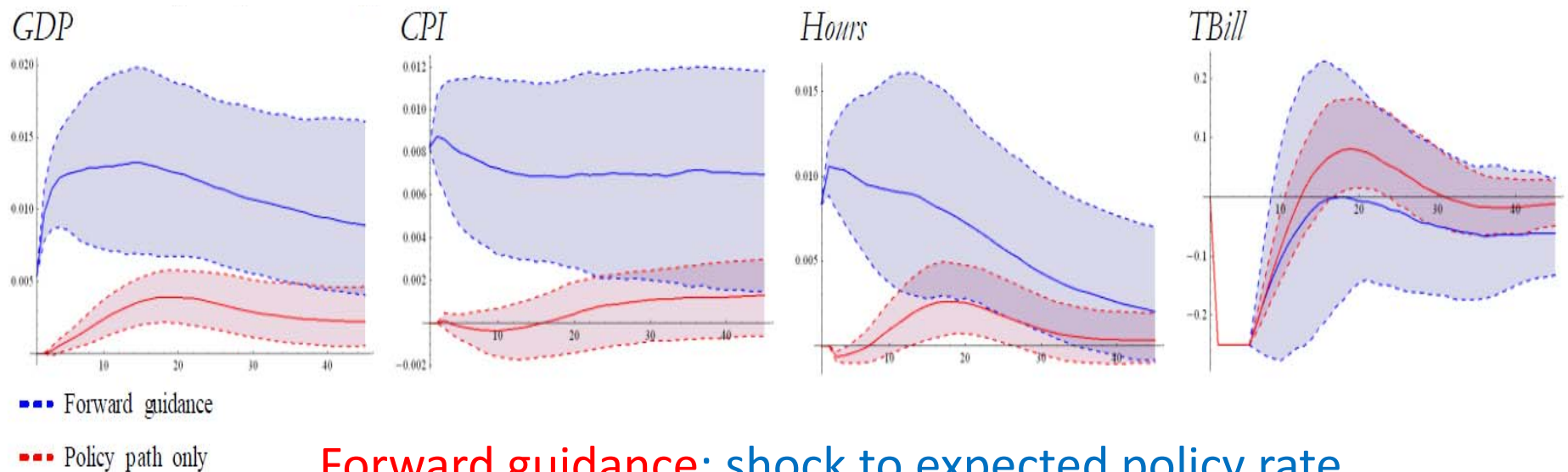
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Summary of results

- Expectations of future policy easing have immediate positive effects on output, inflation, and employment

- Effects larger than "conventional" (unexpected) policy rate changes

- Implications for models: forward guidance → too large effects on π

Summary of results (cont'd)
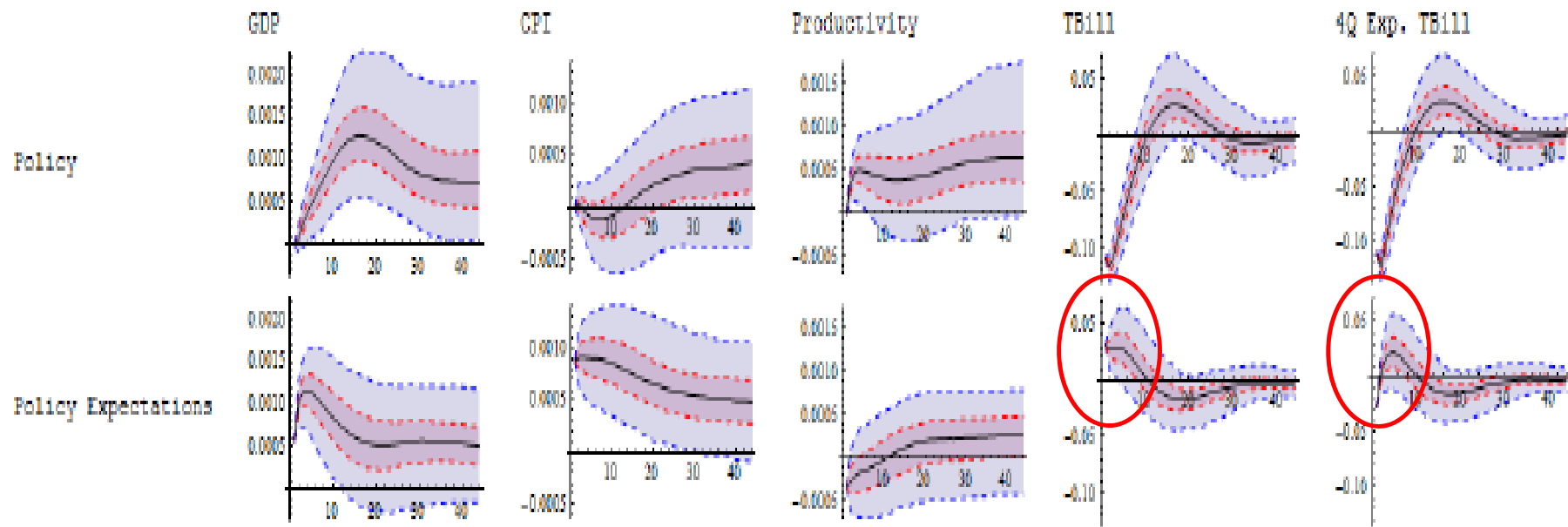
Summary of results (cont'd)

Forward guidance: shock to expected policy rate, followed by a sequence of shocks to actual policy rate that prove expectations to be correct

Main comments

Comment 1 – Changes in monetary policy-making

- Sample period: 1983:3 to 2015:2

- Important changes in policy-making after 2008 GFC

  - Zero-lower bound (ZLB)

  - Forward guidance

  - Large scale asset purchases (LSAP)

- How to deal with such changes? TVP-VAR with news shocks (Mendicino and D'Agostino, 2015)? A non-linear VAR (ZLB)?

Main comments (cont'd)

Comment 2 – Forward guidance and identified shocks (Table 3)

- Forward guidance introduced in December 2008, at ZLB ("[…] *exceptionally low levels of the federal funds rate for some time* [….]")

- Forward guidance has taken several forms since then
 - Open-ended
  - Date-based
  - Outcome-based

Main comments (cont'd)

Table 1 – Evolution of the Federal Reserve forward guidance during the financial crisis

Date	FOMC statement	Type of guidance
16 December 2008	"exceptionally low levels of the federal funds rate for some time"	Open-ended
18 March 2009	"exceptionally low levels of the federal funds rate for an extended period"	
9 August 2011	"at least through mid-2013"	Date-based
25 January 2012	"at least through late 2014"	
13 September 2012	"for a considerable time after the economic recovery strengthens [...] Mid-2015"	
12 December 2012	"at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored"	Outcome-based
19 June 2013	" [...] would be appropriate to moderate the monthly pace of purchases later this year [...] continue to reduce the pace of purchases in measured steps through the first half of next year, ending purchases around mid-year [...] the unemployment rate would likely be in the vicinity of 7 percent, with solid economic growth supporting further job gains"	

Main comments (cont'd)

Figure 4 – Volatility of 1-year interest rate swap in U.S. dollar

(percentage points; daily data)
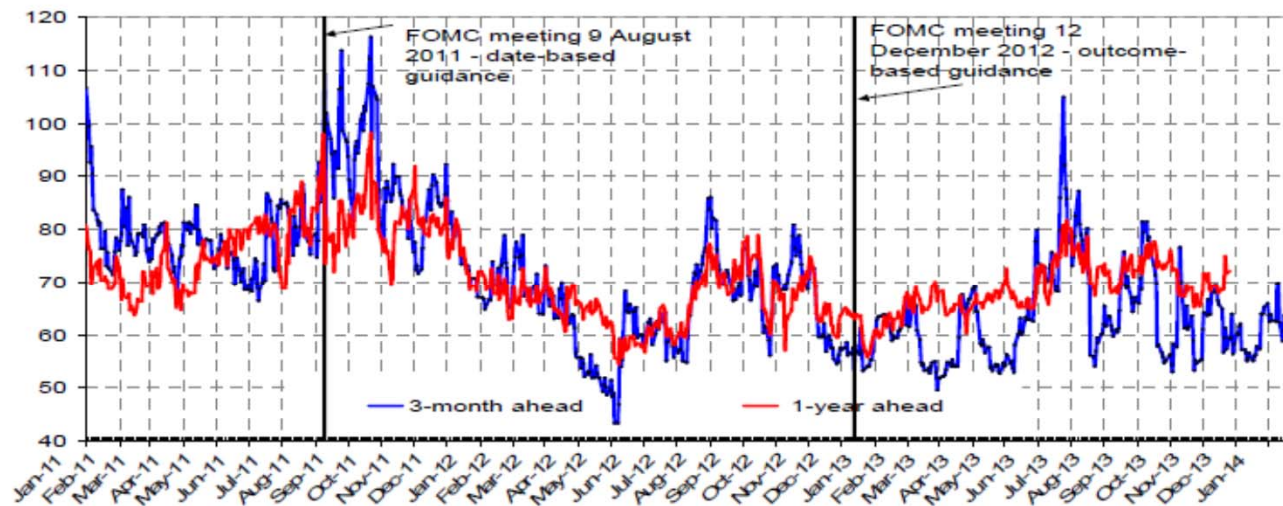
Source: Thomson Reuters.

Note: Volatility of the 1-year interest rate swap at the 3-month and 1-year horizon implied in the prices of options on interest rate swaps (swaptions). The data for the 1-year maturity have not been updated by the provider.
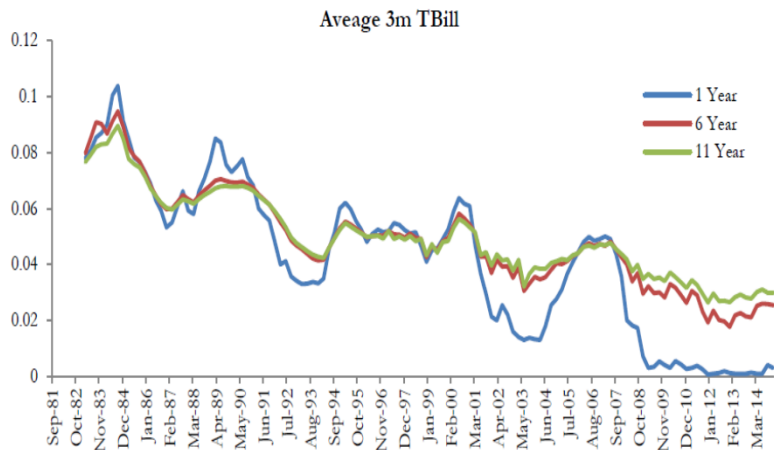
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- Would VAR uncover some of these "forward-guidance" shocks?

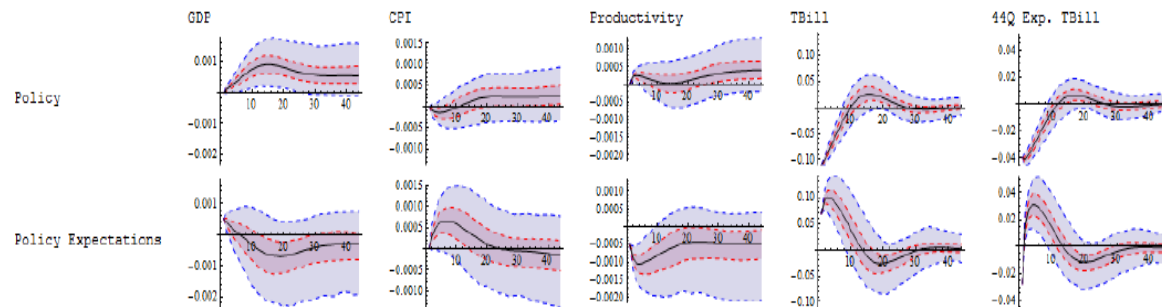- Estimate VAR over 2008-2015 + identify shocks to policy expectations?

Main comments (cont'd)

Comment 3 - Horizon for expectation shocks

- Authors consider 1-, 6- and 11-year expectations on π, Δy and 3m T-bill

- What do shocks to medium and long-term expectations capture? Certainly not monetary policy; changes in natural rate of interest?

Main comments (cont'd)

Table 1. Baseline identification restrictions on contemporaneous impact of shocks

Block / Variable		Policy expectations (η)	Conventional policy (e)
		Shock	
$x1$	GDP	?	0
	CPI	?	0
	Labor productivity	?	0
$x2$	M2 growth	?	?
	Corporate profits	?	?
	Longer-term yield	?	?
i	3m T-Bill rate	+	−
$E^s[x_{t+h}]$	Survey GDP	+	?
	Survey CPI	+	?
	Survey 3m T-Bill	−	?

Notes: The table shows the restrictions imposed to identify structural shocks in the baseline VAR.

Comment 4 – Sign restrictions

- Why should 3m rate move in response to shocks to expectations?

- More plausible to assume rate does not move

- Alternatively, leave response unrestricted.

- In any case, ZLB is an issue. I-VAR (Interaction-VAR; Caggiano et al., 2015)?

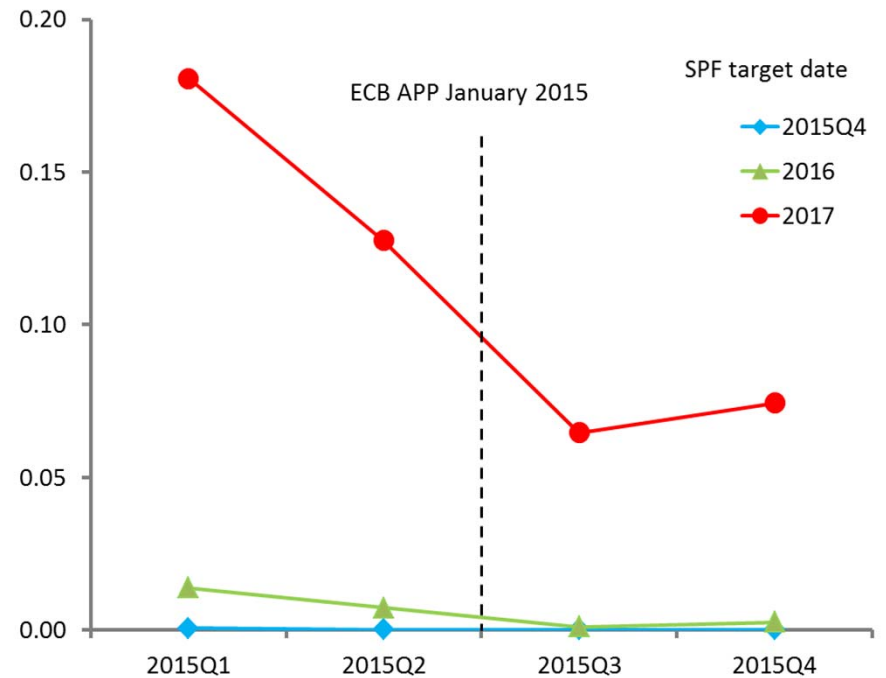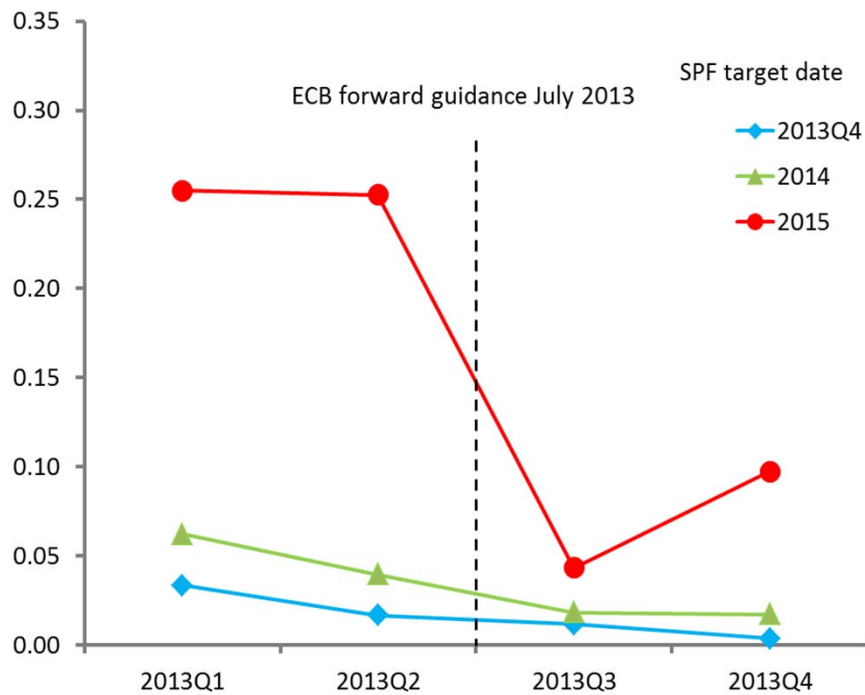- Identification may be picking up announcement of LSAPs and macro news

Main comments (cont'd)

Assumption on ECB MRO rate

Source: ECB Survey of Professional Forecasters

Main comments (cont'd)

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- Adding index of macro surprises and/or Federal Reserve's balance sheet?

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Minor comments

- What is role of corporate profits? No justification in paper, rather "unconventional" choice

- Robustness check: sign restriction for conventional policy shock seem too weak (R$\downarrow$ and $\pi\downarrow$). See Uhlig (2005)

- Variables in level and yearly changes (Y and P): is there any problem?

- Draw model parameters from uniform distribution and derive sign restrictions for impulse responses (Dedola and Neri, 2007)

- "*Monetary News, Surprises and the Macroeconomy*", Gallio (2015). Paper investigates effects of anticipated and unanticipated monetary shocks

All in all …

…. a very interesting, well written, perhaps a bit too ambitious paper ….

…. but room for improving identification of shocks and specification of VAR

Interaction between asset purchases and forward guidance? Key for ECB monetary policy

From latest Introductory Statement by President Draghi: "[…] *the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of our net asset purchases*"

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