BANK FOR INTERNATIONAL SETTLEMENTS

Comments on Lars Other's

Disentangling the information effect from the forward guidance effect

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Expanding the boundaries of central banking in an environment of globalized behavior

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Shocks on FOMC Wednesdays

- Monetary shocks
  - In stationary economy, market would know Fed's reaction function; but in nonstationary economy, surprises about reaction function possible
  - Shock to target rate (Kuttner 2001)
  - Shock to path (Gurkaynak, Sach, Swanson 2005)
  - These shocks can serve as HFI instrument (Gertler and Karadi 2015)
- Information shocks
  - "Delphic" Fed may react to information not known to market (CEFJ (2012, Nakamura and Steinsson 2018)
  - Market will try to infer Delphic shocks
  - Other (2018) identifies Delphic shocks from movements in 5-year, 5-year Forward Inflation Expectation rates (SL Fed)

What does the market actually see?

FOMC STATEMENTS: SIDE-BY-SIDE

Aug 1, 2018

Information received since the Federal Open Market Committee met in June indicates that the labor market has continued to strengthen and that economic activity has been rising at a strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has stayed low. Household spending and business fixed investment have grown strongly. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2 percent. Indicators of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Risks to the economic outlook appear roughly balanced.

In view of realized and expected labor market conditions and inflation, the Committee decided to maintain the target range for the federal funds rate at 1-3/4 to 2 percent. The stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chairman; John C. Williams, Vice Chairman; Thomas I. Barkin; Raphael W. Bostic; Lael Brainard; Esther L. George; Loretta J. Mester; and Randal K. Quarles.

June 13, 2018

Information received since the Federal Open Market Committee met in May indicates that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. Job gains have been strong, on average, in recent months, and the unemployment rate has declined. Recent data suggest that growth of household spending has picked up, while business fixed investment has continued to grow strongly. On a 12-month basis, both overall inflation and inflation for items other than food and energy have moved close to 2 percent. Indicators of longer- term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Risks to the economic outlook appear roughly balanced.

In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 1-3/4 to 2 percent. The stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

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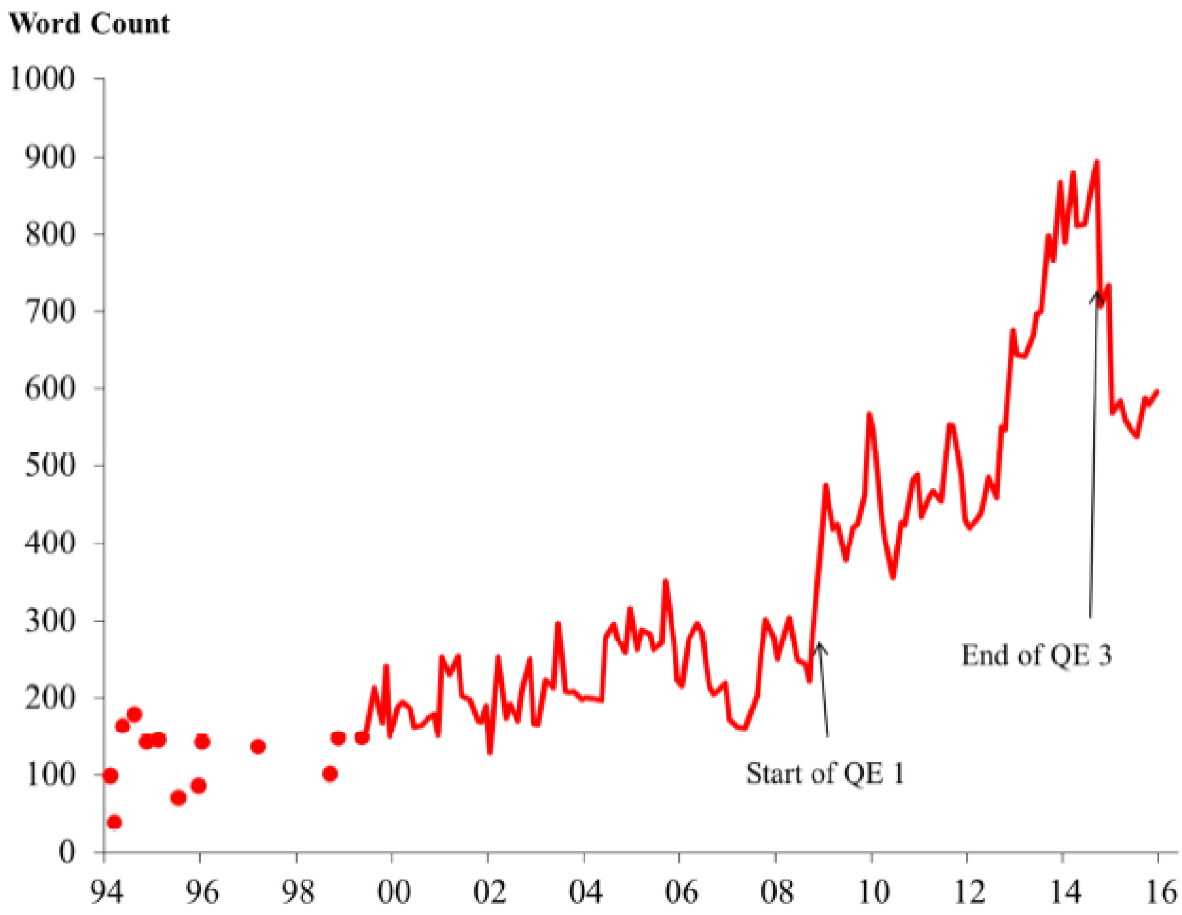
There’s something else that’s nonstationary



Feroli, Greenlaw, Hooper, Mishkin, Sufi (2016): Language after liftoff: Fed communication away from the zero lower bound. US Monetary Policy Forum (February).

Delphic shock most plausible for big FOMC surprises

Ten biggest FOMC events for the US 10-year yield, in order of size

Date of event	Scheduled FOMC meeting?	Easing or tightening?	Change in 10-year yield (basis points)
18 Mar 2009	Yes	Easing	- 47.4
16 Dec 2008	Yes	Easing	- 25.7
3 Jan 2001	No	Easing	24.3
25 Nov 2008	No	Easing	- 21.6
22 Jan 2008	No	Easing	- 19.6
1 Dec 2008	Austin speech	Easing	- 18.9
11 Dec 2007	Yes	Easing	- 18.7
18 Mar 2008	Yes	Easing	17.7
27 Aug 2010	Jackson Hole	Easing	16.8
19 Jun 2013	Yes	Tightening	16.7

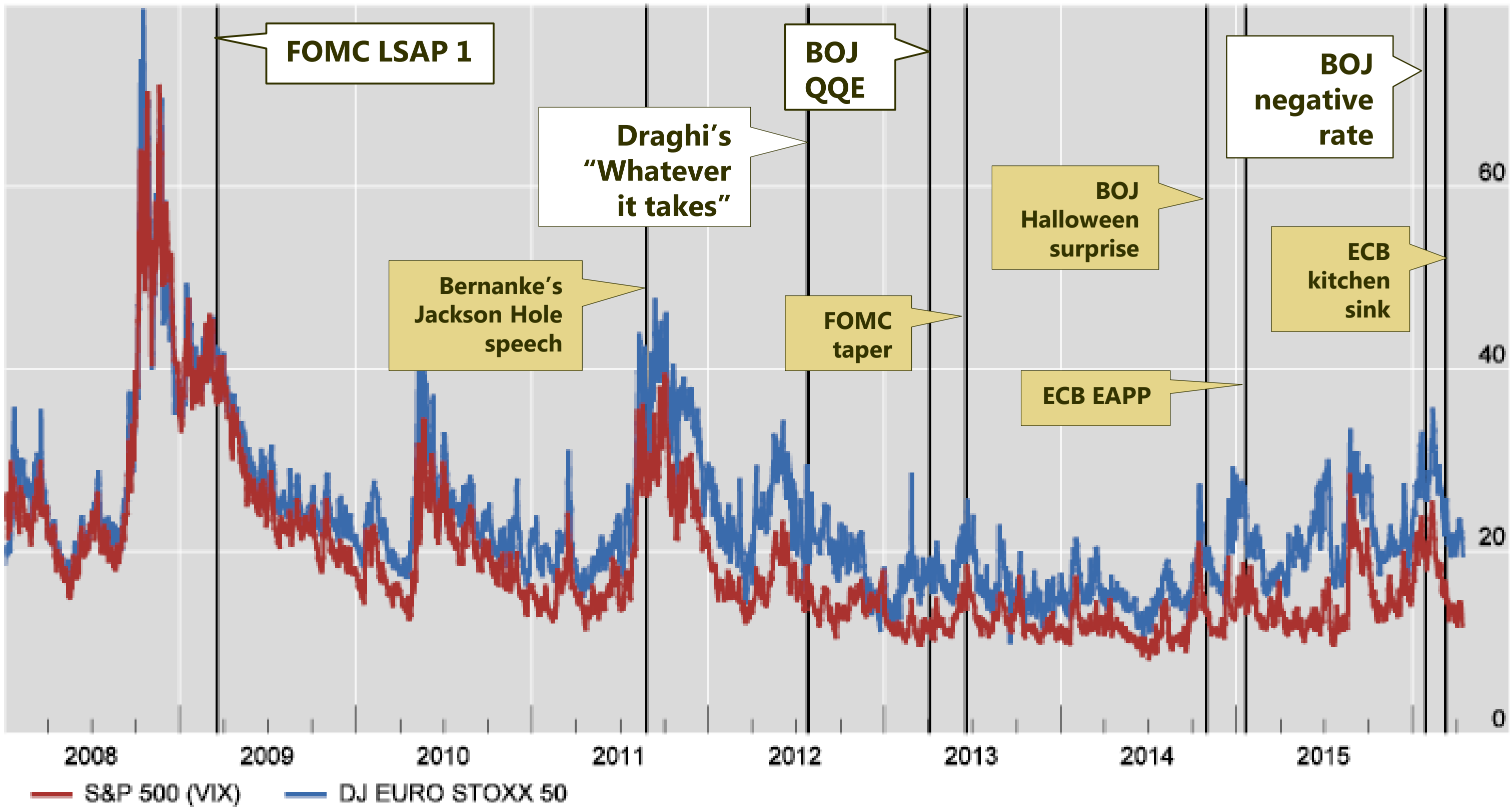
Would the Fed spring a surprise on purpose?

- Policy surprises are time inconsistent
  - Kydland and Prescott (1977): "… not a game against nature but … a game against rational economic agents"
  - It becomes harder and harder to surprise markets
- But on occasion
  - In face of economic shock, urgency of action makes surprise unavoidable
  - If stuck in bad equilibrium, surprise can move us to a good one
- At ZLB, major central banks turned to UMP and to catching markets by surprise
  - Fed and others faced markets that thought central banks had run out of ammunition
  - Can big enough surprise open up other transmission channels?

During UMP, policy surprises became commonplace

As Fed, ECB, BOJ tried to “think outside the box”

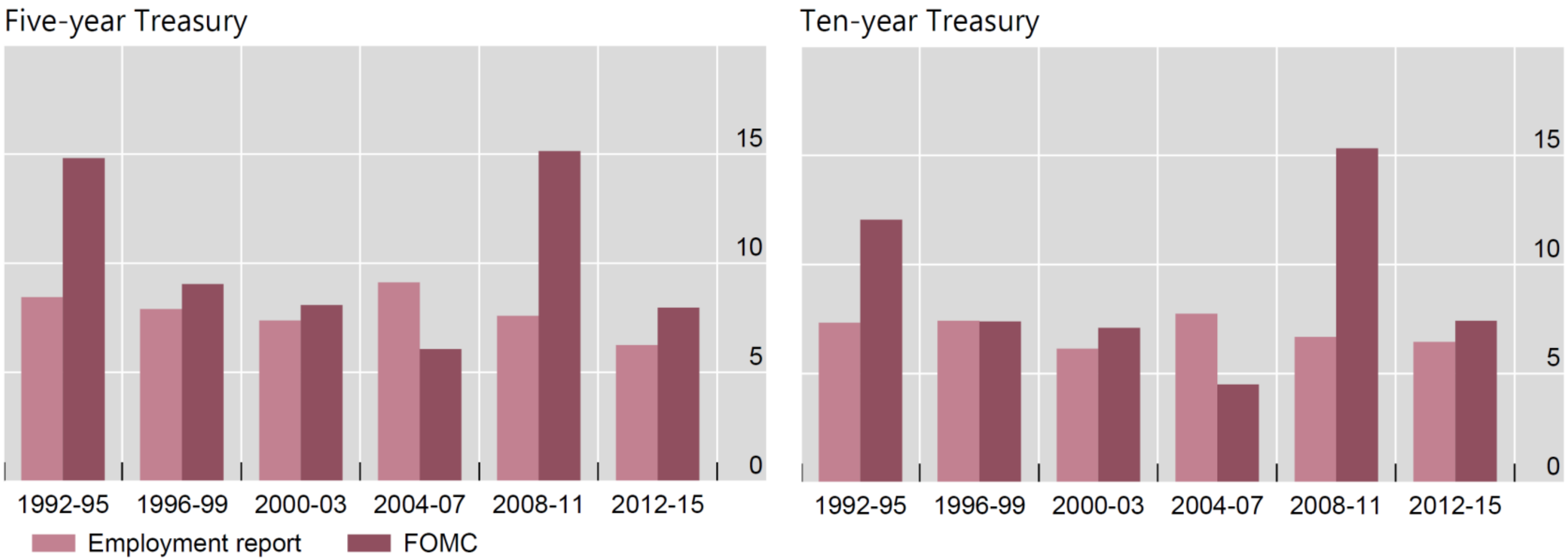
Nine surprises in unconventional monetary policy announcements and implied volatilities in US and euro area equity markets



Employment Report Fridays rival FOMC Wednesdays

Announcement impact: Employment Report versus FOMC statement

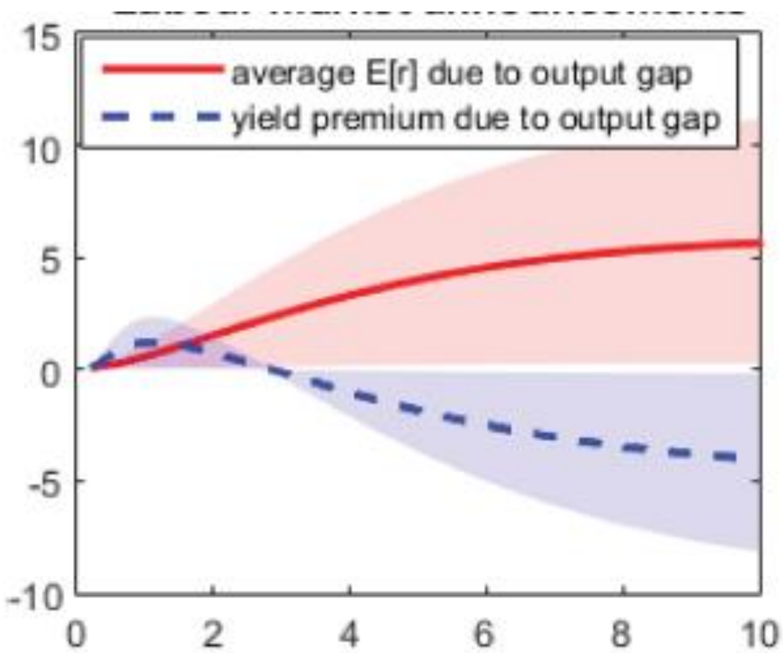
In basis points

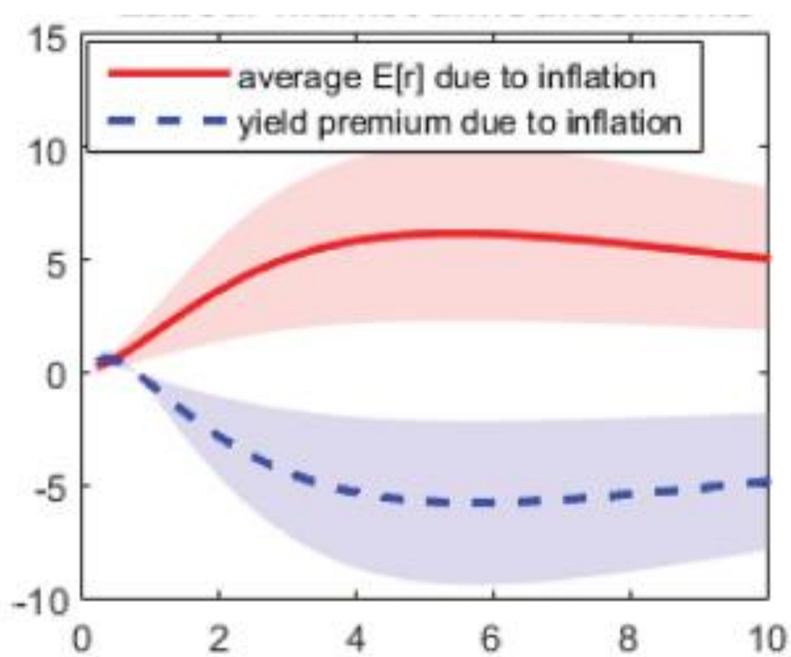


For the Employment report, we show the average of the absolute values of daily yield changes on the day of the report. For FOMC statements, we show the average of the absolute values of daily yield changes on the announcement day, when there is a change in the policy rate target.

Sources: Bloomberg; BIS calculations.

Fitting term structure model to Employment Report Fridays allows us to decompose output effect on path and risk premia





Source: Hoerdahl, Remolona and Valente (2018): Expectations and risk premia at 8:30 AM, JBES forthcoming.

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