Discussion of:
“Policymakers’ Uncertainty”

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Overview

Does policymakers uncertainty matter for monetary policy decisions?

- **Theory:**
  - Policy design mostly in a linear-quadratic set up
  - Role of uncertainty on policy design: all over the place

- **View from the trences:**
  - ‘Balance of Risk’ approach to policy advice
  - Extensive use of scenarios

- **This (awesome) paper:**
  - Transcripts-based measures of FOMC uncertainty and policy actions
  - Show policy actions respond strongly to inflation uncertainty
  - Uncertainty interpreted as ‘tail risk’: credibility of nominal anchor
Measuring tail risk and credibility

- Tail risk from forecasters uncertainty (and the policy response)
- Tail risk from a model of expectations’ anchoring
I@R: Inflation-At-Risk (Andrade, Ghysels and Idier, 2015)

Tail risk from survey forecasts
⇒ Individual forecast distributions of GDP deflator for current year:
  - Uncertainty using left and right tail probabilities with quantiles
    - Overall uncertainty:
      \[ \text{IQR}_t = E_i [q_{it}(0.95) - q_{it}(0.05)] \]
    - Distributional asymmetry:
      \[ \text{ASY}_t = E_i [(q_{it}(0.95) - q_{it}(0.50)) - (q_{it}(0.50) - q_{it}(0.05))] \]
  - Source: SPF, quarterly data over the period 1969-2012.
Tail Risk From Surveys: IQR

- Overall uncertainty high until mid-1990s
- Slowly increasing in the 2000
Positive during the Great Inflation and since mid-1990s; negative during Volker

Time-varying: dips in early 2000 and during the Financial Crisis

Include uncertainty about policy
Tail Risk From Surveys: ASY vs. FOMC

ASY less cyclical than FOMC
Tail Risk And Monetary Policy

- Andrade, Ghysels and Idier, 2015:
  \[ \Delta i_t = \alpha + \beta \text{IQR}_t + \gamma \text{ASY}_t + \Gamma \ast X_t + u_t \]

- Different specs.: control for mean expectations; Greenbook forecasts; endogeneity....

Key Takeways

1. \( \text{ASY}_t \) positively related to interest rate changes \([\approx 13 - 25 \text{ bps.}]\)

2. Policy regimes: reaction to tail risk only after Volker
   - Similar response in both 1981-2012 and 1990-2012 samples
Tail Risk And The Nominal Anchor

- Central bank credibility is tied to long-run inflation expectations
- Use Carvalho, Eusepi, Monech and Preston (2023) to measure tail risk

The model: learning about long run inflation mean

- **Anchoring** → degree of stability of LR expectations:

  \[ \Delta \bar{\pi}^{LR}_t = g_t \times \text{short-term forecast errors} \]

  \[ \text{shocks + policy response} \]

1. Time-varying: decreasing (anchored) or constant (unanchored)
2. State dependent: past forecast errors
Inflation Forecast Errors

Persistent patterns of forecast errors across time
Predicts survey forecasts [professionals, households, US and foreign]

Expectations long-run expectations remain anchored post-2000...

... but tail risk to nominal anchor changes over time
Anchoring: $g_t$

- Expectations become anchored in the late 1990s
- Some tail risk in the past 20 years
- Better assessment if we use a ‘real time’ measure
Long Run ASY: Tail Risk to Nominal Anchor

- **Blue**: conditional on full sample of forecast errors
- **Red**: ‘real time’
Long Run ASY: Compare with FOMC

- **Black**: FOMC
- **Red**: ‘real time’ tail risk to nominal anchor
Tail Risk and Scenarios

- Large inflation tail risk in the aftermath of the pandemic: How did the Fed react?

- Response to inflation tail risk likely to be time-varying

- Focus on the source of uncertainty: alternative scenarios

- Risks to the joint process of inflation and economic activity from probability distribution over scenarios
  - high $u^*$ vs financial crisis
  - ‘Supply’ vs. ‘Demand shocks’