

Monetary Policy without an Anchor: Discussion



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Disclaimer

The views expressed here are mine alone and do not necessarily reflect the official views of the Federal Reserve Bank of New York or the Federal Reserve System.



Summary

- Main goal: Study optimal monetary policy (in response to a positive supply shock) in the presence of imperfect information about the central bank “type.”
- Basic idea: When agents have to learn about the CB’s type, the CB has an incentive to hit the brakes more forcefully in order to build credibility.



Summary, cont'd

- The importance of this reputation channel is larger, the more responsive inflation expectations are to MP decisions.
 - When IE are more anchored, CB can afford to tighten less aggressively in response to shocks, and to “look through” some supply shocks.
 - More anchored IE allow the CB to achieve a better inflation-output trade-off.



Summary, cont'd

- The “reputation dividend” depends crucially on the sensitivity of longer-term IE to MP surprises.
 - Paper estimates this sensitivity for both advanced and emerging market economies.
 - “Standard” identification strategy, using a two-day window around policy announcements.
- Use both market- and survey-based measures of IE.



Findings

- The sensitivity of longer-term IE to MP surprises is economically significant in Brazil, close to zero in advanced economies.
- Model calibration suggests sizable reputation dividend, with meaningful gains from anchored IE (evaluated through the CB's objective function).



- **Measurement:** Ideally we would like to measure IE in a narrow window around policy announcements.
 - Market-based measures allow us to do that, but may suffer from risk and liquidity premia.
 - Survey-based measures are less granular (monthly or quarterly); lately, more high-frequency measures are becoming available: e.g., Morning Consult (from 2018).



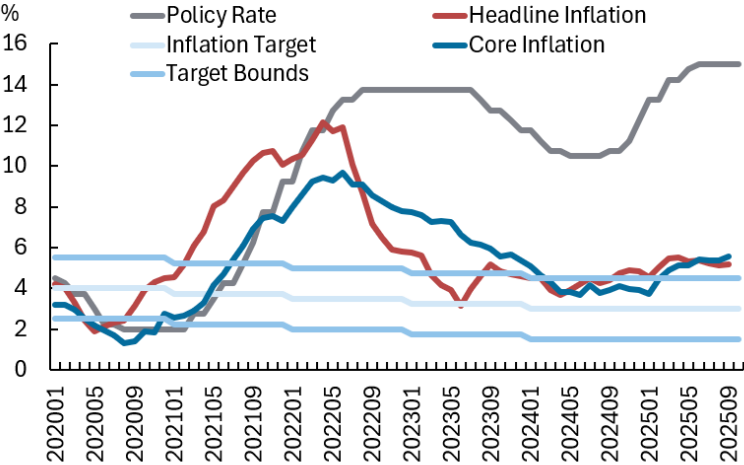
Comments II

- **Big picture:** sensitivity high in Brazil, zero in Chile & Mexico. And yet...
- All three countries adopted inflation targeting roughly at the same time;
- Policy response to inflation surge post-Covid was roughly similar in all three countries: sharp and timely.



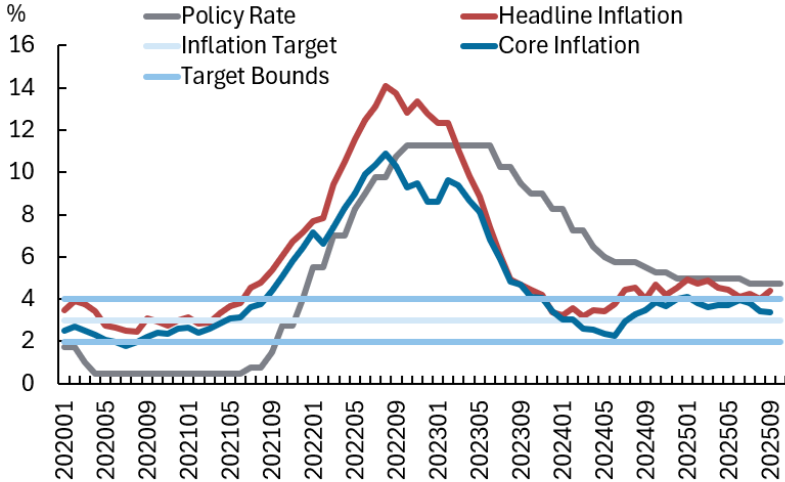
Inflation and policy rate in Brazil, Chile, Mexico

Policy & Inflation Rates



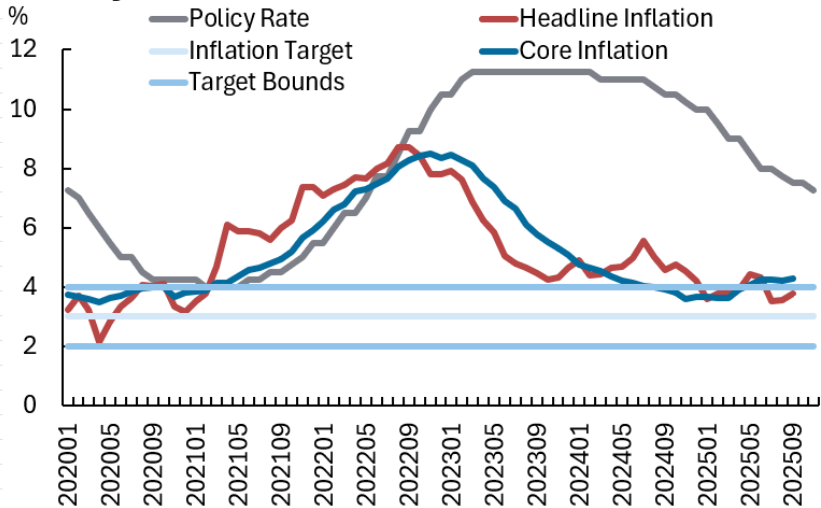
Source: Central Bank

Policy & Inflation Rates



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Source: Central Bank



- **Learning:** Private agents in the model do Bayesian learning (about the CB type).
 - Outside the scope of this paper, but it would be interesting to think about more fleshed-out models of learning (CGLS, diagnostic expectations, etc) and see whether and how the quantitative implications might change.

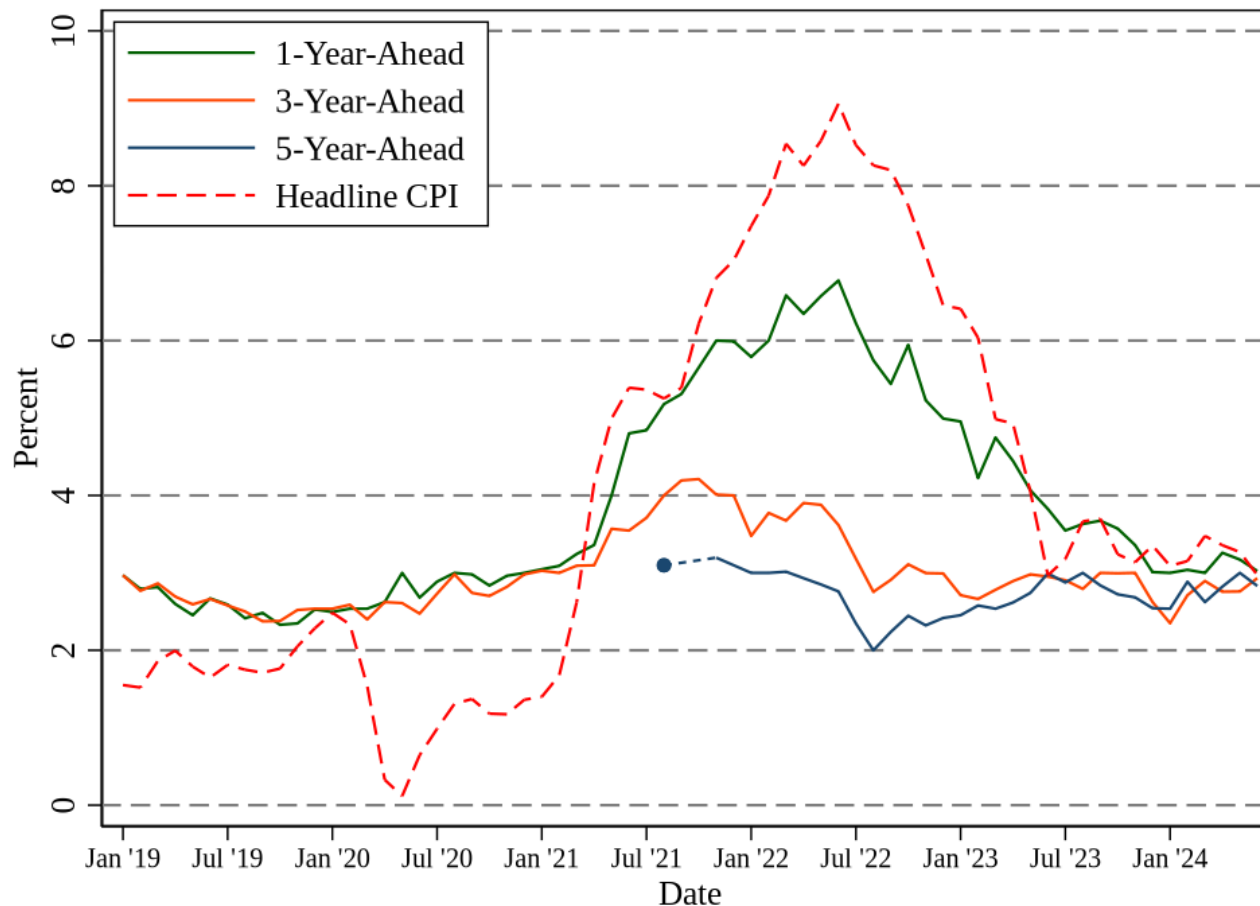
- **Minor comment:** F4 and T3 → semi-elasticity of LT IE to MP surprises is about -0.18.
 - This is the estimate from T1 for the 2010-2024 period; model is calibrated over the pre-Covid period (2010-2019).
 - This is the estimate from survey data, whereas the one from market-based IE data is larger, at -0.48.
 - Unresponsiveness of focus survey and potential risk-premium components in market-based measures → truth probably somewhere in the middle. More work needed to match data?



- **“Level” and “shock” anchoring** (Ball and Mazumder, 2011; Kumar et al., 2015).
 - In the second category, sensitivity of IE revisions at different horizons to short-term forecast errors;
 - co-movement of short- and medium/longer-term IE revisions.
- Term structure of IE.



Term structure of IE (NY Fed SCE)



- As inflation rose in 2021-2022 and then moderated,
 - The median 1-year ahead inflation expectation increased sharply and then declined;
 - 3-yr ahead IE rose less and **peaked earlier**; 5-yr ahead IE remained **broadly stable**.

Sensitivity of IE Revisions to Forecast Errors

	1-Year IE Revisions		3-Year IE Revisions		5-Year IE Revisions
	Jan 2014 to Dec 2019 (N=3,912)	Jan 2020 to Feb 2026 (N=4,476)	Jan 2014 to Dec 2019 (N=3,884)	Jan 2020 to Feb 2026 (N=4,452)	Jan 2022 to Feb 2026 (N=2,356)
One-Year Ahead Forecast Error	0.72*** (0.04)	0.72*** (0.04)	0.41*** (0.04)	0.41*** (0.04)	0.19** (0.07)
Constant	1.18 (0.87)	1.01 (1.14)	0.85 (0.95)	-2.72** (0.87)	0.33 (1.91)
R^2	0.41	0.38	0.18	0.14	0.06
Mean	-0.122	-0.073	-0.081	-0.151	-0.138

Standard errors in parentheses. Sample weights used in the regressions. Monthly dummies included.

Revisions (dep. variable) are defined as 1-year and 3-year inflation expectations in month 12 minus those in month 2.

Errors are defined as realized CPI in month 12 minus expected inflation in month 2.

Period is defined as the month of the respondent's twelfth month in the SCE panel.

All inflation expectations are the respondent's density mean from the SCE core survey.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$



Co-Movement between ST and MT/LT IE Revisions

	3-Year IE Revisions		5-Year IE Revisions
	Jan 2014 to Dec 2019 (N=23,483)	Jan 2020 to Feb 2026 (N=24,072)	Jan 2022 to Feb 2026 (N=14,401)
One-Year Ahead Forecast Error	0.63*** (0.02)	0.49*** (0.03)	0.22*** (0.03)
Constant	0.61 (0.35)	-0.33 (0.35)	-0.04 (0.38)
R^2	0.38	0.23	0.05
Mean	-0.056	0.139	-0.132

Standard errors in parentheses. Sample weights used in the regressions. Monthly dummies included.

Revisions (dep. variable) are defined as 1-year and 3-year inflation expectations in month 12 minus those in month 2.

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Firm surveys of IE

- Many studies have documented large dispersion of firms' IE.
- Recent work (Atlanta, Cleveland, NY Feds) based on qualitative interviews and quantitative surveys:
 - Most important factors in price-setting are strength of demand, profit margins, competitors' prices, and labor costs.
 - **Aggregate inflation not very important.**
- ...Firms are “rationally inattentive” to overall inflation?

