

REASSESSING THE EFFECTIVENESS AND

TRANSMISSION

OF MONETARY POLICY

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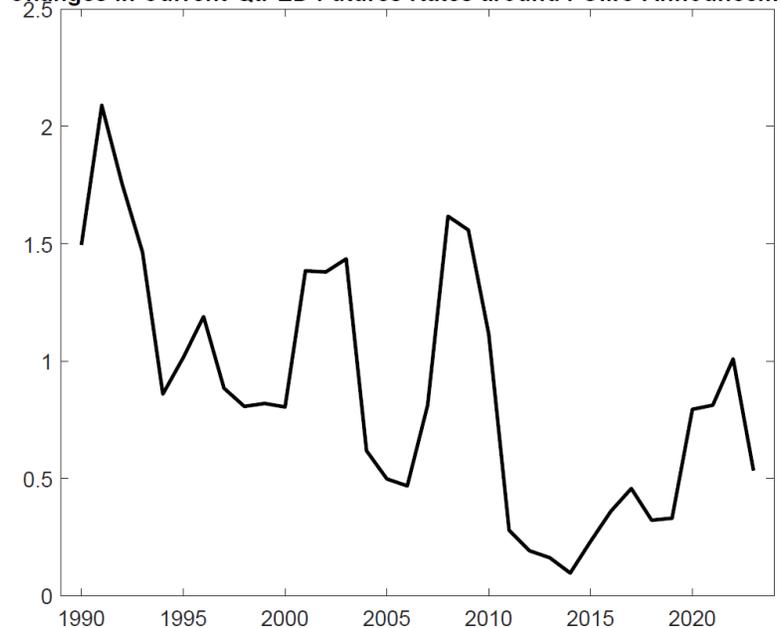
1. Central Bank Decisions Have Become More Predictable

Financial markets and private-sector forecasters have become:

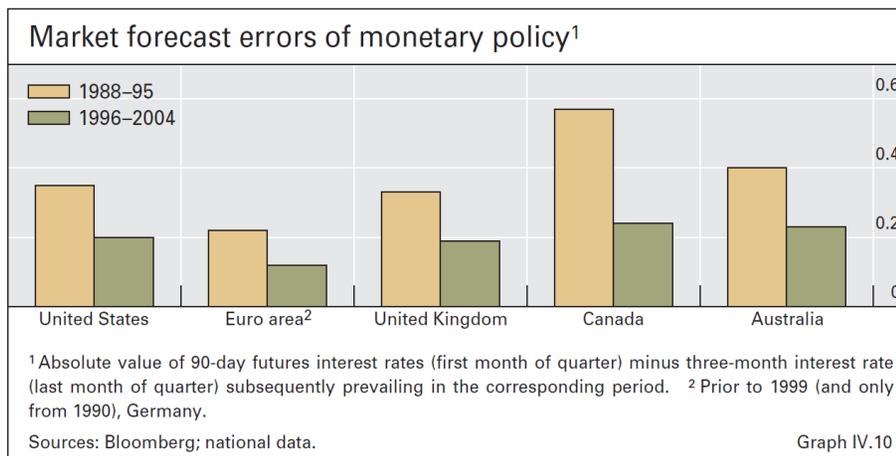
- Better able to forecast short-term interest rates several months ahead
- Less surprised by central bank policy announcements

Swanson (2006), BIS (2004), Brand, Buncic, Turunen (2010), Blattner et al. (2008), Swanson-Jayawickrema (2024)

Changes in Current-Qtr ED Futures Rates around FOMC Announcements



source: Swanson and Jayawickrema (2024)



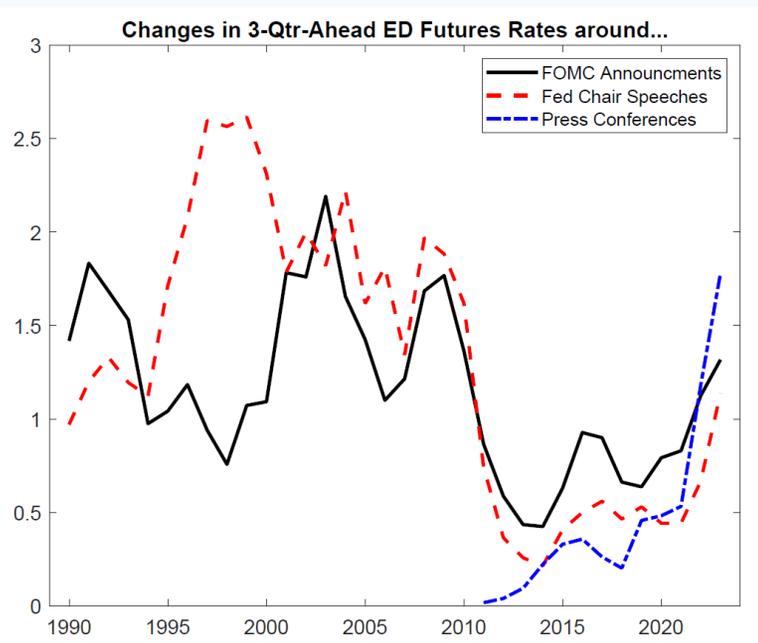
source: BIS (2004)

- Central banks have increasingly communicated decisions to markets ahead of time (forward guidance)

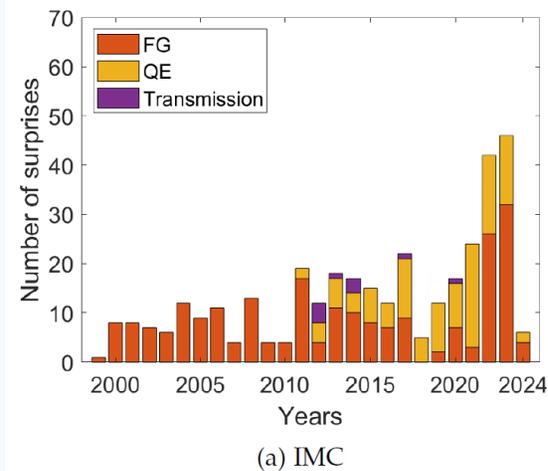
2. Central Bank Communication As Important As Decisions

- Important role of forward guidance has made CB communication as or more important than CB decisions themselves
- Focusing only on CB decisions misses most of monetary policy transmission to financial markets in U.S., U.K., Euro Area (maybe others)

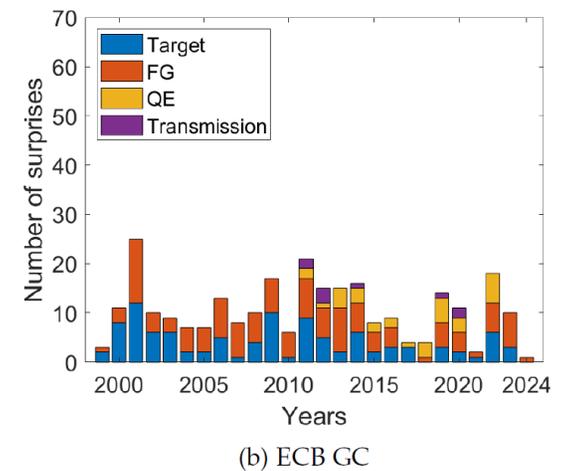
Swanson-Jayawickrema (2024), Mumtaz, Salaheen, Spitznagel (2024), Istrefi, Odendahl, Sestieri (2024)



source: Swanson and Jayawickrema (2024)



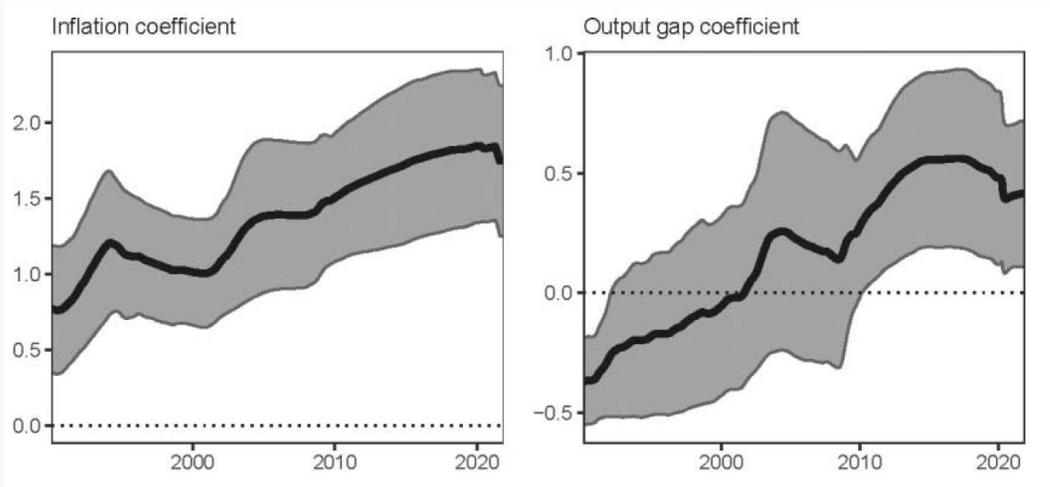
source: Istrefi, Odendahl, and Sestieri (2024)



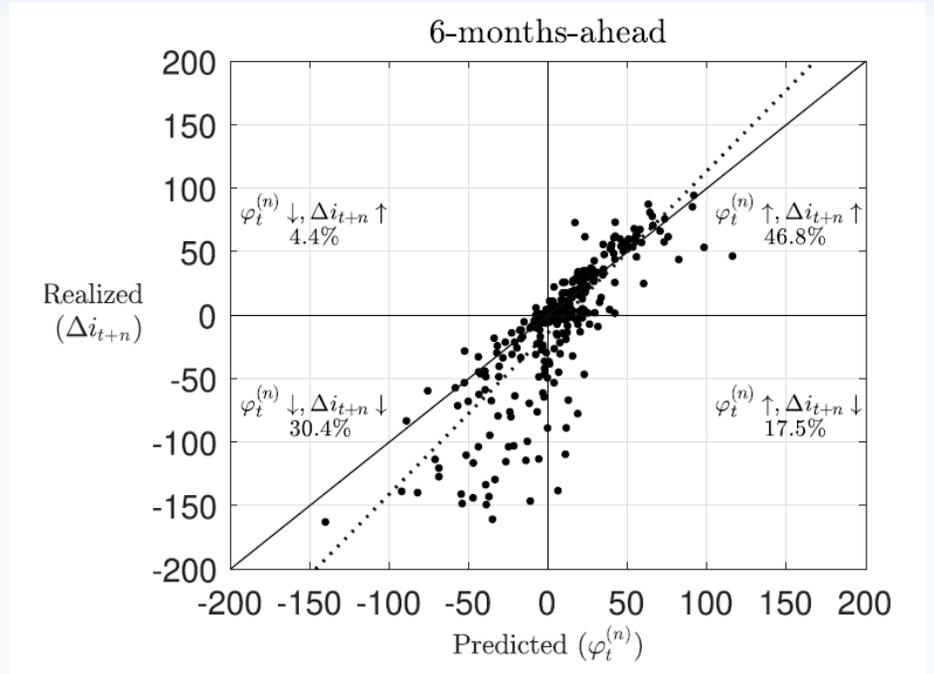
3. Central Banks Have Been More Aggressive than Expected

- Over the past 30+ years, CBs have surprised markets by responding to economic and financial news more aggressively than expected
- Evidence for U.S., U.K., Euro Area, Switzerland (maybe others)

Cieslak (2018), Schmeling, Schrimpf, Steffensen (2022), Bauer-Swanson (2023 AER, NBERMA)



source: Bauer-Swanson (2023 NBERMA)



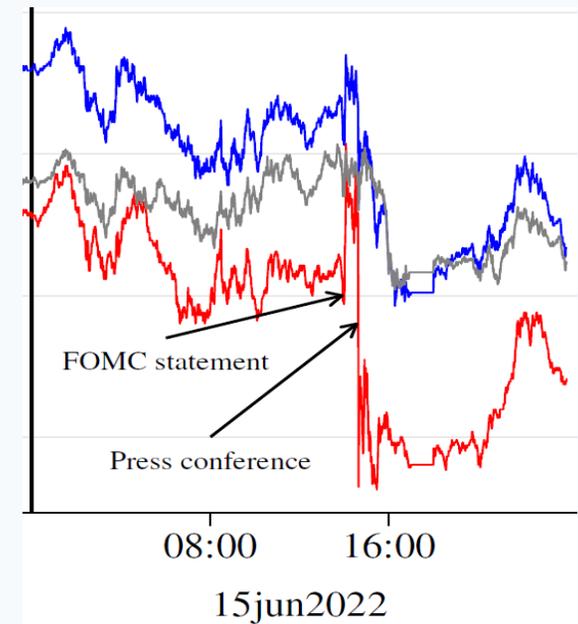
source: Schmeling, Schrimpf, Steffensen (2022)

“The Federal Reserve has seen the need to respond more aggressively than had been our wont in earlier decades.”
Alan Greenspan (Mar. 20, 2001)

“By way of historical comparison, this policy response stands out as exceptionally rapid and proactive.”
Ben Bernanke (Dec. 1, 2008)

4. Central Banks Should Focus on Improving Communication

- Why have markets been so surprised by how aggressively CBs responded to economic and financial developments? Do they understand CB's reaction functions better now? Can their understanding be improved?
 - Bauer, Pflueger, Sundaram (2024): as of 2022, markets still didn't seem to understand how aggressively Fed would respond to inflation
- Did the Fed's switch to Flexible Average Inflation Targeting framework enhance communication? Or hurt it?
 - Mumtaz, Salaheen, Spitznagel (2024): In the U.K., simple communication has been more effective than complex communication
 - Cieslak, McMahon, Pang (2024): the Fed's FAIT framework increased uncertainty and confusion in the markets
- Several FOMC announcements and press conferences in 2022 moved markets in opposite directions. How could those FOMC statements and/or press conferences have been improved?



source: Cieslak, McMahon, Pang (2024)

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