Discussion of "Adverse Effects of Monetary Policy Signalling" by J. Filacek and J. Mateju

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Motivation

- Central Banks often possess information not available to private agents (e.g., Romer and Romer (2000))
- An informational dimension then attached to monetary policy
- How does this modify the effects of monetary policy?

Overview

- Forward-looking CB has superior information about future state of the economy
- Nominal interest rate serves as a noisy public signal about future inflation and output: "updating channel"
- Updating channel distorts, and can even reverse, monetary policy transmission in the presence of partially rational agents
- Might bring the price puzzle (Sims, 1992) to mind
- Evidence from a sample of OECD countries

Zooming in

- New Keynesian framework as in Clarida, Gali, Gertler (1999)
- CB's policy rate signals its beliefs about future inflation and the future output gap:

$$i_t = \rho + \phi_\pi E_t^F [\pi_{t+1}] + \phi_y E_t^F [y_{t+1}] + \epsilon_t$$

- Two types of sectors: rational (F) and "partially rational" (P) with shares Ω and $1 - \Omega$ (each sector comprises consumers and producers)

Zooming in (2)

- Partially rational agents' (partially adaptive) expectations given by

$$E^p\left[Z^p_{t+1}\right] = \gamma^z\left(E^f\left[Z^{AG}_{t+1}\right] + \frac{\epsilon_t}{\phi_z}\right) + (1-\gamma^z)\, Z^p_t\,, \text{ where } Z = \{\pi\,,\, y\}$$

- As $\Omega\downarrow$,$\gamma\uparrow$, updating channel becomes stronger
- Contractionary policies make partially rational agents optimistic:

$$E^p\left[\pi^p_{t+1}\right]\uparrow, E^p\left[y^p_{t+1}\right]\uparrow$$

  - can drive up both output and inflation in the P sector

Comments and suggestions

- Main result nice and intuitive
- 'Rationalize' or, even better, endogenize partial rationality:
  - on the former, inattentiveness seems quite natural: partially rational agents' expectations resemble those in Mankiw, Reis (2002)
  - on the latter, possibly consider rational inattention (Sims (2003), Mackowiak, Wiederholt (2009))
- Could agents mistake demand shocks for suprise monetary policy shocks?

More comments and more suggestions

- How does partial rationality interfere with nominal rigidities?
- Optimal CB transparency and volatility due to surprise monetary policy shocks:
  - seems to be inviting a tradeoff
  - if CBs too transparent, then any mistakes/surprise shocks will impede the monetary policy transmission and destabilize the economy
- Forward guidance (also Gaballo (2015))