

Central Bank Communication that Works: Lessons from Lab Experiments

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The views expressed herein are those of the author and should under no circumstances be interpreted as reflecting those of the Banque de France or the Eurosystem.

This paper

- Very interesting and stimulating read
- A rich set of results
- Policy relevant: not all forms of communication work

Experiment versus Reality

Two remarks:

1. Experiment design
 - ✓ "Occasional" central bank communication
2. Findings
 - ✓ Central communication and outlook for rates, prices and expenditures

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Experiment design

- In the experiment, central bank announces monetary policy decisions **occasionally**
 - ✓ announces only changes in policy (in two treatments)
 - ✓ announces inaction periods (in one of the treatments)
 - ✓ inaction periods considered exogenous
- In reality, central bank communication is systematic
 - ✓ Both changes and inactions are announced
 - ✓ Inactions related to forward guidance (FG) are not exogenous
 - ▶ signaling either the state of the economy or a new reaction function
- Both the model and the experiment abstract from this reality

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■ Findings from the experiment

- ✓ Neither type of FG yields improvement in interest rate forecasts
- ✓ however communication improved price and expenditure forecasts (economic outlook)

■ At odds with some empirical evidence

- ✓ In many FG countries, interest rate uncertainty of professional forecasters fell (Istrefi and Mouabbi, 2018)
- ✓ In response to FG in the US, interest rate uncertainty fell but outlook uncertainty increased (Andrade, Gaballo, Mengus, Mojon, 2019)

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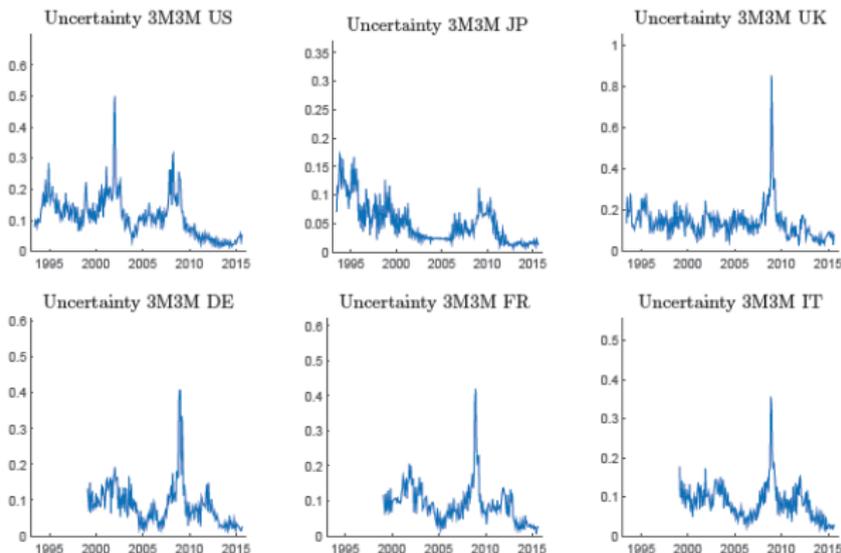
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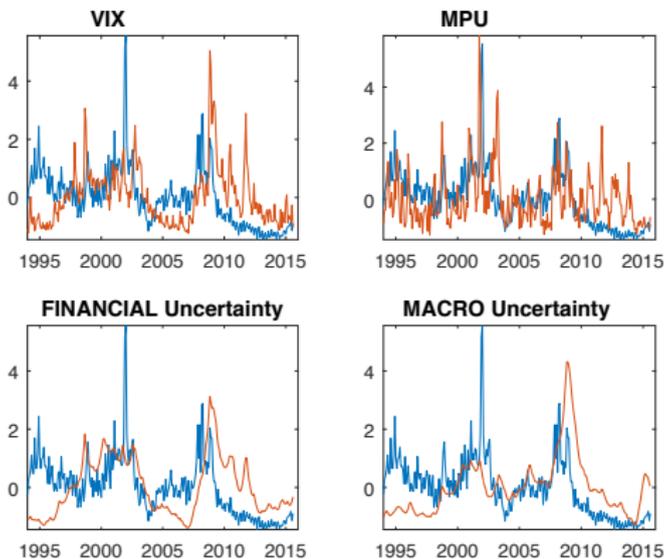
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Subjective interest rate uncertainty, Istrefi and Mouabbi (2018)



- Uncertainty on short-term interest rates 3-months ahead as perceived by professional forecasters (Consensus Economics surveys);
- Accounts for **disagreement** and **variability of forecast errors**;
- At the ZLB and with FG communication, interest rate uncertainty fell.

US interest rate uncertainty vs. other measures



Note: Our measures in blue, other measures in red. MPU denotes Monetary Policy Uncertainty Index of Baker et al. (2016). Macro and Financial Uncertainty reflect uncertainty as in Jurado et al. (2015). All measures are standardized to be comparable. Negative values arise when uncertainty measures are below their sample averages.

- At the ZLB and with FG communication, interest rate uncertainty fell significantly.

Andrade, Gaballo, Mengus, Mojon, (2019)

- FG announcements can generate uncertainty on inflation and GDP growth
- Case of the US in reaction to date dependent FG in 2011
- Professional Forecasters agreed on expected interest rates
- Yet, uncertainty about outlook increased
- Why?
 - ✓ Interpretation of the motivation for the FG is important
 - ✓ "Low rates for longer" can be interpreted as: a longer accommodation or CB expecting a longer crisis
 - ✓ Communication about a date does not tell apart the two
 - ✓ In the US, only a fraction believed in more accommodation, others became more pessimistic about the future outlook
- Same could have happened in the experiment (Treatment Com Commit).

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