

Outlines of the medium-run for central banking

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Fundamental problems

- ▶ Time scales
- ▶ Transmission channels

Practical problems

- ▶ Time scales
- ▶ Monetary policy in SFC models
- ▶ SFC models for policy design

Draghi, 4 July 2013

The Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time. This expectation is based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics.

Draghi, 4 July 2013, cont'd

From the press conference:

Question: *It sounded a lot like the statement I listened to when I was here in June.*

Draghi: *Yes, that is why I said you haven't listened carefully. The Governing Council has taken the unprecedented step of giving forward guidance in a rather more specific way than it ever has done in the past. In my statement, I said "The Governing Council expects the key" —i.e. all interest rates— "ECB interest rates to remain at present or lower levels for an extended period of time." It is the first time that the Governing Council has said something like this. And, by the way, what Mark Carney said in London is just a coincidence.*

How is forward guidance supposed to work?

Expectations hypothesis

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A nearly irrelevant aside

- ▶ The expectations hypothesis is empirically refuted
- ▶ Sarno, Thornton, Valenti (2007)

Expectations hypothesis

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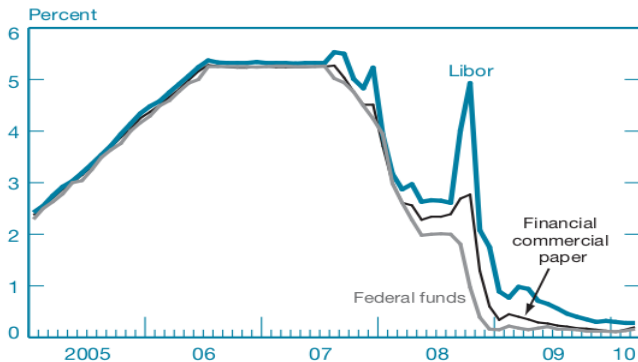
- ▶ The expectations hypothesis is empirically refuted
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Market mechanics

Where do prices along the term structure come from anyway?

Term spreads in money markets

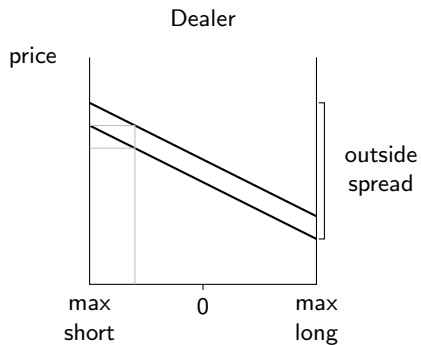
Federal Funds, One-Month Libor, and Commercial Paper Rates



Source: Board of Governors of the Federal Reserve System.

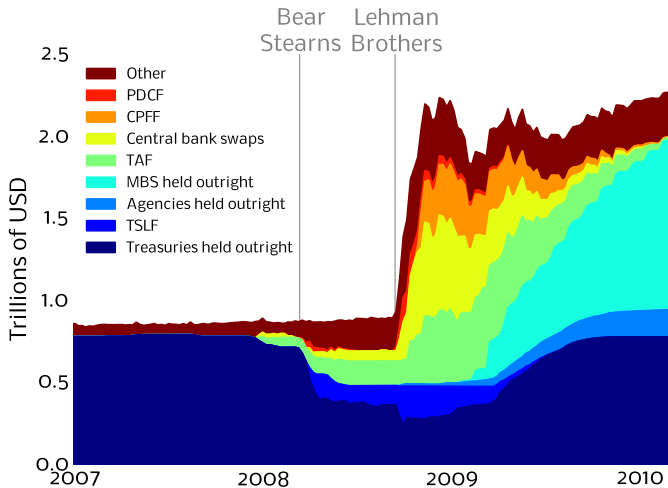
Source: Adrian, Kimbrough, and Marchioni (2011)

Dealers



Treynor (1987)

Thank you



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