The changing nature of the monetary policy transmission mechanism

- Comment on the session -

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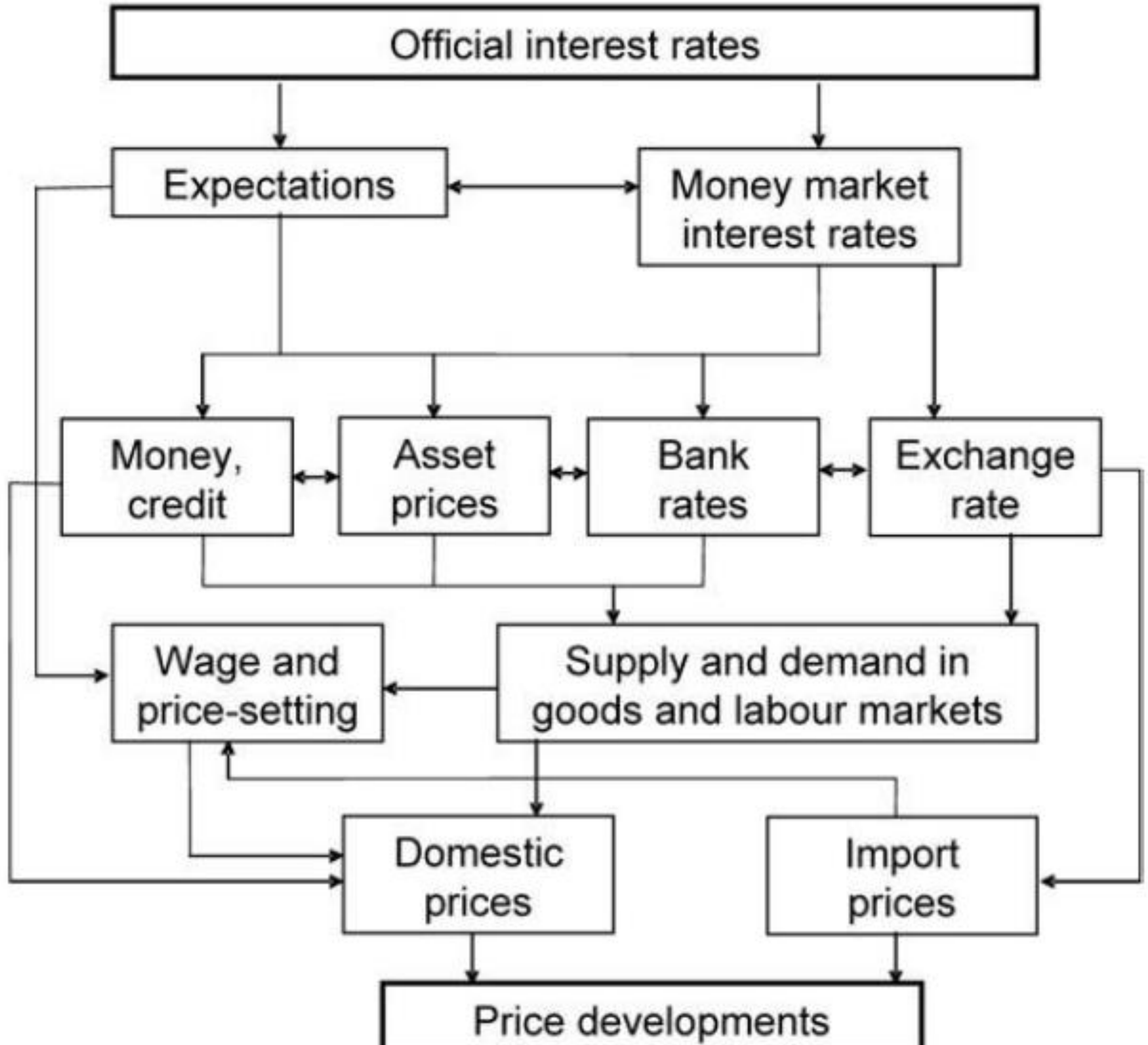
Changing transmission mechanism



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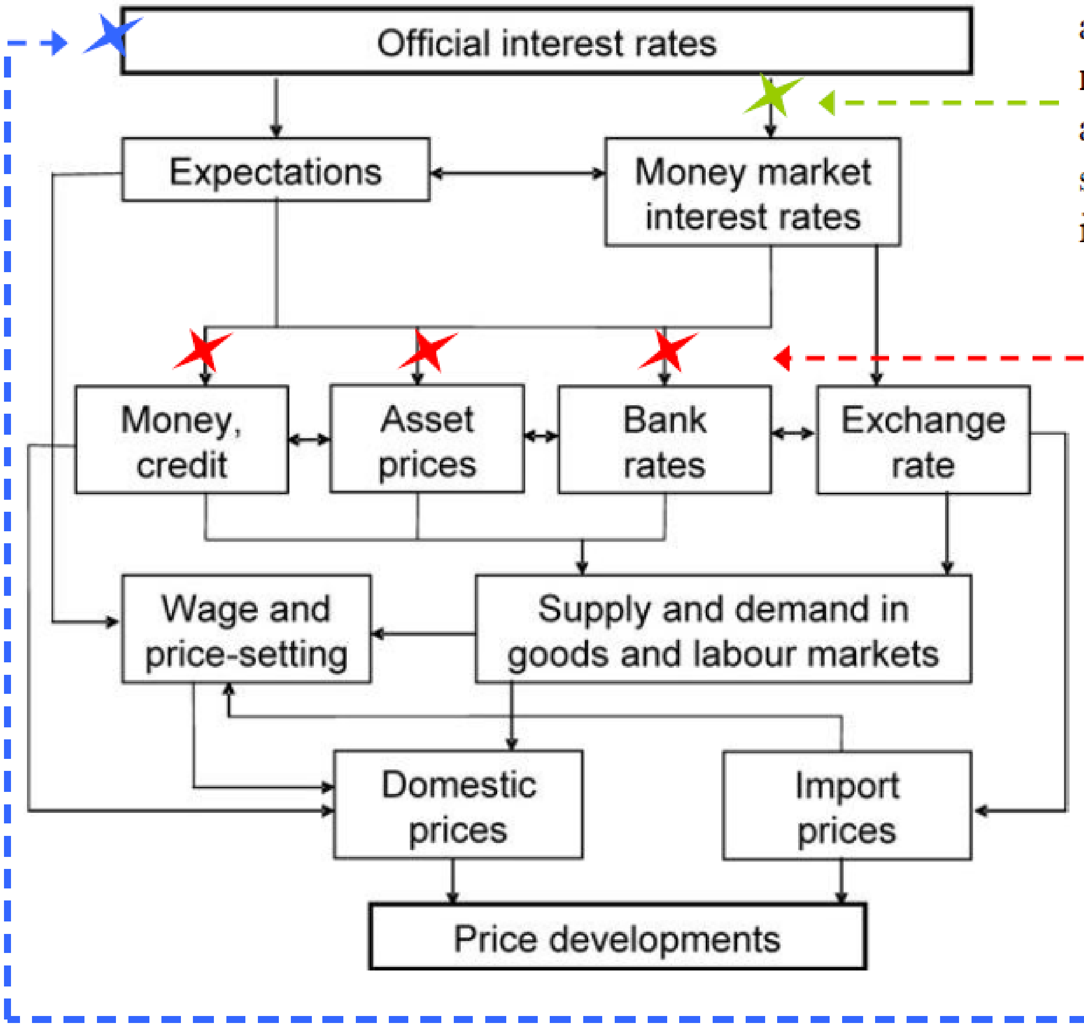

(i) **volatility of demand for reserves** and (ii) **limited redistribution of reserves** among depository institutions, affect central bank's ability to control short-term interest rates in the interbank market.

disruptions in other segments of the financial market may hamper the transmission of the monetary impulse across the full spectrum of financial assets.

When the effect of the crisis on the real economy is large, **the zero lower bound for interest rates** may become a binding constraint for monetary policy decisions.

Within this context…

- This session analyzed three important issues on which transmission effectiveness may impinge on:
  - The issues of central bank credibility
  - Responsiveness of inflation items to demand conditions
  - The Balassa-Samuelson effect

1. Central bank credibility and the expectations channel: Evidence based on a new credibility index

- The objective of the study is to devise a new index for central-bank credibility and then to assess its explanatory power over interest-rate volatility in inflation-targeting countries
  - Considering the asymmetry on measuring of the credibility
  - Without imposing any ad-hoc thresholds

Discussion

- The study offers a novel and innovative way to measure central-bank credibility, overcoming the problems of the previous measures
  - However, how do the new indices compare with those already established
  - Some comparisons established, but only in a qualitative fashion
  - Is there any more rigorous quantitative way to prove that the new indices perform better than the old ones?

Discussion (2)

- Inflation targeting is heavily criticized for the incapability to deal with imported inflation (e.g. Stiglitz 2008, says, IT would almost certainly fail)
  - How does this relate to credibility?
  - E.g. the authors recognize the imported price shock of 2008 and qualitatively argue it did not affect credibility
  - Hence: is credibility differently understood when shocks are external, compared to the case when surprises come from the central bank itself?
- In a similar vein: does expectation formation (adaptive vs. rational) affect the build-up of credibility?

Minor remarks

- Why the GARCH/EGARCH model(s) are considered more appropriate in this case?
  - Maybe make the argumentation on this more compelling?

2. Sensitivity of inflation to demand conditions in Turkey: Determining CPI items responding to output gap and credits

- The objective of the paper is to understand the sensitivity of the CPI sub-items to economic policies
- The main finding is that about fourth of the items are sensitive to credits, and a third to output gap developments
  - Still, these represent not large shares in the total CPI basket

Discussion

- One of the arguments is that the credit is reflecting the output gap
  - Then, why this should be considered a separate channel?
  - Could some measures be presented – e.g. simple correlations between the output gap and the credit growth?
  - Still, as the authors point out, the output gap may be considered a reflection of the conventional monetary policy, while the credit growth of the unconventional one
    - As this is the main argument the authors want to pursue, considering the channels separately and not interchangeably, may be still worthwhile to pursue

Discussion (2)

- The estimation of the central equation may be challenging
  - In particular, the identification of the effect of gap/credit on inflation may be unconvincing, as it may suffer endogeneity problems (due to simultaneity or the work of an unobservable factor)
  - These issues should be paid particular attention
- The central equation assumes accommodative formation of expectations
  - While this may be plausible for Turkey, it still seems too restrictive, since the forward-looking component may still have explanatory power over inflation

Minor remarks

- The study does not dwell on cases where both the output gap and the credit growth are significant in explaining inflation
  - How are these then classified?
  - In terms of estimation, it would be interesting to check if both variables remain significant for these cases, when put together in the equation
- The identification of the lag structure may be made clearer
  - Is it obtained through visual analysis, or more rigorous statistical tests have been pursued?

3. Is there a Harrod-Balassa-amuelson effect present in the data? New quarterly panel data evidence from 25 European countries

- The objective of the paper is to test the famous Balassa-Samuelson hypothesis for a panel of 25 European countries
- The main finding is that the hypothesis is confirmed
  - The effect is found stronger for transition economies
  - The effect is found stronger for the pre-crisis period.

Discussion

- The paper treats an interesting question, which actually maintained the interest over the decades
  - However, why raising such an issue now, when the Eurozone faces deflation and inflation considerations are completely out of the policymakers’ focus?
  - Hence, the bold question is, what is the main lesson from this analysis for the present moment and how does it feed policymaking?

Discussion (2)

- What is distinct for transition economies that may make the work of the B-S effect potentially different?
  - Their treatment within a larger panel deserves attention
  - Comprehending also a broader set of transition economies (comparing, e.g. early and late transition)
  - Maybe increases the contribution of the paper (though not entirely highlighted in the present version)

Discussion (3)

- How do we actually interpret the central coefficient (in front of the productivity differential)?
  - Is it small / large?
- It seems a bit weird that the B-S effect is stronger over the crisis
  - Any explanation?

Minor remarks

- Why an assumed AR(1) process in the disturbances will make estimates more efficient?
- The argument made for the usage of FE model could be made stronger
  - E.g. why not consider the class of IV models, treating potential presence of endogeneity in the regression?
- Has cross-sectional dependence been addressed in the estimates?
  - Maybe provide some arguments for and against, and judge the potential influence of the CSD.

Thank you for the attention!