DISCUSSION OF MOESSNER, DE HAAN, JANSEN: «THE EFFECT OF FORWARD GUIDANCE AND THE ZERO LOWER BOUND ON INTEREST RATE SENSITIVITY TO NEWS IN SWEDEN»

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NORGES BANK

Summary

Questions and Strategy

- Overriding questions:
  - Do market participants understand that interest rate paths are *conditional* forecasts?

- Strategy: Study the response of Swedish swap rates to macro news
  - Before and after interest rate paths were introduced in 2007
  - Before, during, and after ZLB in 2009/2010
  - Before, during, and after unconventional monetary policies in 2008-2010

Praise

- Establishing facts about how central bank communication actually works is essential
- Transparent empirical strategy
- Well-written
  - Distinction between Odyssian and Delphic forward guidance
- Topical issue
  - Forward guidance has become more important during and after the financial crisis
  - Fed has stressed that future evolution of interest rate is «data driven»

Comments
Interpretation FG

- Has FG reduced the sensitivity of interest rates to macro news?
  - If no, markets understand conditionality

- Test of conditionality vs reaction pattern
  - Drop in market response could indicate that the market learns more about reaction pattern – not lack of understanding of conditionality

- When measuring the effect of *news*, whose initial forecast is relevant?
  - Paper: $\text{News} = X - E^m(X)$
    - Only the surprise vis-à-vis consensus forecast
  - Alternative: Could it matter how the news comes in relative to the Central Bank projection for X?
    - Foreign currency markets have reacted differently to economic news than money markets

Comments
ZLB

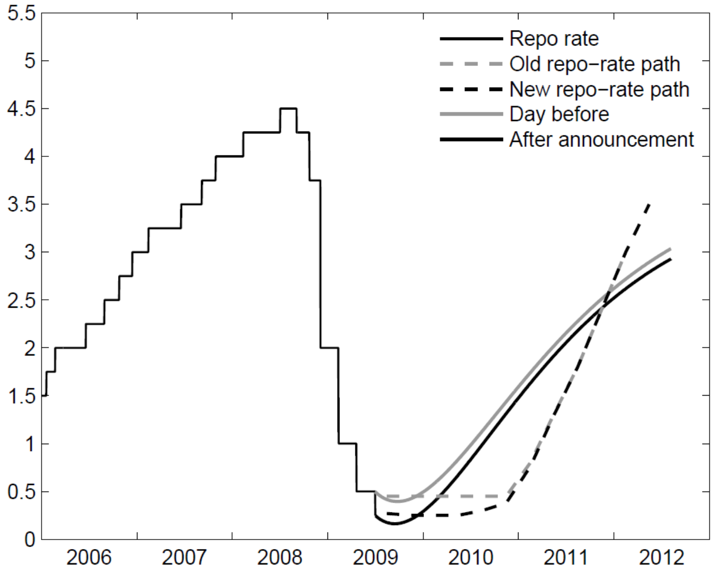
- Find evidence that the sensitivity of interest rates to Swedish macro news was reduced under ZLB

- Was this really a ZLB period?
  - Period used: Policy rate 0.25 %
  - Now: Policy rate 0 %

- Did the market believe in the ZLB period?

- During the financial crisis, macro news could have a different impact on interest rates

Market expectations of the forward path of the repo rate before and after the Riksbank's press release on 2 July 2009



Woodford (2013)

Comments

Interpretation US news

- The dampened US influence under Swedish FWG
  - Unlikely that this indicates markets do not understand path-conditionality
  - Not necessarily related to more knowledge about reaction pattern of Riksbank
  - Could be due to UMP and ZLB in the US?
- Why is the starting point to use US news, not European news?
  - Does US news affect the Swedish swap rates more than European news?
- Why not use foreign interest rate (US, euro) rather than foreign macro news?

Comments

Minor Remarks

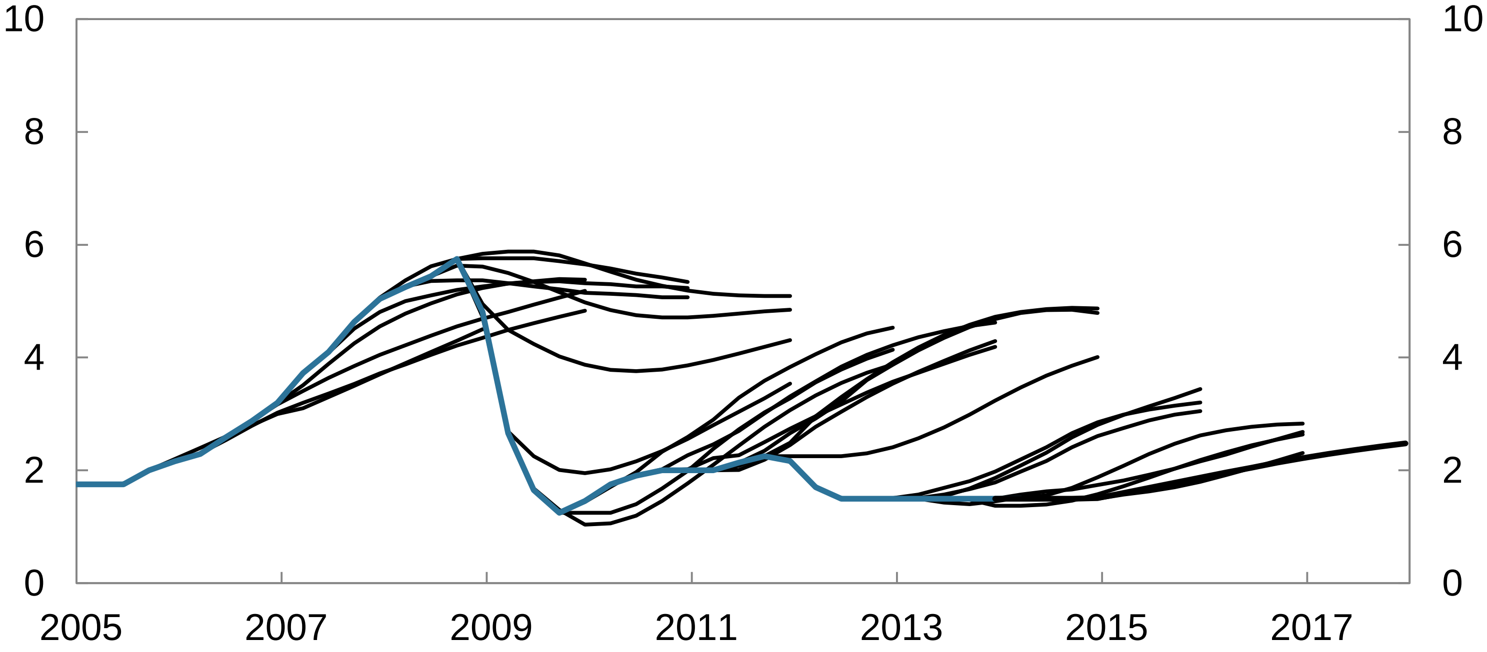
- The paper studies the effect of unconventional policy
  - Riksbank swap line with the Fed
    - To address funding shortage in US dollars
  - Loan facility in SEK (fixed and variable interest rates, various maturities)
  - More financial stability policy than monetary policy?

- Why should changes in 5Y and 10Y swap rates reflect conditionality?
  - Global factors affect long-term interest rates.

- Relevant variables:
  - News related to house prices and credit not included.

Conditionality is understood

Norges Banks's interest rate forecasts. MPR 3/05 – 1/14. Percent

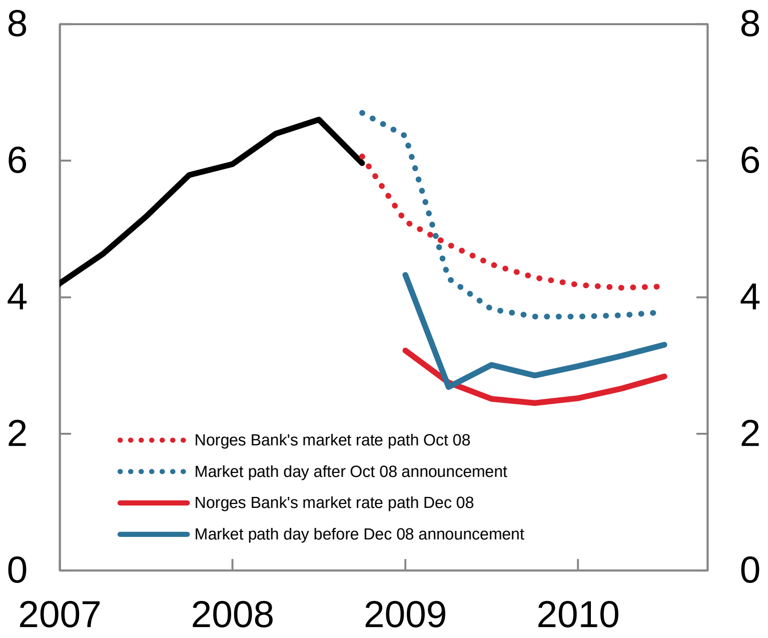


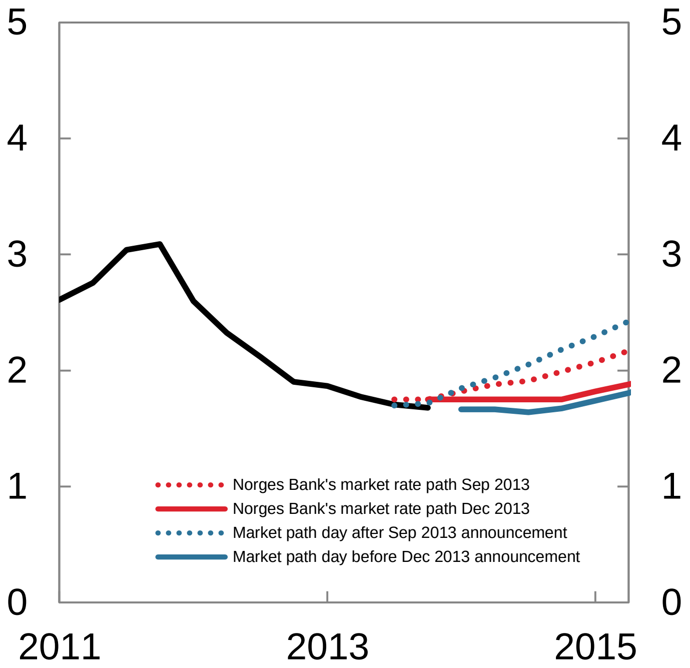
Source: Norges Bank

Understanding of reaction pattern

Market rates close to new interest rate path

Percent





1) Norges Bank's market rate path is calculated as Norges Bank's forecast for the key policy rate plus an estimated 3-month interbank risk premium. Source: Norges Bank

Summary

- Interesting paper!
- Markets understand that interest rate paths are conditional
- Changes in interest rate sensitivity to macro news might be affected by the financial crisis and US monetary policy (and do not necessarily reflect Swedish monetary policy)