

Monetary Policy Under Heightened Uncertainty

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Federal Reserve Bank of New York
Economic Advisory Panel
November 15, 2019

Always Uncertainty?

Economist
**The cloud of
uncertainty**

Dithering in the dark



“More than at any point in recent history, the global economy’s fate is tied to the capriciousness of policymakers?”

A popular measure of policy uncertainty by Bloom and coauthors recently hit its highest level....

What is the date?

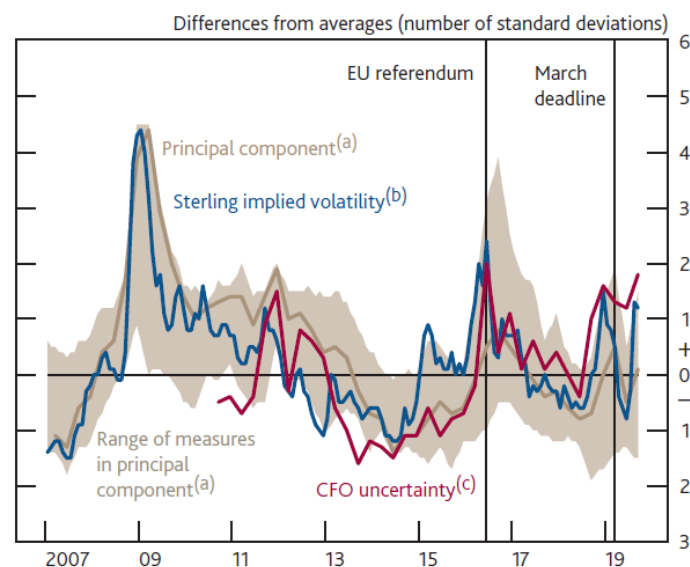


Measuring Uncertainty: Key Issues

- **First or second moment?**
- **Broad groups of measures**
 - News based measures
 - Survey based measures
 - Financial market measures
 - ***Can send very different signals***
- **How to assess the effects?**

Chart 4.4 Some measures suggest that uncertainty is close to post-crisis highs

Selected measures of uncertainty



Sources: Bloomberg Finance L.P., CBI, Consensus Economics, Deloitte, Eikon from Refinitiv, GfK (research on behalf of the European Commission), Institutional Brokers' Estimate System, ONS, policyuncertainty.com and Bank calculations.

- (a) See Chart 4.1 footnote (b). Differences from average for principal component are since 1988.
- (b) Monthly weighted average of the three-month option-implied volatility of the sterling-euro and sterling-dollar exchange rates. Series starts in September 2001.
- (c) Proportion of firms reporting that the general level of external financial or economic uncertainty facing their business is 'high' or 'very high'. Series starts in 2010 Q3. Not seasonally adjusted.

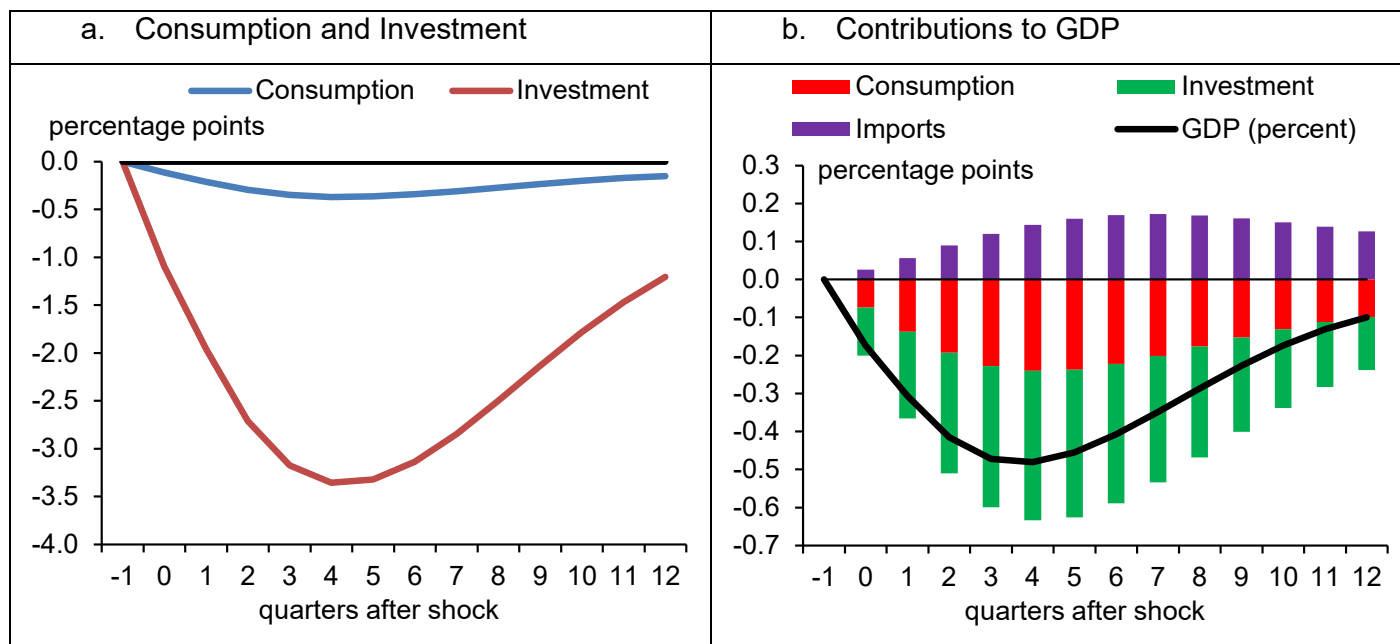
Source: BoE, Monetary Policy Report, Nov 2019.



Assessing the Impact on the Economy

Different Sectors

SVAR impulse responses to uncertainty shock in UK



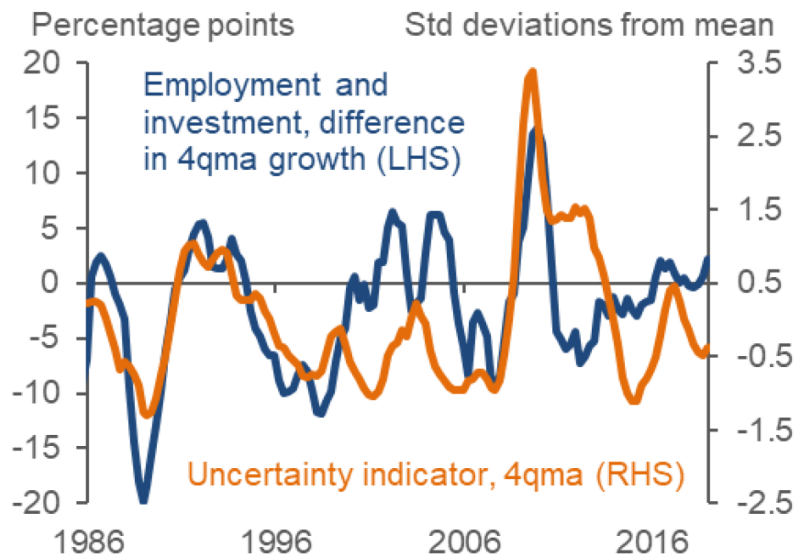
Source: Forbes (2016), "Uncertainty about Uncertainty," Bank of England speech.



Assessing Impact on the Economy

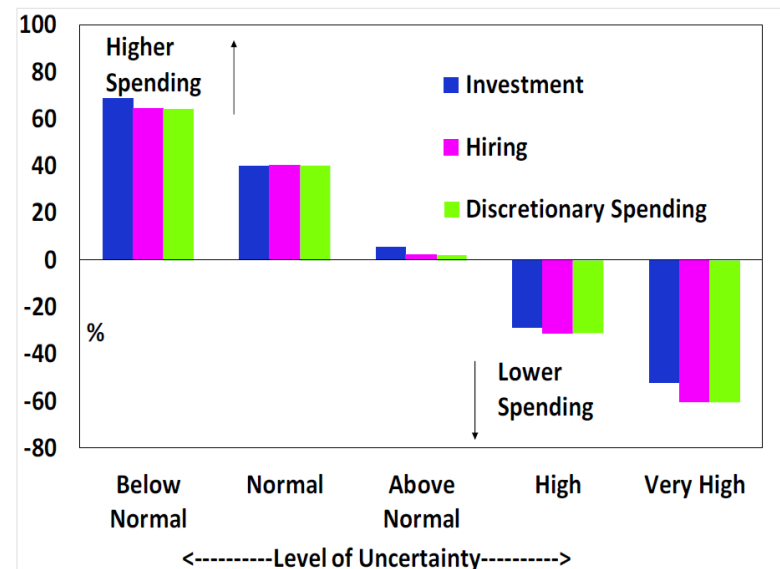
Boosts Labor Market?

Chart 9: More uncertainty boosts employment relative to investment



Source: Broadbent (2019), "Investment and Uncertainty: The Value of Waiting for News," Bank of England Speech

Figure 7. UK – Net Balances of Firms Expecting to Increase Investment/Hiring/Discretionary Spending, Split By Level of Uncertainty

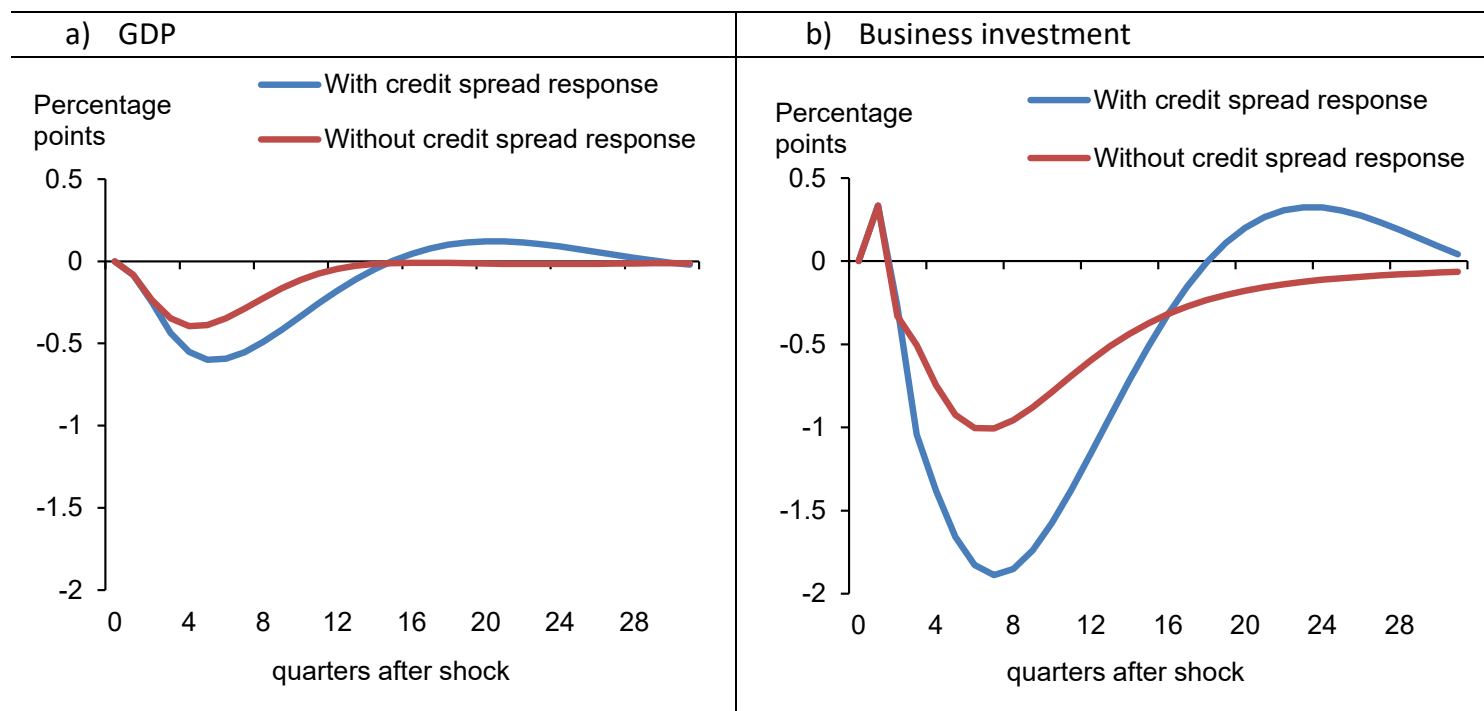


Source: Saunders (2019), "Shifting Balance of Risks," Bank of England Speech



Assessing the Impact on the Economy: *Identification*

SVAR impulse responses to uncertainty shock in UK

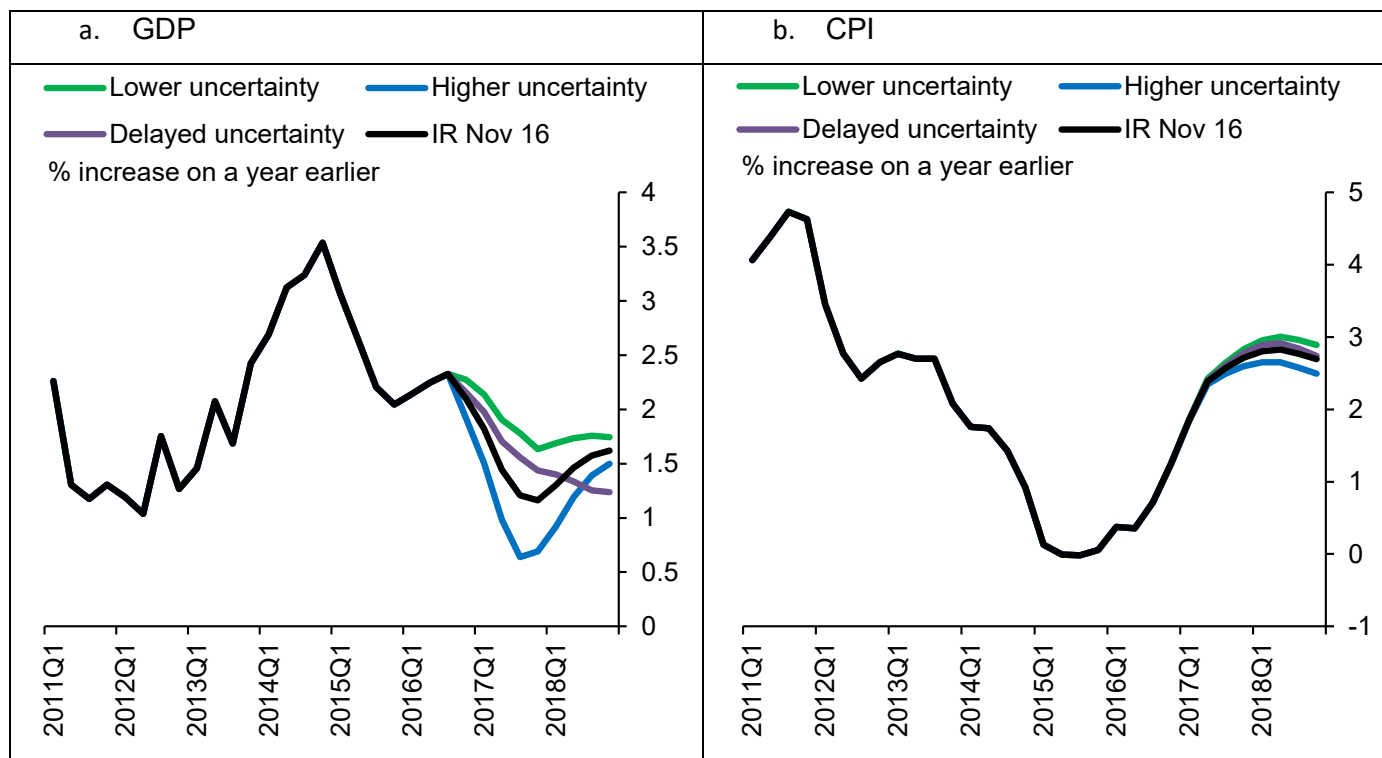


Source: Forbes (2016), "Uncertainty about Uncertainty," Bank of England speech.



Assessing the Impact on the Economy: *Duration of Expected & Actual Uncertainty*

SVAR impulse responses to uncertainty shock in UK



Source: Forbes (2016), "Uncertainty about Uncertainty," Bank of England speech.



Considerations for Monetary Policy

- **Incorporate “uncertainty” measure directly in forecast**
 - BoE experience
 - Impact on inflation much more muted than GDP
- **Considerations around ELB**
- **Orphanides “balanced approach” (Jackson Hole, 2019)**
 - Focus on deviations of growth, not output gap
 - More weight on near-term growth, natural growth (n^*) rule

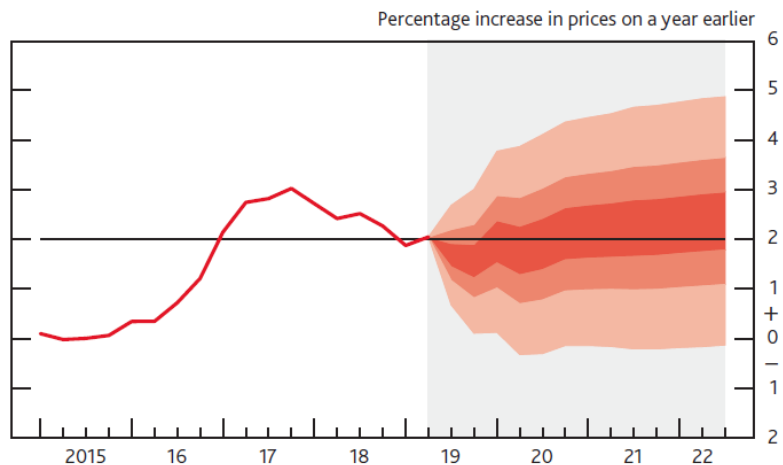
$$i_t^N = i_{t-1} + 0.5(n_{t+3|t} - n_t^*)$$

- **Shift communication away from central case**
 - Fan charts, probability distributions
 - Scenario analysis

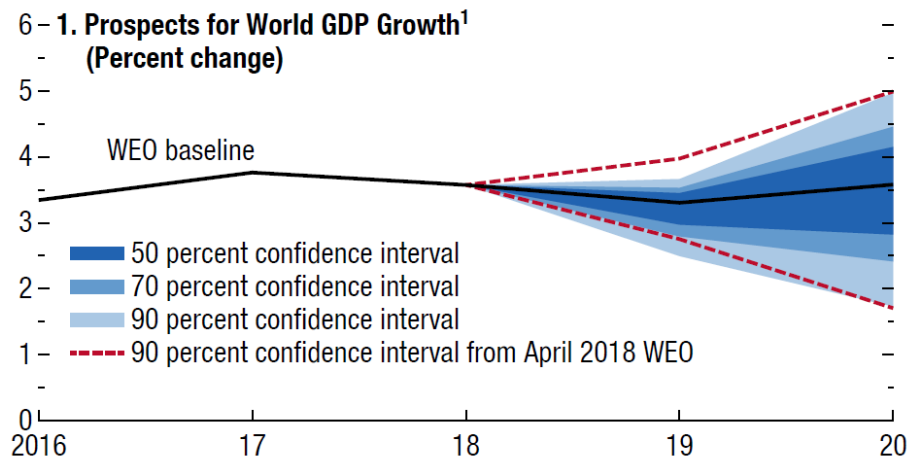


Communication Challenge?

Chart 5.3 CPI inflation projection based on market interest rate expectations, other policy measures as announced



Source: BoE (2019), *Inflation Report*, August



Source: IMF (2019), *World Economic Outlook*, April

Charts 5.3 and 5.4 depict the probability of various outcomes for CPI inflation in the future. They have been conditioned on the assumptions in Table 5.A footnote (b). If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's best collective judgement is that inflation in any particular quarter would lie within the darkest central band on only 30 of those occasions. The fan charts are constructed so that outturns of inflation are also expected to lie within each pair of the lighter red areas on 30 occasions. In any particular quarter of the forecast period, inflation is therefore expected to lie somewhere within the fans on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions inflation can fall anywhere outside the red area of the fan chart. Over the forecast period, this has been depicted by the light grey background. See the box on pages 48–49 of the May 2002 *Inflation Report* for a fuller description of the fan chart and what it represents.

