Discussion of De Grave and Theodoridis' "Forward Guidance, Quantitative Easing, or both?"

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Federal Reserve Board

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Riksbank Conference on "The Future of Forward Guidance"

The opinions expressed in this presentation are my own and do not reflect the views of the Board of Governors or its staff.

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- Monetary policy rule with time-varying inflation target
- Consider anticipated shocks to
  - short rate (forward guidance): similar to Laséen and Svensson (2011) and many others
  - total debt (LSAP)
  - maturity composition (MEP)

Findings and overall comments

- Findings:
  - Dynamic adjustment costs estimated to be more important than static ones $\Rightarrow$ yield effect of maturity shocks highly transitory
  - Anticipation estimated to important for short rate and maturity composition shocks but not for total debt shocks
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- Overall comments
  - Ambitious attempt to consider all aspects of unconventional policy with anticipation
  - Title suggests study of interaction between forward guidance and QE but at the moment, the contribution is really about bigger real effects of QE
  - Paper still preliminary with many details missing; my comments may due to misunderstanding

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    - Adjustment costs: this paper

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  - implies that selling short-term bonds or buying long-term bonds should reduce long-term yields by equal amounts (see Fig 4 and discussion bottom of p. 16)
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  - A change in the level of Treasury debt outstanding in the model has no effect as long as the proportional maturity composition is unchanged.
    - Inconsistent with the evidence in Li/Wei (2013), Greenwood/Vayanos (2014), and most models of the Vayanos-Vila type.

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- Problems with the adjustment cost story (continued):
  - If term premia are, in fact, compensation for risk, then they should vary with the level of risk in the economy.
    - Indeed, in VV-type models, the effectiveness of QE depends on how much fundamental risk there is.
    - This is important, in part, because forward-guidance policies likely affect interest-rate volatility (King 2016.)
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  - Extend to consider maturity composition effects?

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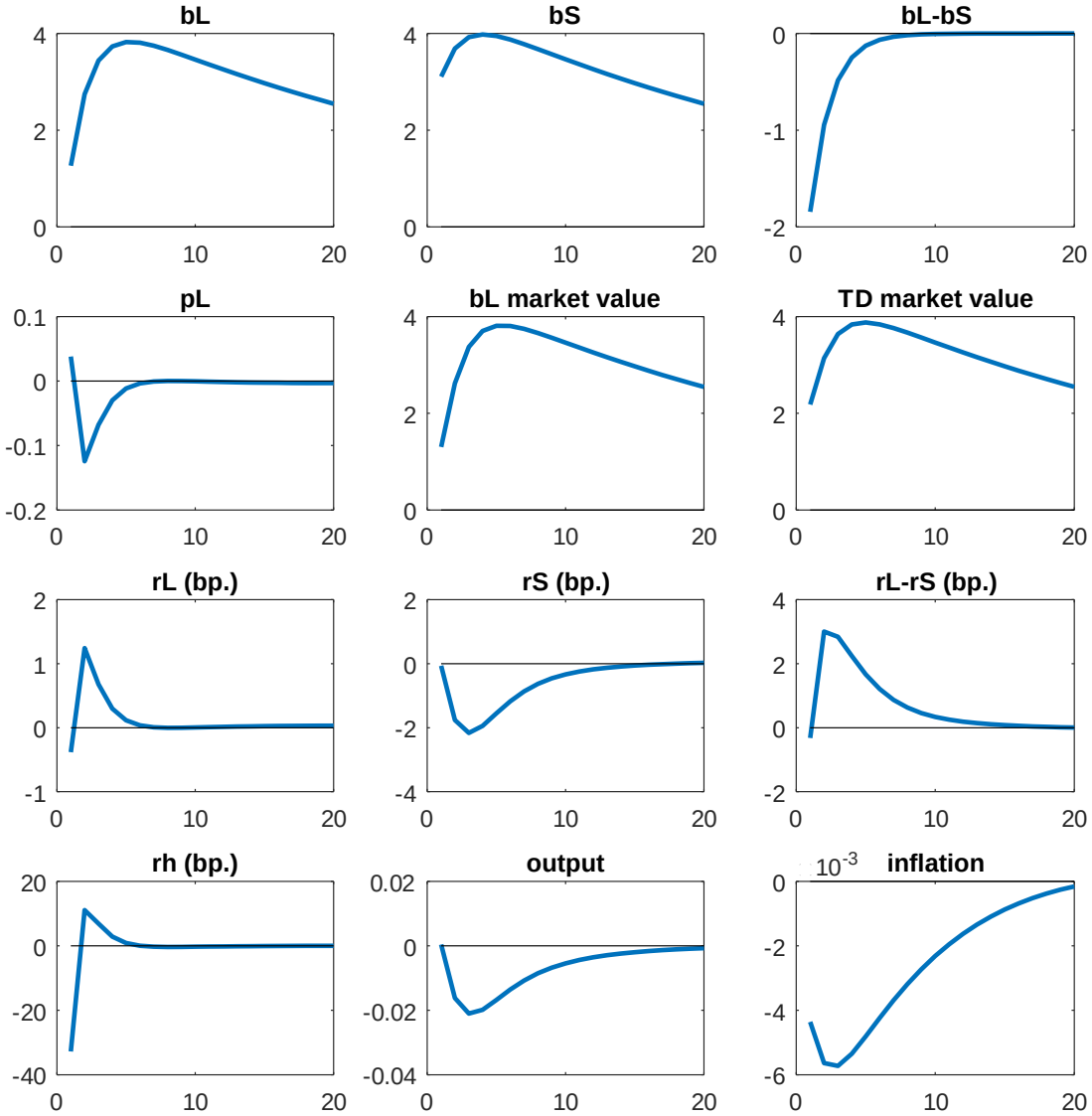
  - However, I don't quite under Figure 4 IRF to a total debt shock

FIgure 4: IRF: debt shock



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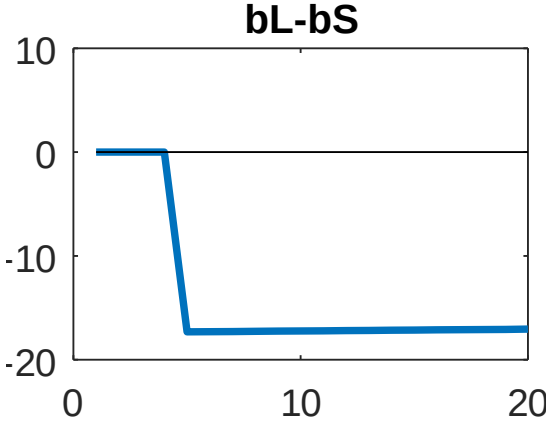

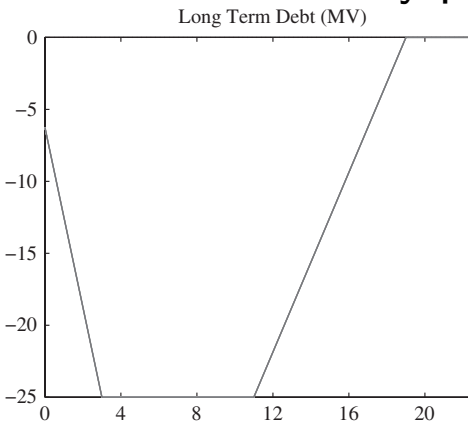

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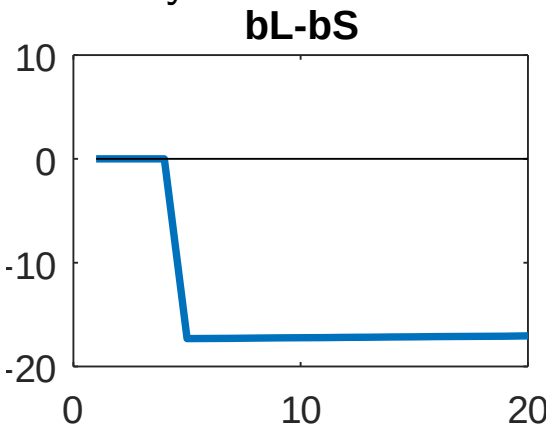

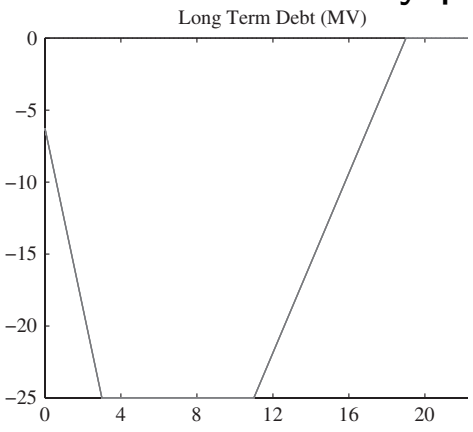

  - Why not estimate this parameter? How sensitive is the real effect to the persistence of maturity shocks?

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- Model fit?
  - Compare Figures 1 nd 2: Model appears to miss the quick debt build-up after the crisis
  - Yield fit?

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- Some suggestions
  - Consider higher order solution to generate non-trivial term premiums
  - Consider risk-based preferred-habitat element to break the irrelevance results
  - Experiment with maturity rule specifications, especially relaxing the permanent shock assumption
  - Look into the interaction between forward guidance and QE