

Discussion: Policymakers' Uncertainty

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Most recent FOMC statement

Policymakers' uncertainty in June 2023 statement:

...The economy is facing headwinds from tighter credit conditions for households and businesses, which are likely to weigh on **economic activity, hiring, and inflation. The extent of these effects remains uncertain.**

In light of how far we have come in tightening policy, the uncertain lags with which monetary policy affects the economy, and potential headwinds from credit tightening, the Committee decided at today's meeting to maintain the target range for the federal funds rate...

This Paper: Policymakers' Uncertainty

- ▶ Uncertainty affects monetary policy decision
 - Uncertainty over economic variables
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 - But, direction of effect is unclear
- ▶ Challenge: measuring policymakers' uncertainty and policy preference
- ▶ Approach: Text-analysis measurement using FOMC meeting transcripts

Dictionary Approach

- ▶ Measures constructed as frequency of pre-specified words in sample text

$$\frac{\# \text{words from list}}{\text{Total } \# \text{ words in text}}$$

- ▶ Dictionaries/word lists:

- Inflation words
- Real economy words
- Financial markets words
- Uncertainty words
- Increasing words
- Decreasing words
- Policy words
- Hawkish words
- Dovish words

Text-Based Measures of FOMC Member Beliefs

- Uncertainty over $k \in \{\text{inflation, real economy, financial markets}\}$
$$\frac{(\# \text{ words in sentence with } k \text{ word and uncertainty word})}{\text{Total } \# \text{ words in econ round}}$$

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- ▶ Sentiment ($\uparrow - \downarrow$) about macro variable k
$$\frac{(\# k \text{ words near increasing words}) - (\# k \text{ words near decreasing words})}{\text{Total } \# \text{ words in econ round}}$$

Excluding occurrences in uncertainty sentences

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Excluding occurrences in uncertainty sentences

- Policy stance

$$\frac{(\# \text{ Hawkish words in policy sents}) - (\# \text{ Dovish words in policy sents})}{\text{Total } \# \text{ words in policy round}}$$

Where policy sents are sentences with policy words

Key Results

- ▶ \uparrow inflation uncertainty, \uparrow real economic sentiment \implies \uparrow hawkish stance
 - Control for staff forecasts (GB), public uncertainty
 - Inflation uncertainty driven by policy-induced uncertainty

- ▶ Channel: monetary policymaker credibility
 - Credible \equiv committed to fight inflation \implies nominal anchor
 - Uncertain about inflation
 - \rightarrow risk high inflation and FOMC not aggressive enough
 - \rightarrow lose credibility, high inflation, lose nominal anchor
 - Thus, uncertainty over inflation \implies contractionary policy

Comments

Broader discussion

1. Text measures in monetary + behavioral economics

- Text approach to measure expectations/approximate information sets
- Inform models of expectation formation and influence on policy
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2. Variety of ways to interpret central bank credibility in literature

- Credibility \rightarrow ability to maintain price stability
- Commitment to following objective function or past forward guidance?
- Ability to forecast/anticipate economic movements well?
- Expand monetary models and policymaker toolkit \implies broader interpretation

Specific Comments

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3. Interaction terms: Uncertainty \times Sentiment
 - Different effects from uncertainty for inflation vs. deflation
 - Allow for asymmetric effects

Thank You!