

Ben S. Bernanke, Vincent R. Reinhart, and Brian P. Sack
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Success in reducing inflation and, consequently, nominal interest rates has increased the likelihood that the nominal policy interest rate will become constrained by the zero lower bound. When that happens, a central bank cannot use further rate reductions to stimulate aggregate demand and must rely on “nonstandard” policies. To assess the effectiveness of such policies, we analyze the behavior of asset prices surrounding central bank statements and other economic news, and we estimate “no-arbitrage” term structure models and compare actual term structure behavior with those predictions. We find evidence that central bank communications can help shape expectations of future policy actions, and some evidence that large-volume central bank asset purchases would affect the price of the targeted asset. However, the best way to deal with the zero lower bound is to maintain a sufficient inflation buffer and adopt preemptive policies to avoid encountering the bound in the first place.

JEL classification codes: E41, E42, E58, E61.