Comments on Kenneth Kuttner

"Outside the Box: Unconventional Monetary Policy in the Great Recession and Beyond"

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Summary of Kuttner paper

- In the U.S., unconventional monetary policy (UMP) worked.
  - Some ambiguity about the magnitude and persistence of its effects.
  - Considerable ambiguity as to whether it worked through forward guidance or portfolio rebalancing.
- In any future use of UMP:
  - conduct it in a rule-like way;
  - use both forward guidance and asset purchases;
  - would be ideal if Fed could have flexibility in terms of what it buys;
  - no reason not to use UMP even if we are away from zero lower bound.

The "glass is half empty" view of UMP

•I agree that the evidence on the efficacy of UMP is mixed and ambiguous.

•I also agree that, on balance, UMP likely had positive effects.

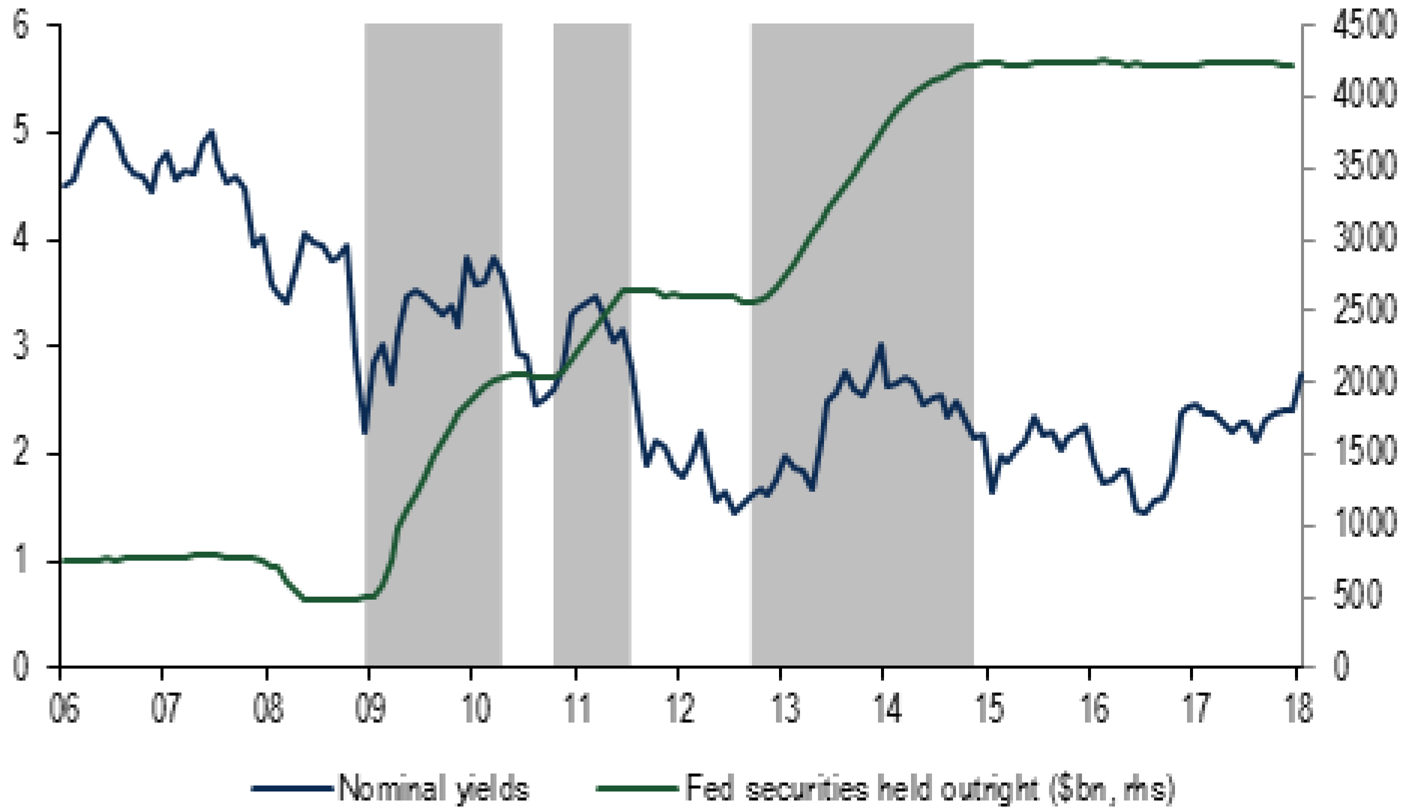
•But I disagree with the concluding section's upbeat view about the prospects for use of UMP as a monetary policy tool.

LSAPs and yields on 10Y Treasuries

•Rates on 10Y Treasuries were *higher* at the end than at the beginning of the implementation periods for QE1, QE2 and QE3 (though not MEP). (Next overhead.)

(Graphs below from Greenlaw et al. (2018), "A Skeptical View of the Impact of the Fed's Balance Sheet" NBER Working Paper 24687.)

Exhibit 4.1. Bond yields tended to rise during the implementation of QE1, 2 and 3



EFFECTS OF LSAPS ON YIELDS

- Regression studies
  - Tend to find little persistence in effects of Fed actions (Wright (2012), Swanson (2017)).
- Event study evidence should be interpreted cautiously
  - The market reaction may be in part an overreaction.
  - Only a small subset of Fed actions are considered in the event study literature.

MAYBE THE REACTION IS IN PART AN OVERREACTION

- Unambiguously, some Fed announcements caused yields to move substantially.

- March 18, 2009: yields fell 44bp in 30 minutes after FOMC statement.

- However, that fall was reversed over the next 6 weeks.

- End of day 10Y yields:

End of day 10Y yields:	17March2018	3.01%
	18March2018	2.53%
	19March2018	2.60%
	....	
	28April2018	3.01%

INTERPRETATION OF BEHAVIOR AFTER ANNOUNCEMENT

- One explanation is that offsetting news came in.

- Another possibility: the market took time to digest the Fed announcement, subsequently backtracking on its initial reaction.

- Consider the effect of a different type of announcement (Wolfers and Zitzewitz (2018), Hamilton (2018)):

    - Equity futures fell 5% in the hours after announcement of Trump's 2016 election victory, regained it all by noon the next day.

Exhibit 4.2 Cumulative change on all "Fed" days (meetings, minutes, Chair speech)

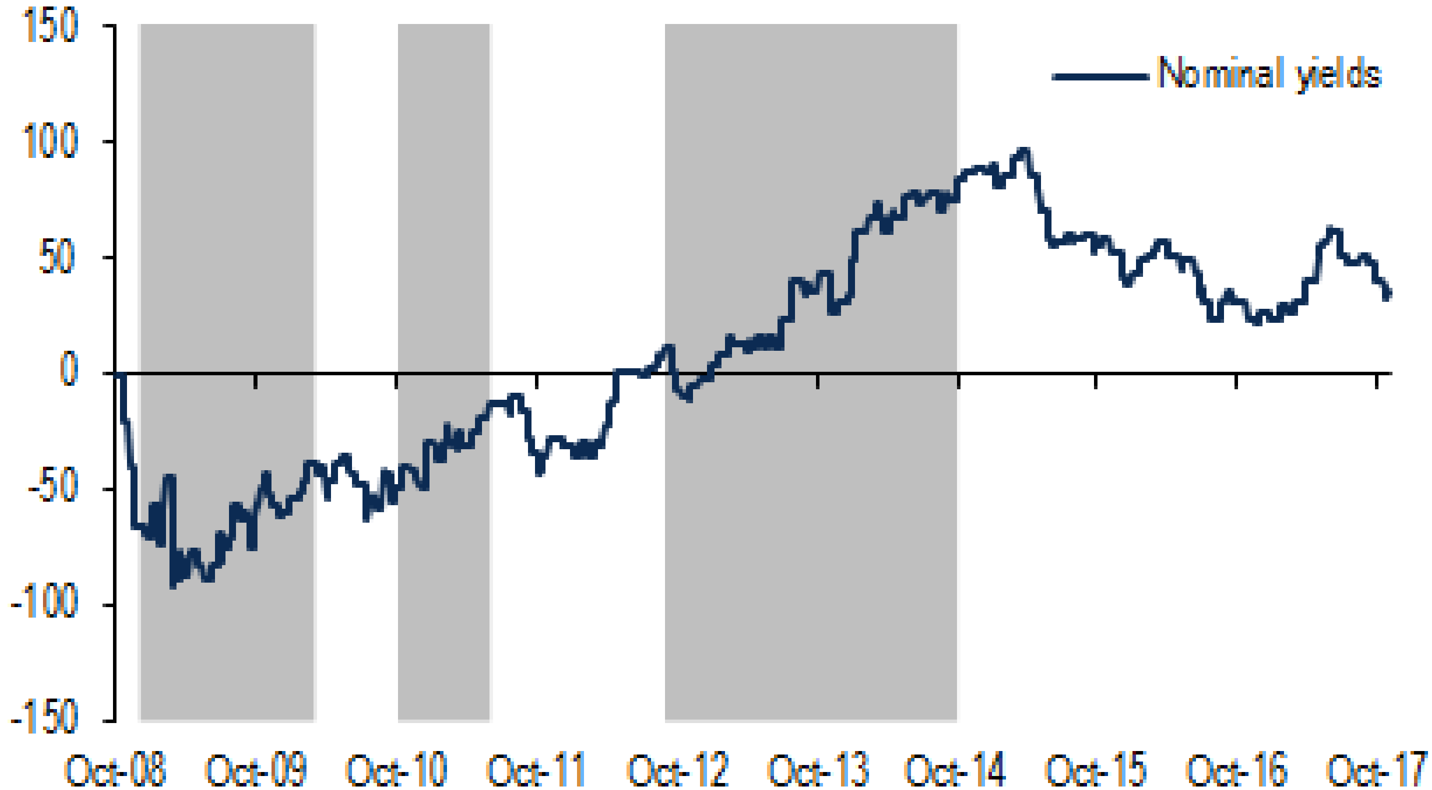
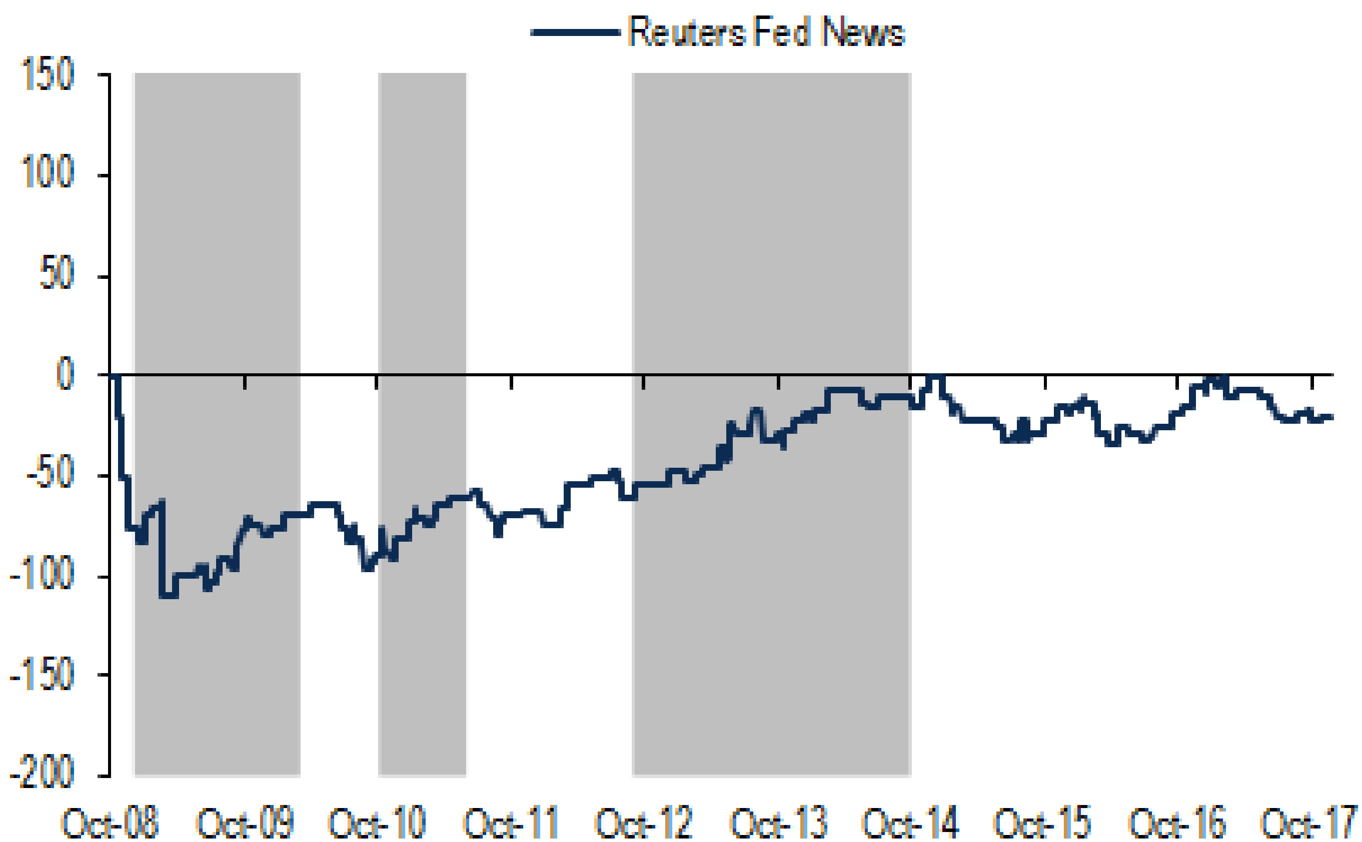


Exhibit 4.9 Cumulative change on all Reuters Fed news days



The Shrinkage Shrug

- Jan 2017: Blue Chip and the primary dealer survey expected
  - balance sheet shrinkage to start in mid- to late 2018
  - end-of-2019 balance sheet \$3.8-\$4.0 trillion
- In fact
  - shrinkage started October 2017
  - planned end-of-2019 balance sheet = \$3.6 trillion
- Did the hawkish surprise move rates?

POLICY IMPLICATIONS

- Considerable evidence that perceptions of Fed policy affect private sector decisions.

    - Implication: clear communication / use of rules / forward guidance can and should be part of the Fed toolkit.

- But stay away from LSAPs if you can.

- The short term interest rate is a more reliable and better understood instrument.