

Discussion of ‘On the Quantitative Effects of Unconventional Monetary Policies’ by Javier Garcia-Cicco

Kosuke Aoki

LSE and Bank of Japan

16 September 2010

Framework

- Small Open Economy NK model with
 - Liquidity premium
 - Deviation from UIP
 - Term premium
- The other part
 - Calvo pricing with full indexation
 - Perfect pass through
 - Policy rate follows a Taylor rule

Modelling Unconventional MP

- Frictions : liquidity premium, deviations from UIP, term premium
- Unconventional MP affects those friction terms directly
 - Base money $\rightarrow$ liquidity premium
 - Reserves $\rightarrow$ UIP shock
 - Relative supply of long and short bonds $\rightarrow$ term premium

Estimated policy effects

- Estimated for Chile, 2003 to 2009
- Liquidity premium = $-0.014 * \text{money}$
- Deviation from UIP = $0.2 * (\text{change in foreign reserve})$
- Term premium = $-0.017 * (\text{relative supply of long \& short bonds})$

UMP considered

- Policy instruments
 - Money market rate
 - Base money
 - Bonds (long and short)
 - Reserves
- Policy considered
 - Purchase of foreign assets by selling money
 - Purchase of domestic debt by selling money
 - Purchase of long debt by selling short debt
 - Purchase of foreign assets by selling debt

UMP

- Effects of expected future interest rate policy also considered
 - Money market rate fixed forever
 - Money market rate temporarily fixed, followed by Taylor rule. Exit date uncertain to private agents (credibility issue)
 - Exit from UMP: anticipated vs unanticipated

Main results

- Liquidity provision has big effects, dependence on expectations about future policy
- Policy affecting term premiums has small effects, less dependence on expectations
- Exit policy contractionary

UMP for emerging economies

- Studies of UMP for advanced economies are becoming rich. Micro-founded. Kiyotaki-Moore, Gertler-Karadi, Curdia-Woodford etc
- But studies of UMP for emerging economies is scarce
- The paper is one of earliest papers. Should emphasize this more.

UMP for emerging markets

- Need more emphasis on the difference between UMP in advanced economies and UMP in emerging markets
- They adopted different types of policies, maybe reflecting different economic structure

UMP in emerging economies

- Ishi, Stone and Yehoue (2009, IMF WP)
- Zero bound is not a concern
- Liquidity provision (domestic and foreign exchange) important
- Quantitative easing and credit easing not common
- Paper should focus on those facts

UMP in the model vs reality

- Paper
 - Purchase of foreign assets by printing money
 - Purchase of domestic debt by printing money
 - Purchase of long debt by issuing short debt
 - Purchase of foreign assets by issuing debt
- Reality
 - Provision of domestic liquidity
 - Provision of foreign exchange

UMP for emerging markets

- Features specific to emerging economies not explicitly modelled
 - Dependence on foreign borrowing and sudden stop
 - External shocks
 - Less developed domestic financial markets
 - This may limit available options for UMP

UMP and credibility

- Paper considers credibility about exit policy
- CBs in emerging economies may have less credibility about LR inflation
- UMP is less transparent and more discretionary than the traditional MP
- QE and credit easing may destabilize inflation expectation in those countries
- UMP for emerging markets should take this into account

Frictions

- Paper estimates frictions, which is useful
- Those frictions are reduced form. What are possible problems?

Reduced-form frictions

- Results may be informative as long as estimated parameters are stable.
- Estimation based on 2003 to 2009. Do estimated parameters reflect policy multipliers?
- Lucas critique → analysis of dependence on expectations less reliable
 - Anticipated vs unanticipated, credibility etc
 - (But the framework is NK model)

Motivation for UMP

- Response to financial market malfunction?
 - Then market malfunction should be explicitly modelled
- Alternative to interest rate policy?
 - Then the effects of UMP should be carefully distinguished from the interest rate channel
 - Paper fixes the policy rate, so this is useful

Is exit strategy costly?

- Depends on how we motivate UMP
 - Response to market malfunction → exit not costly as long as market function recovers
 - Alternative to the interest rate channel → exit may be costly
 - Here we need a structural model