JOHNS HOPKINS
SCHOOL of ADVANCED
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Bologna Institute for Policy Research
Via Belmeloro, 11 - Bologna (Italy)
+39 051 292 7811 www.bipr.eu

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Speaker: Chiara Scotti, Board of Governors, Federal Reserve System, U.S.
Host: Filippo Taddei, Director of the Bologna Institute for Policy Research

Unconventional Monetary Policies: A Multi-Country Review

After traditional monetary policies stagnated during the Great Recession of 2007-2009, central banks across the globe turned to alternative methods: unconventional monetary policies. These expansionary strategies, such as forward guidance and asset purchases, sought to stabilize economies and financial markets. Yet due to their novelty, questions around unconventional policies remain. Chiara Scotti, Financial Stability Assessment section chief at the Federal Reserve, in a research paper with John Rogers and Jonathan Wright, examined the effect of monetary policy surprises. Their results show that the unconventional monetary policies implemented by the four major central banks (Federal Reserve, Bank of England, European Central Bank and Bank of Japan) were effective in easing financial conditions when policy rates were stuck at the zero lower bound.

Central Banks traditionally stimulate or slow economic growth, prices and employment through changes in policy rates. However, by late 2008, the United States Federal Open Market Committee (FOMC), as well as most of the other major central banks, had brought their policy rates near zero and started to implement unconventional policies.

A first type of unconventional policy used was forward guidance: a promise to maintain short-term rates low for some time. In the case of the Fed, forward guidance started with general terms, such as "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period." In 2011, the Fed attached a calendar date of "mid-2013" to low rates. In 2012, conditions such as "until unemployment is above 6.5 percent" were added, and subsequently forward guidance was linked to more general conditions. The European Central Bank (ECB), Bank of England (BOE), and Bank of Japan (BOJ) employed similar forward guidance policies.

Secondly, the major central banks implemented different forms of asset purchases. The Fed introduced the Large Scale Asset Purchases (LSAP) programs to acquire assets—mainly government bonds and agency debt. Conversely, the ECB was forbidden from buying government bonds to avoid the appearance of country buyouts and only bought assets insofar as to repair the transmission mechanism of monetary policy. Therefore, the ECB initially focused on primarily changing the terms of its Longer Term Refinancing Operations (LTROs), by introducing the so-called fixed-rate full allotment, proposing new and longer maturities and expanding the types of eligible collateral. As such, it became easier for institutions to borrow money.

The bank of England and Bank of Japan also introduced asset purchases programs.

Chiara Scotti argued that unconventional monetary policies positively affected financial markets. Scotti began her analysis by recording the exact time and date of policy announcements (whether they be at large financial meetings or through speeches) from the Fed, ECB, BOE, and BOJ, in order to obtain a measure of monetary policy surprise. In particular, Scotti compared minute-by-minute prices of long-term bond yields around the time of each announcement and defined their change as a measure of monetary policy surprise.

Then, through an event-study approach, she estimated the pass-through of changes in government bond yields to other asset prices and found that these unconventional monetary policies were successful in easing financial conditions, in particular in lowering corporate bond yields and increasing stock prices. Further analysis from Scotti showed that LSAP may have a more significant impact on some market prices, than forward guidance. Nevertheless, forward guidance announcements tended to affect short-term securities more than long-term, as expected. Overall, the effects of both types of unconventional policies persisted for a significant period of time. Additionally, unconventional policies from the Fed had spillover effects on other countries' yields, while foreign policies had a more muted effect on U.S. yields.