INTERNATIONAL MONETARY FUND

SUMMARY OF INFORMAL DISCUSSIONS WITH CENTRAL BANKERS AND OTHER OFFICIALS ON UNCONVENTIONAL MONETARY POLICIES*

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A series of conference calls was held in March 2013 with selected representatives of central banks and other official agencies in advanced and emerging market economies to seek views on unconventional monetary policies (UMP).[1] The key points raised during the discussions are summarized below. No views have been attributed to individual participants, and Fund staff is ultimately responsible for the contents of this summary.

A. Objectives of UMP

1. Three principal objectives of UMP were widely mentioned by participants: (i) ease monetary conditions at the zero lower bound (ZLB), (ii) address market dysfunction, and (iii) repair the transmission of monetary policy. Many participants noted that while it is analytically convenient to distinguish different objectives, in practice the objectives of UMP have been closely linked.

B. Effectiveness and Channels

2. Most participants agreed that UMP had been effective in substantially reducing tail risks, reducing deflationary pressures, and restoring market functioning in the U.S., U.K., Japan, and euro area.

[1]Messrs. Charles Bean (Bank of England), Agustín Carstens (Bank of Mexico), Jaime Caruana (Bank for International Settlements), Stephen G. Cecchetti (Bank for International Settlements), Norman Chan (Hong Kong Monetary Authority), Stanley Fischer (Bank of Israel), Thomas Jordan (Swiss National Bank), Mikio Kajikawa (Ministry of Finance, Japan), Choongsoo Kim (Bank of Korea), Ravi Menon (Monetary Authority of Singapore), Tiff Macklem (Bank of Canada), Hiroshi Nakaso (Bank of Japan), Peter Praet (European Central Bank), Jeremy Stein (Board of Governors of the Federal Reserve System), Lars Svensson (Sveriges Riksbank), and Alexandre Tombini (Central Bank of Brazil).

3. There was also broad agreement that bond purchases had significantly lowered bond yields in the countries making the purchases. Most also saw evidence that other measures had decreased bank funding costs and lowered lending rates, at least in some countries.

4. All participants acknowledged that it is very difficult to estimate the effect of UMP on real activity, owing to long and variable lags, changes in the transmission mechanism brought on by the crisis, and the absence of a well defined counterfactual. It is equally difficult to estimate the effects of UMP on lending volumes, as some of these effects come through channels not well captured in standard models.

5. Forward guidance was seen as a potentially very effective instrument, although some participants expressed doubts. Several participants remarked favorably on thresholds-based guidance of the sort recently introduced by the U.S. Federal Reserve, which some suggested avoids the shortcomings of price level targeting or nominal GDP targeting, while still providing an automatic stabilizer. Several participants saw greater transparency in central banks' future interest rate paths as helpful, also at the time of exit from UMP. Opinions differed as to whether asset purchases are important to give credibility to forward guidance.

6. A few participants underscored that policies implying very large increases in central bank balance sheets are only available to central banks with strong credibility. Had these policies been adopted by central banks with less credibility, inflation would have increased substantially.

7. There was broad agreement that bond purchases decrease long-term interest rates through both the portfolio rebalancing and signaling channels. Forward guidance, instead, mostly works through the signaling channel. The portfolio rebalancing channel relies on frictions in arbitrage along the yield curve.

8. Participants generally agreed that the first rounds of bond purchases had strong effects on yields, inter alia by substantially reducing tail risk. Most participants thought, however, that bond purchases would likely show diminishing returns, in particular with respect to their effects on the real economy. Several participants noted that at some point, marginal costs from further bond purchases would exceed marginal benefits, but predicting where the two curves cross is difficult.

9. Several participants suggested that central banks should not stray too far from purchasing government bonds. While central banks could purchase private assets in specific circumstances, mostly to alleviate targeted market imperfections, doing so intervenes in the allocation of credit in the economy, and borders on fiscal policy. When government bonds are purchased, instead, the private sector remains free to choose which other assets to buy in their place.

C. Negative Side effects of Bond Purchases

10. Most participants mentioned that bond purchases could have negative side effects in the longer run. The following potential negative effects were brought up most often:

- Perception of debt monetization. Once this perception arises, bond purchases can have adverse effects on interest rates and the real economy. To decrease this risk, central banks can preannounce limits on purchases. More importantly, fiscal authorities need to commit to a credible medium term plan.
- Delays to reforms. Persistently low interest rates may reduce the perceived need for fiscal, structural, and financial sector reforms.
- Impaired market functioning, especially in the money market. Most participants cited the objective of encouraging money market activity as the main reason why short- term rates have been kept slightly above zero.
- Exit problems. Rising interest rates could increase government financing costs. Some tensions could arise, although these should not impinge on central bank independence.
- Reach for yield. While bond purchases are meant to induce more risk taking, this could over time lead to excesses.
- Debt forbearance. There is some evidence of forbearance, mostly in the commercial property sector. Differences arise by country.
- Rhetoric on currency wars. UMP may contribute to exchange rate depreciation and lead other countries to follow suit. However, most participants thought the term "currency war" was exaggerated. Rather, exchange rate movements have been the natural consequence of policy loosening in countries hit by the crisis.
- Distributional effects. Lower long-term interest rates reduce the annuity rate for pensioners and strain pension funds. Yet, other segments of the population have generally profited from positive wealth effects, coming through higher asset prices and lower discount rates.

- Impact on saving. Extended periods of low interest rates reduce households' incentive to save, and over time could change the general culture of saving.

D. Cross-Border Spillovers

11. Most participants considered that, on balance, Emerging Market Economies (EMEs) had benefited from UMP in the U.S., U.K., Japan, and euro area. UMP substantially reduced tail risks, improved financial market functioning, and raised growth prospects. These effects buoyed growth in EMEs through both real and financial ties, compared with potential counterfactuals.

12. Several participants, however, also highlighted the possible destabilizing effects of UMP on EMEs. They pointed out that successive rounds of bond purchases in particular had produced increasingly negative side effects. While participants agreed that appreciation of EME currencies was to be expected, several noted that the pace and extent of appreciation (as well as exchange rate volatility) had at times been excessive. Likewise, while capital flows to EMEs are generally welcome, the size and composition of flows to some countries had fueled asset price bubbles and undermined financial stability.

13. Several participants considered that UMP had put an undue burden on policy in EMEs. It was difficult to tighten monetary policy without attracting further capital flows. They suggested that foreign exchange intervention could be an important part of the policy toolkit. Macroprudential policy could be overwhelmed, and additional measures might be needed to curb capital inflows, such as capital controls.

14. This said, there was widespread agreement on the need to strengthen the resilience of the financial sector to sudden reversals of capital flows and a fall in asset prices.

E. Exit

15. Several participants brought up the risk of a sharp increase in long-term interest rates. This would dampen recovery in the advanced economies, put pressure on government finances, and could give rise to sharp changes in capital flows and exchange rates.

16. Most participants agreed that central banks in advanced economies should in principle be able to limit the risk of a sharp increase in long-term rates. Enhanced forward guidance and improved communication could help guide expectations of future policy rates. It was pointed out that central banks could also pre-commit to the timing and pace of asset purchases (much as central banks agreed to steadily sell their gold reserves in the early 2000s). Nonetheless, several participants emphasized that scope remains for unpredictable and possibly disorderly market reactions.

17. Regarding the transmission of monetary policy in the presence of substantial excess reserves, most participants considered that increases in reserve remuneration rates, or on liquidity absorbing instruments, would increase market rates as well.

F. Looking Further Ahead

18. Participants mostly agreed that when conditions revert to normal, monetary policy in the advanced economies would return to using a short-term policy rate as its main instrument. Some suggested that there may be scope to continue using the central bank's balance sheet to affect the shape of the yield curve for financial stability purposes, for example if a flatter yield curve encourages financial institutions to issue longer term debt.