A Reassessment of Monetary Policy Surprises and High-Frequency Identification
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Discussants: Simon Gilchrist, Mark W. Watson

Harald Uhlig opened the discussion with several comments. First, he noted that the reaction of CPI is largely in the first period so it would be interesting to see the impulse responses separately for interest rates, prices, and inflation excluding the first period. He also suggested plotting the impulse response for the real interest rate. Second, he explained that it would be useful to see how much of the variance of the price response is explained by the monetary shock. He also added that he was surprised by the especially large reaction of industrial production, a comment echoed by James Stock, and that he agreed with discussant Simon Gilchrist that, if true, it might lead us to rethink the channels of monetary policy. Third, he asked whether the identification strategy relied on Fed Funds futures being predictable, and if so, whether this implied there was money to be made. Finally, he commented that monetary policy has changed over time and how the authors deal with such issues (e.g., the zero lower bound).

The authors responded by first highlighting that the predictability is only ex-post, therefore there is no money to be made. Moreover, they noted that while many papers have given reasons for this predictability (e.g., rational risk premia, irrational expectations, or imperfect information), the reason for predictability are not important to their paper. In relation to the large responses, the authors pointed out that the monetary policy shock in their paper is a 25 basis point shock to the 2-year US Treasury yield. This is roughly equivalent to a 55 basis point shock to the Fed Funds rate which is part of the reason the estimated effects look large. Moreover, they explained that the 2-year US Treasury was never constrained by the zero lower bound in their sample period and that this is also why Gertler and Karadi used the 1-year and 2-year US Treasury yields in their analysis.

The authors then responded to comments by discussant Simon Gilchrist about information effects. They explained that the predictability regressions they showed are not a Fed information effect as all the information used is publicly available and pre-dates the Federal Open Markets Committee announcement. They also found Simon Gilchrist’s analysis of dividend strips to be very interesting and would need to look into that.

James Stock then asked how the authors chose their controls. He suggested using a big data method, such as principal components analysis, to systematize the approach. He also asked about whether the results are driven more by the orthogonalization procedure or by the inclusion of central bank speeches. In response to the latter, the authors explained that the orthogonalization procedure was the main driver of the difference with the prior literature while the speeches helped improve the precision of the results and first-stage F-statistic.

Jonathan Parker raised some concerns about the empirical approach. He explained that if the monetary policy rule is time-varying, then the authors would be estimating a VAR-equivalent of a local average treatment effect (i.e., an average effect over the sample). He pointed out that the discussion by Mark Watson helped highlight this issue. In particular, if the dynamics of the system are changing, then the correlation between the control variables and the way they fit is also likely to be time-varying. Therefore, including anything other than the shock in the regression will change the weighted average being estimated. He added that this would be like estimating average treatment effect but with the weights on the different time periods changing. The authors responded that they would need to think further about this but appreciated that it is a valid concern. They pointed out that all the past monetary
VAR analysis assumed a constant structure, so that their analysis was consistent with previous work, but suggested that an interesting avenue for future research could be to explicitly model a time-varying policy rule and place that within a VAR to see how much of a difference it makes.

Valerie Ramey pointed out that one approach to help put the magnitudes of the effects in context is to create multipliers. She suggested that one way do so, if the sign of the result does not change, is to take the cumulative response of industrial production up to a given horizon and divide that by the cumulative response of the Fed Funds rate up to that horizon. She also commented that it would be useful as a credibility check to see what the results imply in a macro counterfactual, i.e., how would the economy have behaved if the shocks had not hit. Finally, she agreed with Jonathan Parker’s point about the importance of heterogeneous treatment effects and suggested that there would be significant value in having a paper on time-series regressions with heterogeneous treatment effects.

Martin Eichenbaum asked about the role of risk premia and Andrea Eisfeldt followed up with a question on the response of the prices of mortgage-backed securities. The authors argued that risk premia did not play a major role in their analysis and that they could certainly look into the impulse response of mortgage-backed securities.