

Discussion of

“Unconventional monetary policy and market expectations: some evidence for the euro area”

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Central banks and financial markets: who moves first?

- One view, supported by both theoretical and empirical investigations, is that financial-market prices are good predictors of monetary-policy actions: **monetary dominance**.
- Another view, carefully investigated by the authors of this paper, is that central banks may tend to accommodate market expectations: **market dominance**.
- A key **concern** about market dominance is that discretionary reaction to financial markets can **overburden monetary policy**, with detrimental consequences for the economy.

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How to test for market dominance in the eurozone?

- Want to assess whether **ECB's unconventional monetary policies** reacted deliberately to financial markets.
- To do this, need to **control for financial-market expectations** of macroeconomic fundamentals.
- Also need to **control for** the market's reactions to anticipated policy, as measured by **news of monetary policy**.

Tests performed provide evidence of market dominance

- **Granger causality tests:** ECB's unconventional monetary policies did react to a certain extent to both **market expectations** and **stress in financial markets**, especially when the unconventional policies were introduced.
- **GMM regressions:** idem.
- **VAR estimation:** idem.
- Extensive **robustness analysis** confirms the overall findings.

How to interpret such evidence of market dominance?

- One plausible interpretation is that the **ECB considers financial stability** when setting monetary policy.
- It is not particularly surprising that the ECB, as well as other central banks, attach **special importance** to financial stability considerations.
- It is, however, controversial whether financial stability should be viewed as an explicit **objective of monetary policy**.

Connection between financial stability and monetary policy

- There is debate on the appropriate **role of financial stability** in monetary policy frameworks. For an overview, from a Swedish and European perspective, see respectively:
 - “Monetary policy and financial stability – a simple story,” by Roberto Billi and Anders Vredin, Sveriges Riksbank Economic Review, 2014:2.
 - “Financial Stability and Monetary Policy: How Closely Interlinked?” by Frank Smets, Sveriges Riksbank Economic Review, 2013:3.

Conclusion

- The article convincingly provides evidence of **market dominance** over monetary dominance in the euro area.
- It also sheds light on the strong **connection** between monetary policy and financial stability considerations.