

# Interest Rate Uncertainty as a Policy Tool

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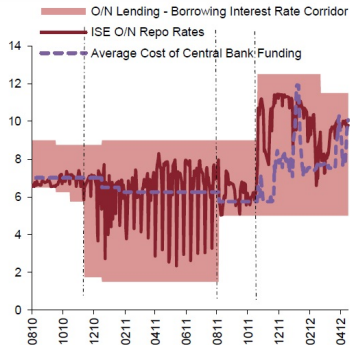
*Discussion by Javier García-Cicco  
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\*The views expressed are those of the author and do not necessarily represent official positions of the Central Bank of Argentina or its Board members.

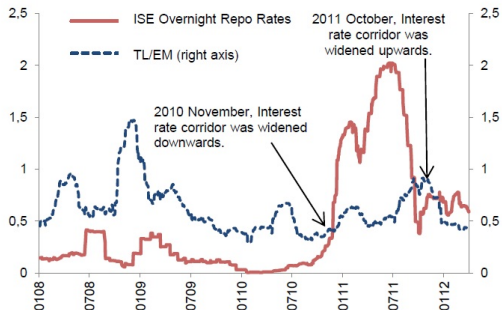
CBT Policy and Overnight Repo Rates (Percent)



Source: ISE, CBT.

Chart 9.

ISE Overnight Repo Rates and Volatility in TL  
(Standard deviation of daily percentage changes in last 50 days)



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► What are the macro effects of widening the O/N rate corridor?

- ▶ This paper:



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  - ▶ FDI effect (new).
- ▶ My comments: Insightful first approach to the question.
  - ▶ The effects of domestic interest rate volatility.
  - ▶ It's use as a policy tool.

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  - ▶ Size of the volatility shock (2 sd) and calibrated persistence: What is the mapping with the policy implemented in Turkey?
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  - ▶ Time-to-build in both types of investment.
- ▶ Role of countercyclical markups.
  - ▶ Basu and Bundick (EMA, 2017), Seoane (IER, 2017).



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- ▶ What is the problem to be solved?
  - ▶ Policy discussions: “excessive” capital flows.
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  - ▶ Sticky prices and aggregate demand externality? Fahri and Werning (EMA, 2016).

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- ▶ Welfare analysis I:
  - ▶ How does welfare change in the presence of this shocks?
  - ▶ Traditional reasoning without inefficiencies: more volatility  $\Rightarrow$  less welfare.
  - ▶ With rigidities/frictions it depends on the model.

- ▶ Welfare analysis II:
  - ▶ The policy design exercise may require a model where the interbank market is explicitly included.
  - ▶ In such a framework, policy rate  $\neq$  market rate.
  - ▶ Recent examples: Arce et al (JME, forthcoming), Piazzesi et al (2019).

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- ▶ Is the problem to be solved generated by inconsistencies in the policy framework?
- ▶ Some related examples:
  - ▶ Argentina 2018.
  - ▶ Uruguay 2013.



- ▶ A way of thinking about this policy in a DSGE model.
- ▶ Let  $R_t$  be the policy rate and  $M_t$  the quantity in the market where policy operates (e.g. the amount traded in the interbank market).
- ▶ Let  $R_{t|t-1}^T$  be the desired rate (e.g. Taylor rule), and  $M_{t|t-1}^T$  the quantity consistent with  $R_{t|t-1}^T$ .
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- ▶ Ex-post these might differ due to shocks.
- ▶ Alternative regimes:
  - ▶ IT:  $R_t = R_{t|t-1}^T$ , and  $M_t$  might differ from  $M_{t|t-1}^T$ .
  - ▶ Quantity target:  $M_t = M_{t|t-1}^T$ , and  $R_t$  might differ from  $R_{t|t-1}^T$ .
  - ▶ Hybrid regime: Use the rule

$$\lambda(R_t - R_{t|t-1}^T) = (1 - \lambda)(M_t - M_{t|t-1}^T), \quad \lambda \in [0, 1]$$

- ▶ Widening the corridor is analogous to decreasing  $\lambda$ .
- ▶ This is related to the work by Berg *et al.* (IMF, 2010).