Risk, Uncertainty and Monetary Policy

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November 4, 2010
My discussion

- Econometric questions
- What it means for monetary policy
Underlying idea

- Take a statistical forecast of volatility
  - Interpreted as **quantity** of risk

- Take implied volatility from options
  - Difference is **price** of risk
Risk Aversion (Bollerslev and Zhou)
Price and quantity of risk
Two questions

- Why do risk aversion measures look different?

- What happens to the Bekaert et al. risk aversion measures during the crisis?
**Structural VAR**

- VAR in business cycle indicator, real funds rate, risk aversion and uncertainty

- Controversial identifying assumptions
  - Uncertainty shocks have no SR effects
  - Risk aversion shocks have no SR effects on monetary policy or the economy

- Conclusions seem sensible
  - Consistent with work of Adrian and Shin
  - Consistent with “event study” evidence
Should monetary policy respond to “bubbles”?

- Kohn (2006) argued against monetary policy responding to bubbles because:
  1. Hard to detect bubbles in real time
  2. Increasing funds rate cannot pop bubbles
  3. Easier to let bubble burst and then clean up mess
Should monetary policy respond to “bubbles”? 

- Paper indicates that policy should react to risk premia 

- Regulatory response --- if it works --- is best 

- Benefits to central banks communicating some willingness to have monetary policy respond to risk premia