US Monetary Policy and Foreign Bond Yields

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Discussion by Jonathan Wright

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Findings of the paper

- US monetary policy surprises have generally less than 1-1 effect on foreign LC yield curves.
- US monetary policy surprises have generally at least 1-1 effect on foreign $ yield curves.
- CMP easings steepen foreign yield curves.
- UMP easings flatten foreign yield curves.
Measuring monetary policy shocks

- Hunger for way of measuring monetary policy surprises that applies to pre-ZLB and ZLB eras.
  - FOMC-day changes in two-year yields.
    - This paper and Gertler and Karadi (2013).
  - FOMC-day changes in some estimated shadow rate (Wu and Xia (2013)).

- Two-year yield is itself influenced by ZLB (Swanson and Williams (2014)).
Monetary policy surps from 2-year yields
Monetary policy surps from 10-year yields
Cross-country differences in pass-through

UMP pass-through from US ten-year yields:

- Australia: 0.76
- Germany: 0.41
- Japan: 0.12

Might consider pooled regression:

\[ \Delta y_{it} = \beta_0 MPS_{US, t} + \beta_1 X_i \ast MPS_{US, t} + \epsilon_{it} \]
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\]
Comparison of LC and $ Yield Curves

- Paper looks at effects of US monetary policy surprises on foreign LC and $ yields.

- Could also look at effect on exchange rate.

- Can compare jump in exchange rate with jump in interest differentials.
Comparison of LC and $ Yield Curves

- UMP shock raises $ foreign yields by 1.3%
- Duration of bonds is 5.6 years
- UMP shock appreciates $ by 3.7% (OITP)
- If risk premia unchanged, LC yields should rise 0.6%. 
How does UMP work?

- Clear that unconventional monetary policy affects own-country term structures.
- Easings lower very long-term forward rates.
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- Explanations for this that don’t involve term premia are far-fetched.
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Explanations for this that don’t involve term premia are far-fetched.

Explanations for cross-country effects are far-fetched\(^2\).
Case Study: 3/18/2009 FOMC Announcement

- Lowered 10-year ZC yield by 52 bps.
- Lowered 10-year forward rate by 35 bps.
Far-fetched

UMP lowering domestic yields must be:

- Lower expected inflation.
- Lower expected deviation of real rates from neutral.
- Lower long-run r-star.
- Lower term premia.
Far-fetched

UMP lowering *domestic* yields must be:

- Lower expected inflation.
  - Wrong sign!
- Lower expected deviation of real rates from neutral.
  - Lasts for 10+ years.
- Lower long-run r-star.
- Lower term premia.
Far-fetched$^2$

Non term-premium explanations for cross-country effects are even more of a stretch.

e.g. Committing foreign central banks to accommodative policy ten-years hence.
Implications for Monetary Policy Spillovers

Monetary policy actions have unintended consequences on foreign financial conditions.

Paper speaks to one dimension: US monetary policy effects on foreign term structure.
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But we can also ask about effects of

- US monetary policy on exchange rate.
- Foreign monetary policy on US yields.
- Foreign monetary policy on exchange rate.
Implications for Monetary Policy Spillovers

General results:

- US monetary easing surprises depreciate dollar.
- Foreign monetary easing surprises depreciate foreign currency.
- Foreign monetary easing surprises have small pass-through to US rates.
Implications for Monetary Policy Spillovers

Fed moving towards tightening while ECB and BoJ easing more.
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ECB and BoJ spillover on Fed is not.
Implications for Monetary Policy Spillovers

Event studies provide laboratory for effects of monetary policy.
Implications for Monetary Policy Spillovers

- Event studies provide laboratory for effects of monetary policy.

- Global fixed income market is $55 trillion.

- Actions of any central bank are tiny.

- Finance theory: Effects should be negligible.

- But paper has shown that US monetary policy moves global fixed income markets.