The Economics of the Fed Put

Anna Cieslak and Annette Vissing-Jorgensen

Discussion by Jonathan Wright

June 1, 2018

Paper Summary

- Negative stock returns predict target funds rate changes
- Based on textual analysis, this reflects consumption-wealth effect and investment
- Stock market decline predicts target changes even after controlling for Greenbook forecasts

Comment 1

- Much of the paper looks at reduced form relation between intermeeting changes in the target funds rate and excess stock returns

Comment 1

- Much of the paper looks at reduced form relation between intermeeting changes in the target funds rate and excess stock returns
- Concerns:
  - Causation goes both ways
  - Most of change in target funds rate is predictable
  - One-year yield is a better measure of monetary policy than target funds rate
  - Especially at the ZLB

Comment 1

- Much of the paper looks at reduced form relation between intermeeting changes in the target funds rate and excess stock returns
- Concerns:
  - Causation goes both ways
  - Most of change in target funds rate is predictable
  - One-year yield is a better measure of monetary policy than target funds rate
  - Especially at the ZLB
- Could use Rigobon-Sack identification with one-year yield and stock prices

Comment 2

- Central Regressions:

$$\Delta FF_m = \beta RS_m^- + error$$

$$\Delta FF_m = \beta RS_m^- + \gamma \Delta GB_m + error$$

- 10% drop in stock market $\rightarrow$ 1% drop in FF
  - Mostly explained by changing forecast
- CVJ Story:

$\boxed{\text{Stocks} \downarrow} \rightarrow \boxed{\text{Fed economic forecast} \downarrow} \rightarrow \boxed{\text{Funds rate} \downarrow}$

Comment 2

- Central Regressions:

$$\Delta FF_m = \beta RS_m^- + error$$

$$\Delta FF_m = \beta RS_m^- + \gamma \Delta GB_m + error$$

- 10% drop in stock market $\rightarrow$ 1% drop in FF
  - Mostly explained by changing forecast
- CVJ Story:

$\boxed{\text{Stocks} \downarrow} \rightarrow \boxed{\text{Fed economic forecast} \downarrow} \rightarrow \boxed{\text{Funds rate} \downarrow}$

- Examples of "animal spirits" 10% drop in stocks:
  - Jan 2018-Feb 2018; May 2015-Feb 2016; Apr 2011-Oct 2011; Apr 2010-July 2010; Nov 2002- March 2003; July 1999-Oct 1999
- No way that these led to 100 bp easings

Comment 2

- CVJ Story:

  $\boxed{\text{Stocks} \downarrow} \rightarrow \boxed{\text{Fed economic forecast} \downarrow} \rightarrow \boxed{\text{Funds rate} \downarrow}$

Comment 2

- CVJ Story:

  $\boxed{\text{Stocks} \downarrow} \rightarrow \boxed{\text{Fed economic forecast} \downarrow} \rightarrow \boxed{\text{Funds rate} \downarrow}$

- Alternative:

  $\boxed{\text{Economic outlook} \downarrow} \rightarrow \boxed{\begin{array}{l}\text{Stock market} \downarrow \\ \text{Funds rate} \downarrow\end{array}}$

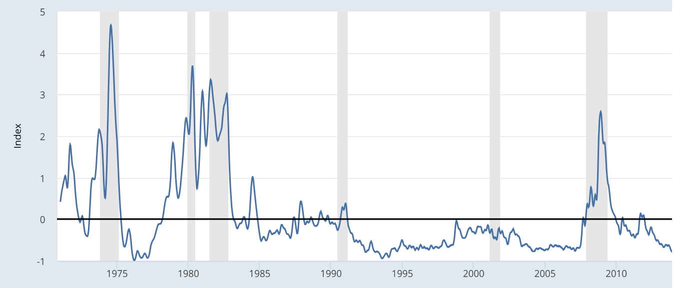
Comment 3

- Empirical work in the paper looks at stock prices
- But this is a stand-in for financial conditions
- Would recommend using a FCI

Comment 3

- Empirical work in the paper looks at stock prices
- But this is a stand-in for financial conditions
- Would recommend using a FCI

Chicago Fed Financial Conditions Index



Comment 4

- Connect more with the existing literature
  - Hayford and Malliaris (2007); Fuhrer and Tootell (2008); Bjornland and Leitemo (2009); Ravn (2012); Hoffmann (2013)
- Fuhrer and Tootell do a similar exercise but get a somewhat different result
- Footnote attributes it all to effective/target funds rate difference
- Sample period and asymmetry seem more likely

Conclusion

- Adverse financial conditions lead to fed easing
- Has been well justified

Conclusion

- Adverse financial conditions lead to fed easing
- Has been well justified
- Strong financial conditions haven't led to fed tightening.
- Lean against wind debate is very open