Monetary Policy and Sentiment Driven Fluctuations
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EDMM Conference, CNB

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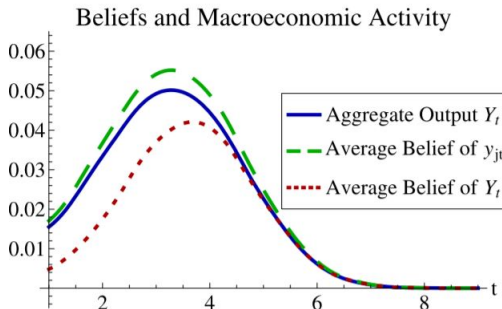   - ▶ As a result: sentiment shocks become endogenous to the stance of MP.

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  ▶ As a result: sentiment shocks become endogenous to the stance of MP.

▶ **New channel for MP:** it can affect how firms use their signal.

▶ Volatility of sentiments is endogenous to policy:

  ▶ Incentive for MP to eliminate the sentiment fluctuations.

▶ MP becomes a source of fluctuations (through its information channel).

▶ The sentiment shocks acts like:

    ▶ demand shocks $\rightarrow$ creates co-movement between y_t and π_t.

    ▶ supply shocks $\rightarrow$ creates a trade-off between stabilizing y_t and π_t.

▶ New trade-off between inflation and output gap stabilization, even in the absence of supply shocks.

- ▶ Inflation reaction has a de-stabilizing effect on output through the sentiment channel.

- ▶ Strong inflation reaction results in indeterminacy.

- ▶ In the presence of both fundamental and sentiment shocks:

   - ▶ MP cannot distinguish between the sources and therefore cannot implement the efficient allocation.

- Angeletos and La'O (2013): IRFs of output and output beliefs.
- The case with purely exogenous signals.

Beliefs and Macroeconomic Activity

Legend:
- Aggregate Output Y_t
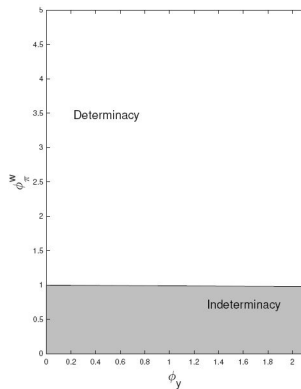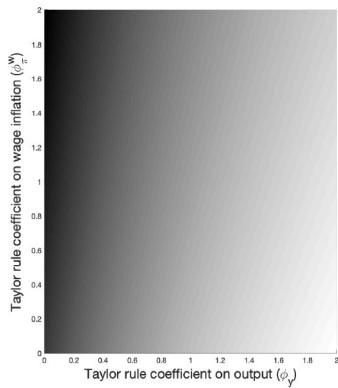- Average Belief of y_{jt}
- Average Belief of Y_t

▶ Angeletos et al. (2020): impulse responses of inflation/unemployment.

▶ Emphasis of the delayed overshooting of expectations.
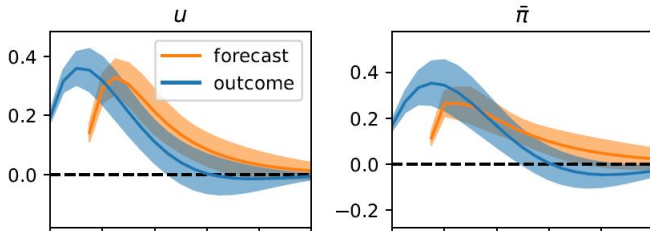
▶ Could this framework with the endogenous signal capture the overshooting effect?

▶ The Taylor rule is no longer applicable:

▶ Baseline results based on a weight of $\lambda = 0.2$ for the idiosyncratic component of the signal.

▶ How does this weight affect the indeterminacy region?

▶ In a potential estimation of the model, λ could be pinned down via survey expectations.

▶ Related: would the model be easy to estimate with standard methods, or are the indeterminacy regions problematic?

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- ▶ Is it feasible to incorporate CB uncertainty into this framework?