

Summary of *Central Bank Communication and the Yield Curve*

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1. What are the research questions?

- How can central bank communication shape long-term interest rates?

2. Why are the research questions interesting?

- The financial turmoil of 2008 and the subsequent European debt crisis fueled debate about central banks influencing long-term interest rates.
- After the onset of the European debt crisis, the core and peripheral yields spread increased significantly.

3. What is the paper's contribution?

- research on belief-driven equilibria around the European sovereign debt crisis
 - Existing literature: “bad equilibria” appear in theoretical models.
 - Extension: providing empirical evidence for a risk premium channel of monetary policy.
- the literature on signaling channel of monetary policy
 - policymakers' actions reveal their private knowledge to market participants, which in turn can have real economic effects.
 - Extension: extracting two distinct policy shocks that differentiate between standard interest rate shocks and news related to additional policies.
- the literature on identification of ECB communication shocks
 - Existing literature: use only money market rates.
 - Extension: take equity returns into consideration, show a more general link between central bank communication and asset prices.

4. What hypotheses are tested in the paper?

- H1: A negative forward guidance shock decreases bond yields uniformly across all sovereigns by signaling lower future interest rates than what the market expected, but at the same time can also increase the required risk premium on all sovereign debt, dampening the effect of the expectation channel.
- H2: On the contrary of forward guidance shock, a negative pure risk premium shock increases credit-risky sovereign yields.

a) Do these hypotheses follow from and answer the research questions?

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- Yes, they are explaining how central bank communication shape long-term interest rates.
- b) Do these hypotheses follow from theory? Explain logic of the hypotheses.**
- They follow the theoretic framework which developed the forward guidance shock and the risk premium shock.
- 5. Sample: comment on the appropriateness of the sample selection procedures.**
- The sample period covers the start of the 2008 financial turmoil and the subsequent sovereign crisis.
- 6. Dependent and independent variables: comment on the appropriateness of variable definition and measurement.**
- Independent variables are forward guidance shock and the risk premium shock, which are disentangled from ECB communication shocks. Dependent variable is CDS rate chosen for demonstrating credit risk channel.
- 7. Regression/prediction model specification: comment on the appropriateness of the regress/predict model specification.**
- The simple regression contains only two shock variables.
- 8. What difficulties arise in drawing inferences from the empirical work?**
- The empirical analysis only considers four countries in Europe, perhaps they may not be able to represent the EU.
- 9. Describe at least one publishable and feasible extension of this research.**
- Similar procedure can be applied to analyze how Chinese central bank announcement shock decompose to forward guidance shock and the risk premium shock and how the equity market and CDS rate is influenced.