

Bank of England

Unexpected curves

ECB Forum on Central Banking, Sintra

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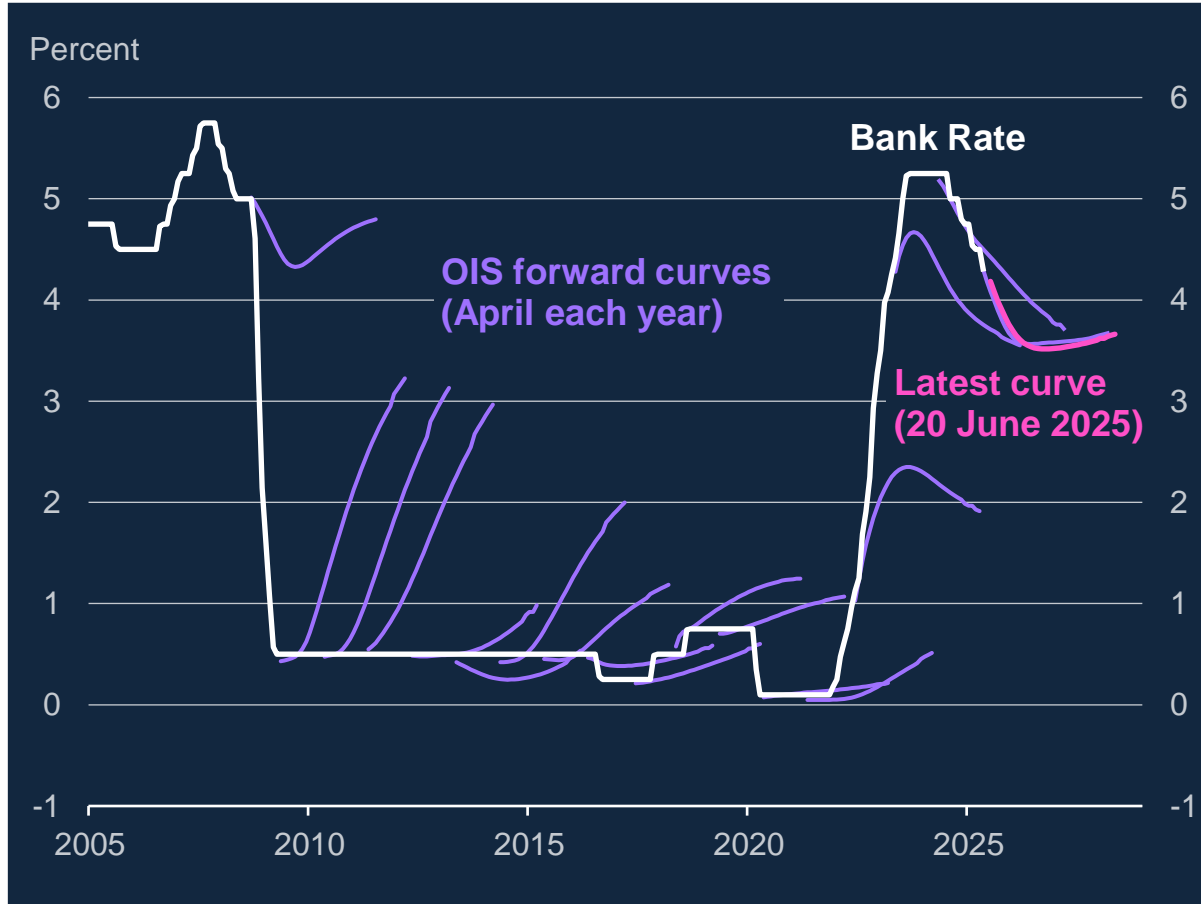


Introduction

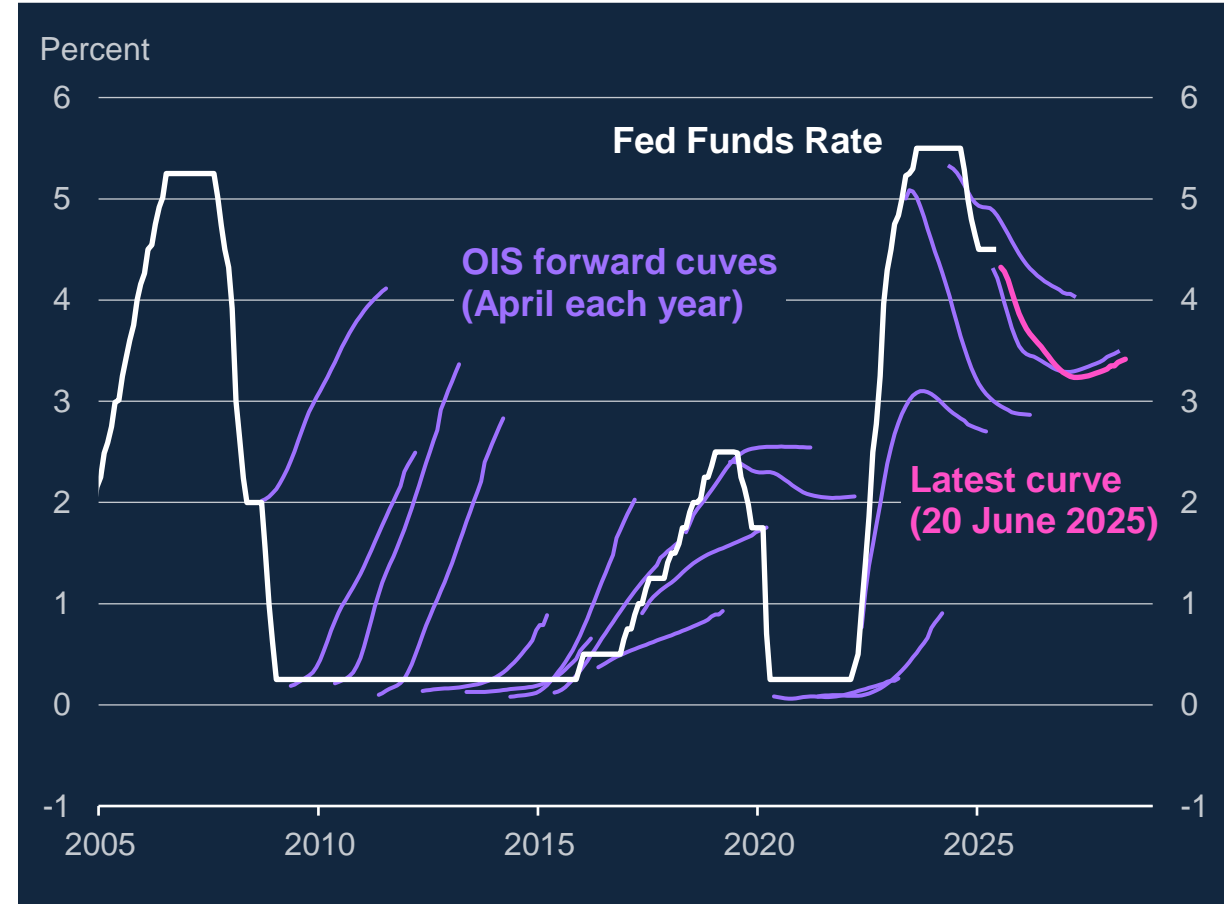
- Why do central banks talk about their decisions in public?
 - First: the current institutional framework of demand management and inflation control
 - Second: because of a desire to affect expectations of future interest rates
- How can central banks credibly and usefully communicate with agents in the economy, especially where interest rates are likely to settle in the long run?
- How can we know where neutral is?
 - Analysing
 - Outsourcing
 - Feeling

Market pricing of future short rates can be persistently wrong

Bank Rate and instantaneous forward curves

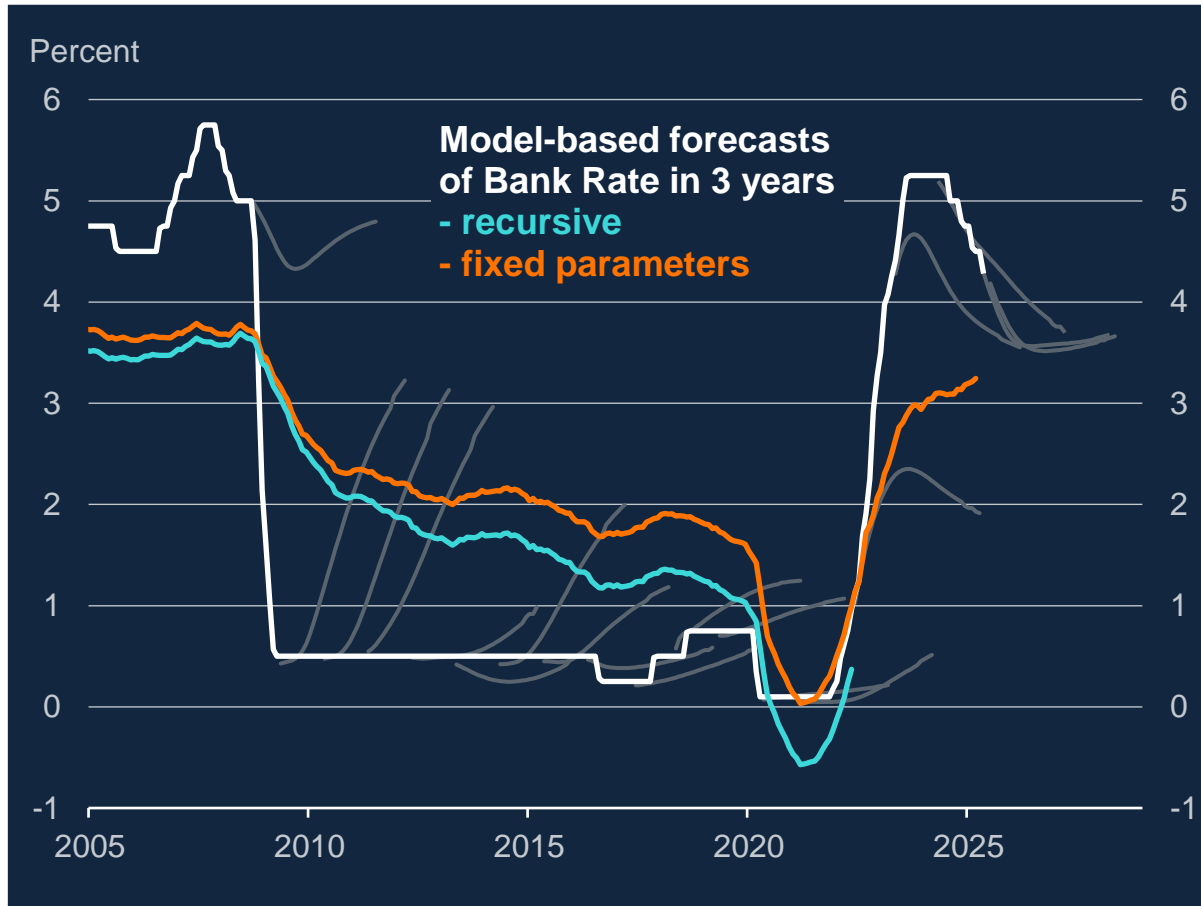


Fed Funds Rate and instantaneous forward curves

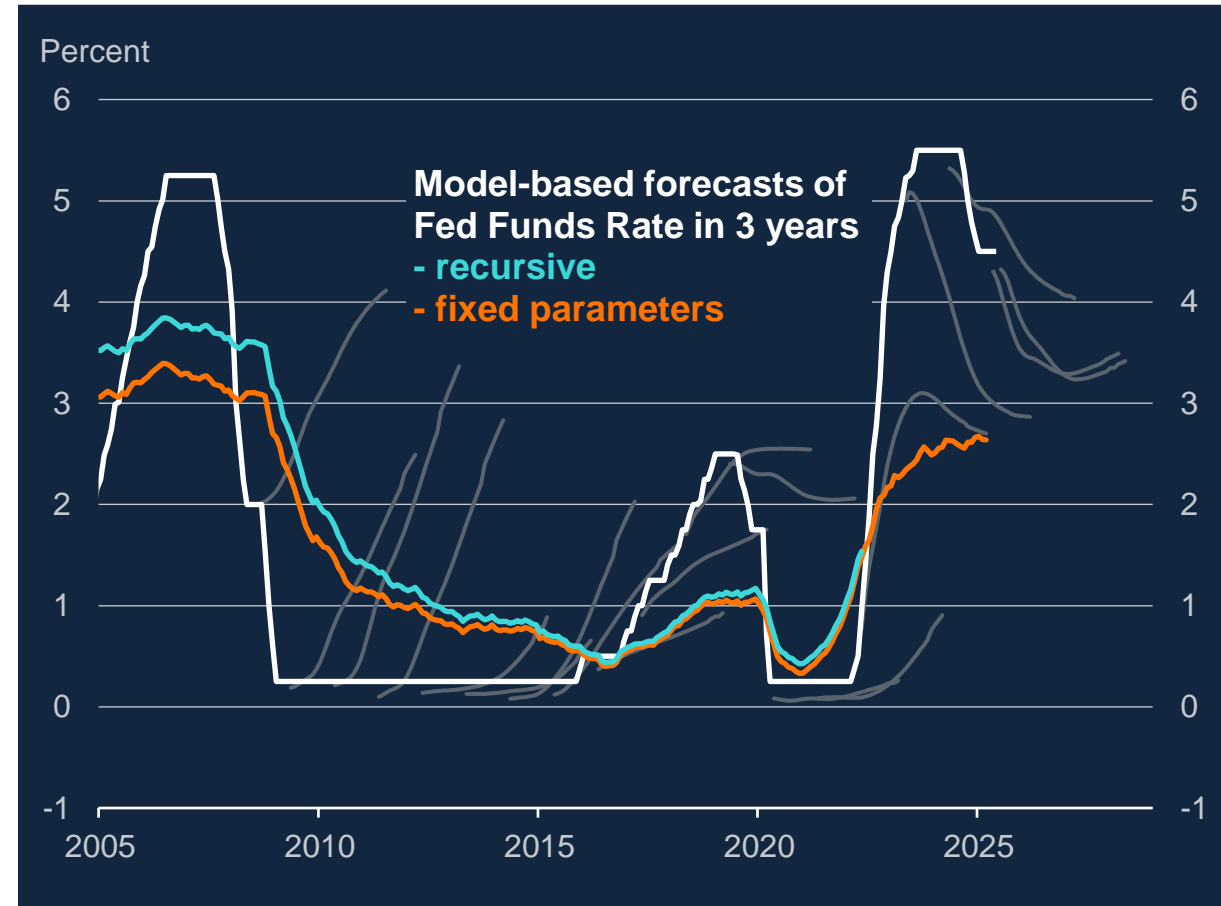


Model-based estimates of nominal neutral rates are competitive predictors of future short rates

Bank Rate and forecasts using neutral rates

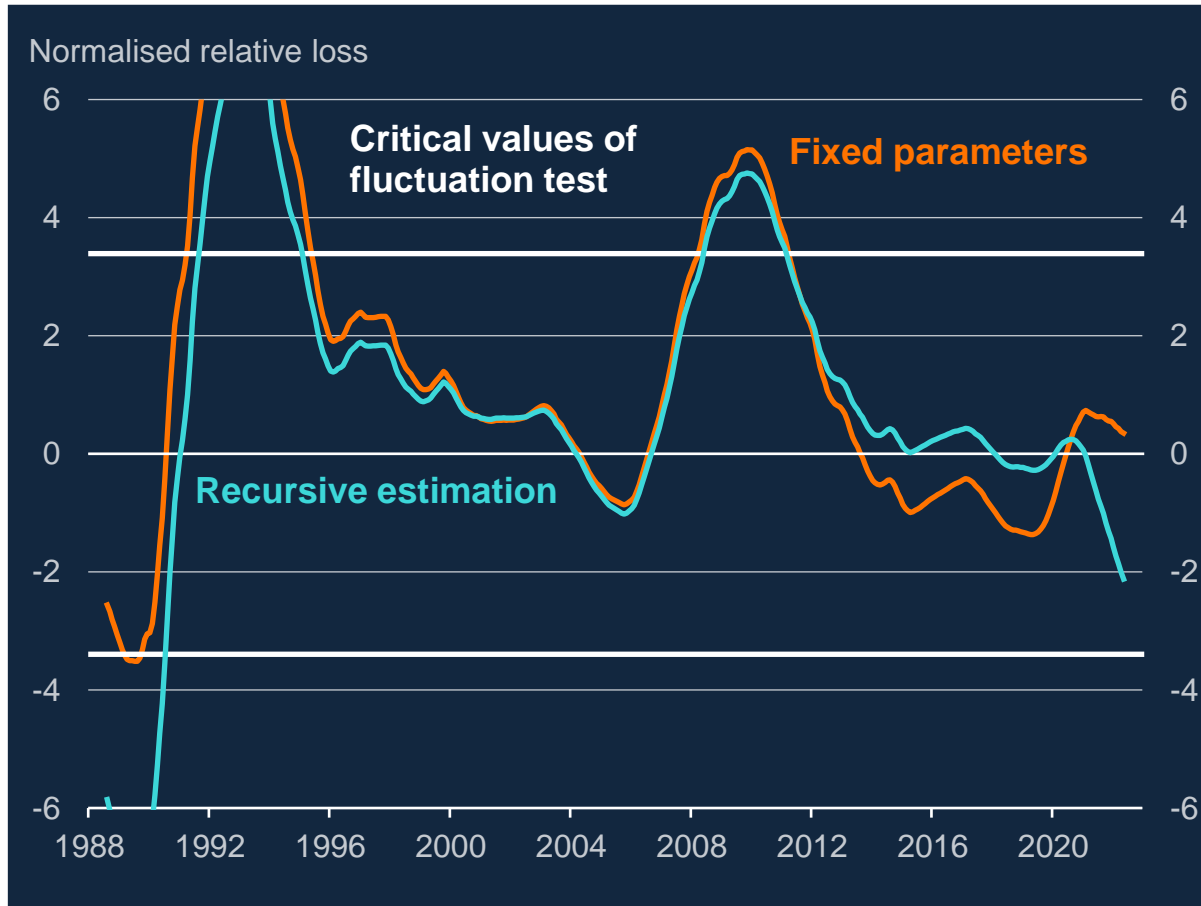


Fed Funds Rate and forecasts using neutral rates

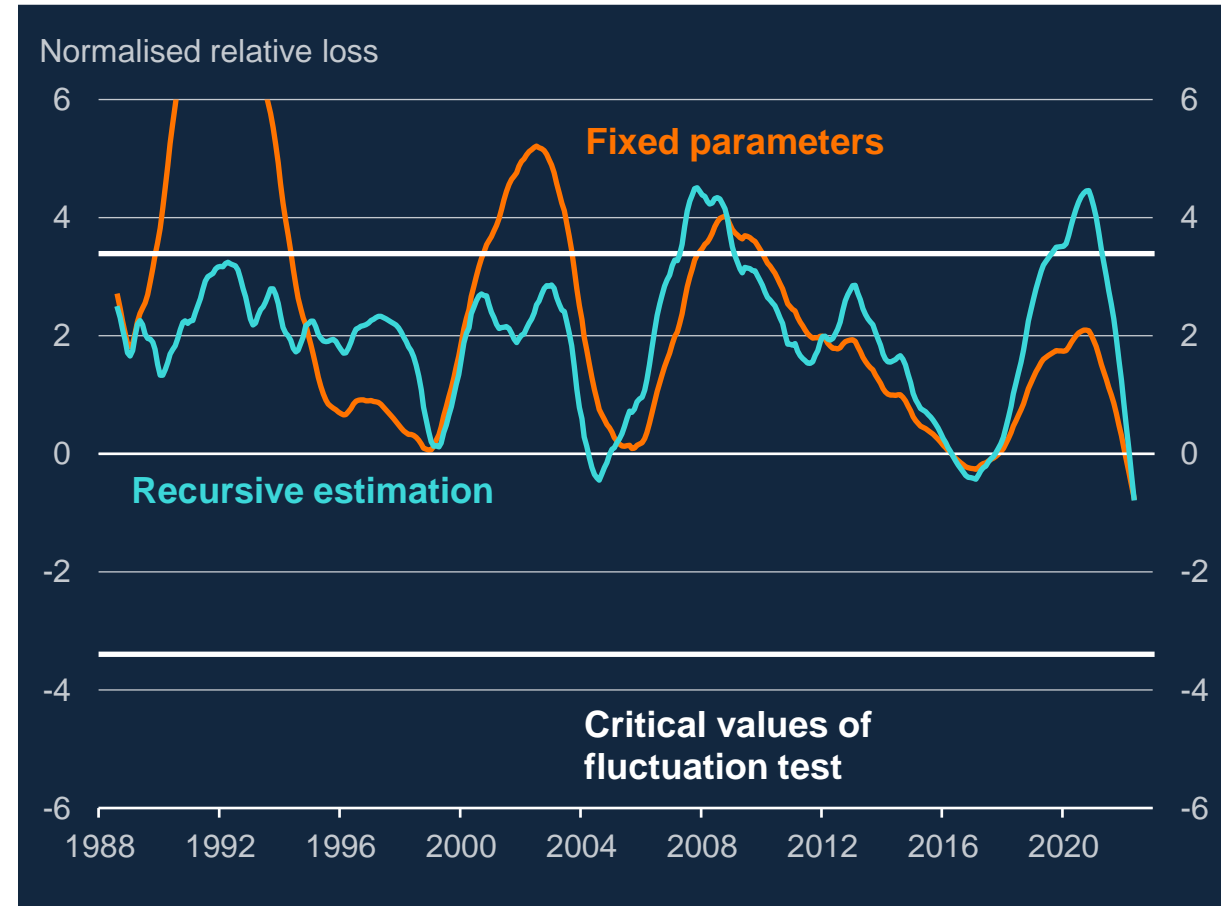


A test for relative forecast accuracy shows that model-based neutral rates have out-performed the market curve

Giacomini-Rossi fluctuation test for UK data



Giacomini-Rossi fluctuation test for US data



I worry that the soft landing is at risk and prefer a lower path for Bank Rate than implied by financial markets

Illustrative paths for Bank Rate

