Does Inflation Targeting Help Information Transmission?
A Discussion

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Overview

- India formally moved into IT framework in 2015.
- The objective of monetary policy was to contain inflation.
- IT has been touted to be useful to clearly communicate with markets, and clarify central bank objectives.
- Authors study using an event study design.
- Findings:
  - Bond market trading volume and volatility $\rightarrow$ No.
  - Equity return volatility $\rightarrow$ No.
- Argument: Monetary policy informative about inflation, but not about growth outlook and risks. Textual analysis supports this view.

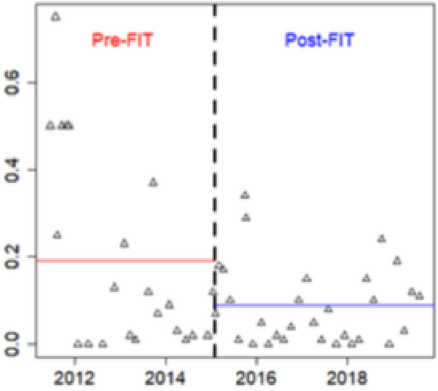
Theory: Information and Bond Market Volatility

- Bond prices fluctuate when interest rates change.
- The extent of volatility only relies on maturity, yield and the credit rating of the issuer.
- Having a clear (transparent) objective function allows bond traders to hedge in the right direction.
- If traders' expectations are better anchored as a result of IT, then it must result in lower volatility in the bond market.
- Not sure if there is a prior on bond market volume.
- If it does not affect volatility, then the relevant question is whether inflation expectations are well anchored in India.

Theory: Information and Stock Market Volatility

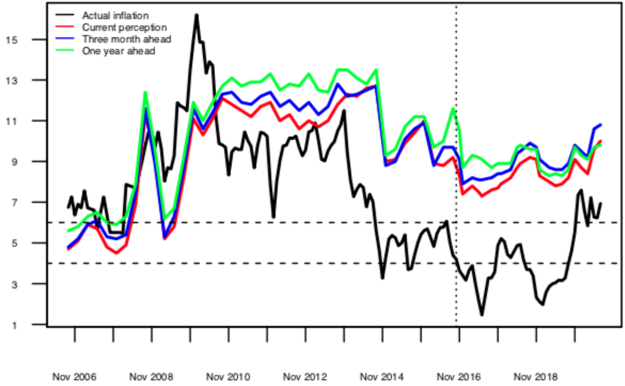
- Stock market volatility: (a) Discount-rate news and (b) Cash-flow news (Campbell and Shiller decomposition).
- Authors argue that there is little about cash-flow news in RBI's MP statements (Growth / risks etc.).
- But what about discount rate news? If IT framework is robust, then it must affect agents' discount rate over time?
- If it does not, again the relevant queston is whether inflation expectations are well anchored in India. This helps anchor discount rates, and so market price volatilities.

IT Framework as Anchoring Expectations



IT Framework as Anchoring Expectations

Patnaik and Pandey (2020), RBI Survey



Another Reason for Findings

- The MPC sets the policy rate. But are there other things that the RBI is also doing at the same time?
- For example: Open Market Operations in the G-Sec market, Targeted Long-term Repo Operations, unilateral changes in the reverse repo rate without the MPC, etc.
- If the sanctity of the MPC and the IT framework is questionable, then it is not a surprise that the markets haven't reacted that differently than before.

Establishing what IT has changed and what it has not

- No doubt that there are linguistic and semantic shifts in policy statements (Mathur and Sengupta 2019).
- Mathur and Sengupta find that lengthier statements are linked to higher volatility in equity and currency markets.
- Going further, Patnaik and Pandey (2020) review the framework.
- But we first need to establish beyond doubt what changed across all of RBI's policy actions with IT before understanding whether there was any new information to transmit to markets.

In summary

- An important question.
- A great setting to use to answer the question.
- Very interesting results.
- Urge to:
  1. Establish what IT changed and did not, quantitatively.
  2. Posit mechanisms through which they authors expect bond and stock market volatilities to be affected.
  3. And consider that *de jure* IT framework announcement and *de facto* reality may be different for finding no effects.