Achieving Price and Financial Stability: Challenges and Potential Pitfalls

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Fundamental challenge:
Fundamental Challenge Facing Central Banks

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Fundamental challenge:

Substantial uncertainty about:

- Key monetary policy indicator - output gap
- Monetary policy transmission
Achieving Price and Financial Stability

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Potential pitfalls:
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$\rightarrow$ Additional policy instruments required to achieve both objectives [Tinbergen rule]
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* Information effects: direct, ex post effects of information disclosure
  + Publishing projected policy path reduces uncertainty and increases policy effectiveness
  – Disclosure of liquidity problems could trigger bank run (e.g. Northern Rock, 9/2007)
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  + Transparency could induce greater discipline (e.g. anticipating public ‘stress tests’)
  – ‘Constructive ambiguity’ could prevent risky activities
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Transparency paradox or potential pitfall:
Disclosure could be detrimental if ex post, but beneficial if ex ante.

→ Commit to regular public stress tests, with ambiguity about precise parameters