

Achieving Price and Financial Stability: Challenges and Potential Pitfalls

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Fundamental Challenge Facing Central Banks

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Fundamental challenge:

Substantial uncertainty about

- Key monetary policy indicator - output gap
- Monetary policy transmission

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\rightarrow Additional policy instruments required to achieve both objectives [Tinbergen rule]

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- + 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