

Forward Guidance and Heterogeneous Beliefs*

Philippe Andrade Gaetano Gaballo Eric Mengus Benoît Mojon

August 20, 2015

First draft: March 2014

Abstract

We analyze the effects of forward guidance when agents have heterogeneous interpretations of whether forward guidance contains a commitment on future policy actions. Using survey expectations, we document that forward guidance lowered disagreement about future short-term interest rates to historically low levels while it did not affect much disagreement about future inflation and future consumption. We introduce heterogeneous beliefs on future policy and fundamentals in an otherwise standard New-Keynesian model. We show that, because the commitment type of the central bank is unobserved, agreement on the future path of interest rates can coexist with disagreement on the length of the trap. Such heterogeneity of beliefs can strongly mitigate the effectiveness of forward guidance. It also alters the optimal policy at the zero lower bound compared to a situation where beliefs are homogenous.

Keywords: Monetary policy, forward guidance, communication, heterogeneous beliefs, disagreement.

JEL Classification: E31, E52, E65.

*Andrade, Gaballo & Mojon: Banque de France, 39 rue Croix des Petits Champs, 75001 Paris. philippe.andrade@banque-france.fr, gaetano.gaballo@banque-france.fr, benoit.mojon@banque-france.fr. Mengus: HEC Paris, Economics and Decision Sciences Department, 1 rue de la Libération, 78350 Jouy-en-Josas, France. mengus@hec.fr. We would like to thank Jean Barthélémy, Marco Bassetto, Francesco Bianchi, Florin Bilbiie, Bill Branch, Alessia Campolmi, Gauti Eggertsson, Yuriy Gorodnichenko, Refet Gürkaynak, Christian Hellwig, Guillermo Ordonez, Adrian Penalver, Vincent Sterk, François Velde, Leo von Thadden, Mirko Wiederholt, Mike Woodford as well as seminar participants at Banque de France, Bundesbank, Chicago Fed, ECB, the 2014 DNB annual conference, the XIIth CEPR Macroeconomic Policy Workshop in Budapest, the 2015 SF Fed annual conference, and the BdF-NY Fed workshop on “Forward guidance and expectations” in New York for helpful comments and discussions. The views expressed in this paper are the authors’ and do not necessarily represent those of the Banque de France or the Eurosystem.