



Forecasting ECB monetary policy: Accuracy is a matter of geography [☆]

Helge Berger ^{a,b,*}, Michael Ehrmann ^c, Marcel Fratzscher ^c

^a Free University Berlin, Department of Economics, Boltzmann str. 20, 14195 Berlin, Germany

^b CESifo, Germany

^c European Central Bank, Kaiserstr. 29, 60311 Frankfurt am Main, Germany

ARTICLE INFO

Article history:

Received 22 June 2007

Accepted 2 December 2008

Available online 11 December 2008

JEL classification:

E52

E58

G14

Keywords:

Monetary policy

ECB

Forecast

Geography

Heterogeneity

Taylor rule

Survey data

ABSTRACT

Monetary policy in the euro area is conducted within a multi-country, multi-cultural, and multi-lingual context. How does this heterogeneity affect the ability of economic agents to understand and to anticipate monetary policy by the European Central Bank (ECB)? Using a database of surveys of professional ECB policy forecasters in 24 countries, we find remarkable differences in forecast accuracy, and show that these have important repercussions on market behaviour. Explaining the differences in forecast accuracy, we provide evidence that they are partly related to geography and clustering around informational hubs, as well as to country-specific economic conditions. In large part this heterogeneity can be traced to differences in forecasting models.

© 2008 Elsevier B.V. All rights reserved.

1. Introduction

Monetary policy in the euro area is conducted within a multi-country, multi-cultural, and multi-lingual context. With the formation of the European Economic and Monetary Union (EMU), countries with markedly different histories of inflation, monetary policy strategies, and central banking traditions, delegated the conduct of monetary policy to a single entity—the European Central Bank (ECB). Since this transition, questions that have come to the fore include whether economic agents in different member countries have been able to adjust and understand equally well the European perspective of monetary policy? To what extent are expectations about monetary policy still influenced by different national and cultural backgrounds? Moreover, to what extent may differences in the ability to forecast monetary policy decisions reflect more permanent information asymmetries related to geographic proximity to the ECB, and country-specific factors?

[☆] We would like to thank Reuters for providing data on their ECB monetary policy polls and Ann-Kristin Koch for able research assistance. Berger thanks the ECB's Research Department and the IMF's European Department for their hospitality. Two anonymous referees, Martin Cihak, Jörg Decressin, Hamid Faruquee, Elmer Sterken, Bob Traa, and seminar participants at the ECB, the IMF and the ifo Institute provided helpful comments. This paper presents the authors' personal opinions and does not necessarily reflect the views of the European Central Bank or the IMF.

* Corresponding author. Tel.: +49 30 838 54037.

E-mail addresses: Helge.Berger@fu-berlin.de (H. Berger), Michael.Ehrmann@ecb.int (M. Ehrmann), Marcel.Fratzscher@ecb.int (M. Fratzscher).

While random heterogeneity in forecasts will characterize many uncertain environments, the presence of systematic heterogeneity is important from a policy perspective. Expectations are a crucial transmission channel for monetary policy, and systematic heterogeneity linked, for instance, to geographical factors can imply that monetary policy in the euro area exerts differential effects in the various EMU countries. Furthermore, systematic differences in expectations among financial market participants imply that their trading behaviour differs, thus leading to heterogeneous investment profitability. Furthermore, a systematically different perception of the ECB's monetary policy could prompt country-specific political controversy about the ECB's role.

This paper analyzes the ability of economic agents in EMU and non-EMU countries to forecast monetary policy decisions by the ECB. In particular, we investigate to what extent expectations are related to geographic location of forecasters and country-specific characteristics. We develop a novel database of monetary policy expectations by 120 financial institutions in 24 countries between 1999 and 2005. The data stem from surveys conducted by Reuters, and provide information on the expected ECB policy rate for the upcoming Governing Council meeting, the probability distribution around forecasters' point estimates, as well as their expectations about the timing of future monetary policy moves. The survey responses accurately represent forecasters' expectations for two reasons. First, they are generally in the public domain, which implies that they must be in line with the recommendations given by the institutions to their clients. Second, as most institutions participate regularly, clients have the possibility to evaluate the respective forecasting performance of the various institutions.

We find that differences in forecast accuracy are substantial, as the top 10% of all institutions have a forecast error that is on average 8 basis points smaller than the error made by the worst 10% of performers. These differences are significant in economic terms, both from a financial market perspective and from a policy point of view, reaching a level of about one-third of the typical ECB policy rate change of 25 basis points during the sample period. Furthermore, they have repercussions on actual trading behaviour, as larger heterogeneity in market expectations causes an increase in volatility in asset prices following the announcement of monetary policy decisions.

What explains this large heterogeneity in anticipating ECB monetary policy decisions? A first result of our empirical analysis is that *geography* matters for forecast accuracy. There is a surprising amount of cross-country variance in expectations about ECB policy rates. But the pattern of forecast accuracy exceeds the concept of nationality. Frankfurt, which hosts the ECB headquarters and the German Bundesbank (one of the euro area's National Central Banks and, arguably, one of the ECB's early role models), also is Germany's financial centre. Being close to this informational hub tends to improve forecast accuracy of forecasters. The advantage of being located in an informational hub is corroborated by equivalent results for forecasters based in London/UK or working for institutions with a subsidiary in the City.

We find furthermore that national *macroeconomic conditions* tend to influence forecast accuracy, as deviations of national inflation from the euro area average affect the quality of forecasts. Forecasters in countries with higher (lower) than euro area inflation tend to produce more hawkish (dovish) forecasts, suggesting that the national inflation environment biases forecasters' views of ECB monetary policy.

We also show that the observed heterogeneity is *systematic* rather than based on differences in the judgmental component among forecasters. To extract the systematic component from observed predictions, we estimate for each bank the implied ECB reaction function underlying its interest rate forecasting model. These Taylor-type rules, which tend to be different across institutions, capture a significant part of the underlying structure of the published forecast.

To our knowledge, the focus on explaining the heterogeneity in monetary policy expectations is novel. It relates to earlier literature on the differences in the transmission of the ECB's monetary policy. In the run-up to EMU, several papers asked whether a change in policy rates would affect national economies in a heterogeneous fashion, possibly due to differences in expectations (Dornbusch et al., 1998; Cecchetti, 2001; Mihov, 2001). However, results are contradictory across studies (Mojon and Peersman, 2003). Evidence using data obtained under EMU is scarce, for the most part because long time samples are needed to estimate the full transmission path from interest rates to inflation. Accordingly, the few studies available analyze only elements of the transmission process (e.g., Angeloni and Ehrmann, 2003). No study has yet been conducted on the homogeneity of interest rate expectations in the euro area, and this is where the present paper attempts to contribute.

In addition, our work is broadly related to the literature on trade in goods and in financial assets, as well as the literature on home bias in the allocation of financial portfolios. For instance, there is substantial empirical evidence that information asymmetries and information frictions are fundamental in explaining trade in goods and financial assets as well as financial investment decisions (e.g. Froot and Stein, 1991; Gordon and Bovenberg, 1996; Portes et al., 2001; Hau, 2001; Dvorak, 2005). Such information asymmetries can take various forms and can be related to language, cultural ties, common legal origins, and institutions, among others. As the literature on home bias and capital flows emphasizes, information is also a key factor inhibiting "optimal" investment decisions based on portfolio theory. Moreover, location decisions by financial firms point to the importance of information-based agglomeration effects. Even though centrifugal factors in the sense of Krugman (1998) exist—for instance, the need to be close to locally dispersed customers—and advances in communication technology continue to lower transaction costs, centripetal forces seem to matter more in the financial services (Tschoegl, 2000; Clark, 2002; Cook et al., 2007).

In particular, geographic proximity and common socio-cultural attitudes remain key when it comes to the realization of information spillovers and economies of scale in information processing (Thrift, 1994; Grote, 2004). Faulconbridge (2004, p. 237) counts "face-to-face contact facilitated by social proximity" among the arguments why financial companies

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات