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# Reactions of US government bond yields to explicit FOMC forward guidance<sup>☆</sup>



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### ABSTRACT

We quantify the effect of explicit policy rate guidance by the FOMC at the zero lower bound of the policy rate on US government bond yields with maturities up to 10 years. We distinguish between different kinds of announcements, namely open-ended and time-contingent forward guidance announcements, and forward guidance announcements containing state-contingency. We find that open-ended and time-contingent forward guidance announcements led to a significant reduction in forward US Treasury yields at a wide range of horizons, with the largest reduction occurring at the 5-year ahead horizon for both kinds of announcements. By contrast, forward guidance announcements containing state-contingency led to a significant increase in forward US Treasury yields for horizons of 3–7 years ahead; this increase could however be due to associated asset purchase announcements.

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## 1. Introduction

In this paper we quantify the impact of explicit FOMC policy rate guidance used as an unconventional monetary policy tool at the zero lower bound of the policy rate on near- to long-term interest rates implied by US Treasury securities with maturities of 1–10 years.

<sup>☆</sup> The views expressed in this paper are those of the author and not necessarily the views of the De Nederlandsche Bank.

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From a policy perspective it is important to quantify the effects of explicit policy rate guidance since explicit policy rate guidance is used as an important unconventional monetary policy tool in the United States. FOMC chairman [Bernanke \(2011\)](#) stated that “Then, as policy rates approached the zero lower bound, central banks began to employ an increasingly wide range of less conventional tools, including forward policy guidance and operations to alter the scale and composition of their balance sheets. Forward guidance about the future path of policy rates, already used before the crisis, took on greater importance as policy rates neared zero.” The minutes of the FOMC meeting of 26–27 April ([FOMC, 2011](#)) mention that forward policy guidance will be changed as part of the exit from quantitative easing, “In addition, changes in the statement language regarding forward policy guidance would need to accompany the normalisation process.”. And [Bernanke \(2011\)](#) expects forward guidance to be continued to be used in normal times, in contrast to balance sheet policies, “In more normal times, when short-term policy rates are not constrained, I expect that balance sheet policies will be rarely used. By contrast, forward guidance and other forms of communication about policy can be valuable even when the zero lower bound is not relevant, and I expect to see increasing use of such tools in the future.”.

Carney, governor of the Bank of England, oversaw the use of explicit policy rate guidance as governor at the Bank of Canada, and stated that “While the Bank believes it appropriate to be sparing in forward policy guidance under ordinary circumstances, the calculus changes under extraordinary ones. When conventional monetary policy has been exhausted at the zero lower bound (ZLB) on nominal interest rates, the additional stimulus that is likely to be called for is impossible to achieve using the conventional interest rate tool. Extraordinary forward guidance is one unconventional policy tool, along with quantitative easing and credit easing.” ([Carney, 2012](#)). The ECB introduced explicit policy rate guidance in July 2013. In the introductory statement to the press conference on 4 July 2013 following the ECB’s Governing Council meeting, the ECB’s President Draghi stated “The Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time.” ([Draghi, 2013](#)). This statement used the words “for an extended period”, which had previously been used on 18 March 2009 by the FOMC in its explicit policy rate guidance (see [Table 1](#)). The Bank of England introduced explicit policy rate guidance in August 2013, including in its news release “In particular, the MPC intends not to raise Bank Rate from its current level of 0.5% at least until the Labour Force Survey headline measure of the unemployment rate has fallen to a threshold of 7%, subject to the conditions below.” ([Bank of England, 2013a, 2013b](#)).

An overview of the literature on central bank communication is provided in [Blinder, Ehrmann, Fratzscher, De Haan, and Jansen \(2008\)](#) and [Knütter, Mohr, and Wagner \(2011\)](#). [De Haan, Jansen, and Moessner \(2014\)](#) provide a survey of communication about future policy rates in theory and practice. The effects of explicit policy rate guidance in the form of quantitative forecasts published by central banks has been studied for example by [Moessner and Nelson \(2008\)](#) and [Detmers and Nautz \(2012\)](#) for New Zealand, and by [Andersson and Hofmann \(2009\)](#) and [Kool and Thornton \(2012\)](#) for Sweden, Norway and New Zealand.

[Okina and Shiratsuka \(2004\)](#) studied the effects of forward guidance in Japan at the zero lower bound. They conclude that forward guidance provided by the governor of the Bank of Japan in April 1999 was effective in stabilising market expectations for the path of short-term interest rates, reducing longer term interest rates and flattening the yield curve, but that it did not manage to reverse deflationary expectations. The previous literature on the impact of unconventional monetary policy in the United States has mainly focussed on the effects of asset purchase programmes (see e.g. [International Monetary Fund, 2013a](#), and references therein), rather than on the new unconventional monetary policy tool of explicit policy rate guidance. [International Monetary Fund \(2013b\)](#) provides an overview of the literature on the effects of central banks’ unconventional monetary policies, focussing on bond purchases, but also including policy rate guidance. [Bank of England \(2013b\)](#) provides a survey of the literature on the effects of forward policy rate guidance. The following papers study the effects of forward guidance in the United States. [Campbell, Evans, Fisher, and Justiniano \(2012\)](#) analysed the effect of FOMC policy rate guidance more generally, decomposing news in FOMC statements into news about the target and the path of monetary policy, and found that forward guidance in monetary policy statements has significantly affected US Treasury yields since 2007. [Woodford \(2012\)](#) illustrates the effects of some instances of explicit FOMC policy rate guidance on OIS rates. [Swanson and Williams](#)

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