

Monetary Policy Decisions by the World's Central Banks using Real-Time Data*

MOUNU PREM[†]

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This draft: May 2019

Abstract

Optimal monetary policy is predicated on forward-looking actions based on real-time forecasts for future variables. However, monetary policy could also be based on past data, due to forecast uncertainty, high predictive power of past information for the future, or policy inconsistency with Central Bank (CB) statements. Do deeds follow words in the real world? This paper tests for the role of real-time information on both past data and forecasts about future variables in setting monetary policy rates in the world. It contributes to the literature on the conduct of monetary policy in three novel dimensions. First, by using real-time data available to CBs at the time they take their policy decisions. Second, by estimating the model on a panel of monthly data extending from 1994 through 2011 and comprising 28 economies. Third, by testing for differences in the conduct of monetary policy over time and across country groups. The empirical findings are very supportive to the nested model for the reaction of monetary policy makers to real-time information on past realizations and forecasts of both inflation and activity variables. The weight attached to inflation forecasts is nearly ten times as large as the weight on past inflation.

Keywords: monetary policy, Taylor rule, heterogeneous panels

JEL: E50, E52, E58

*We thank Carlos Medel for generous help with data provision. We also thank Sebastián Claro, Markus Eberhart, Francisco Gallego, José Tessada, Rodrigo Caputo, Luis Óscar Herrera, Alberto Naudón, Ernesto Pastén, Felipe Saffie, and Claudio Soto for useful comments.

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