

Central Banking for Open Economies in a Changed World

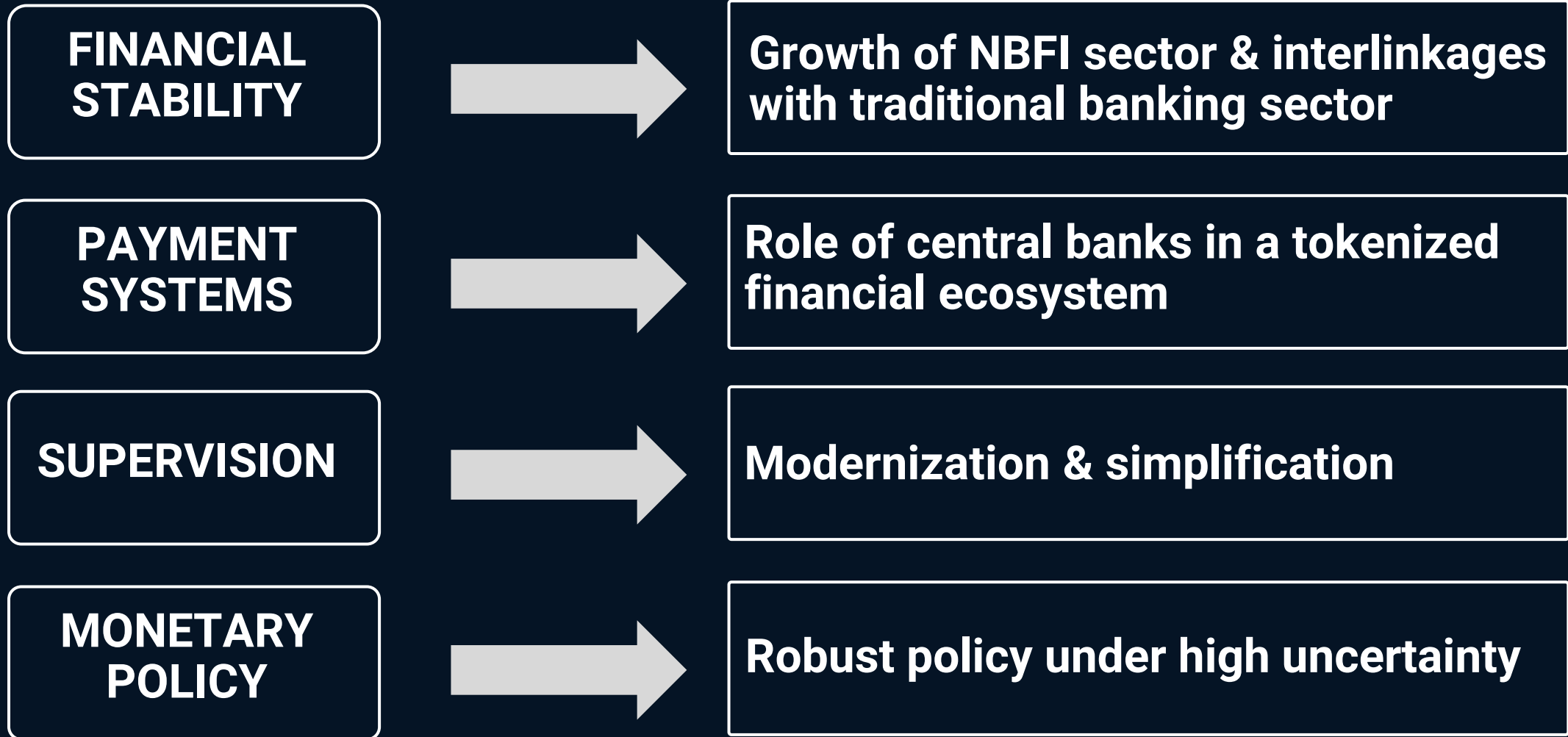
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CHALLENGES FACING CENTRAL BANKS:



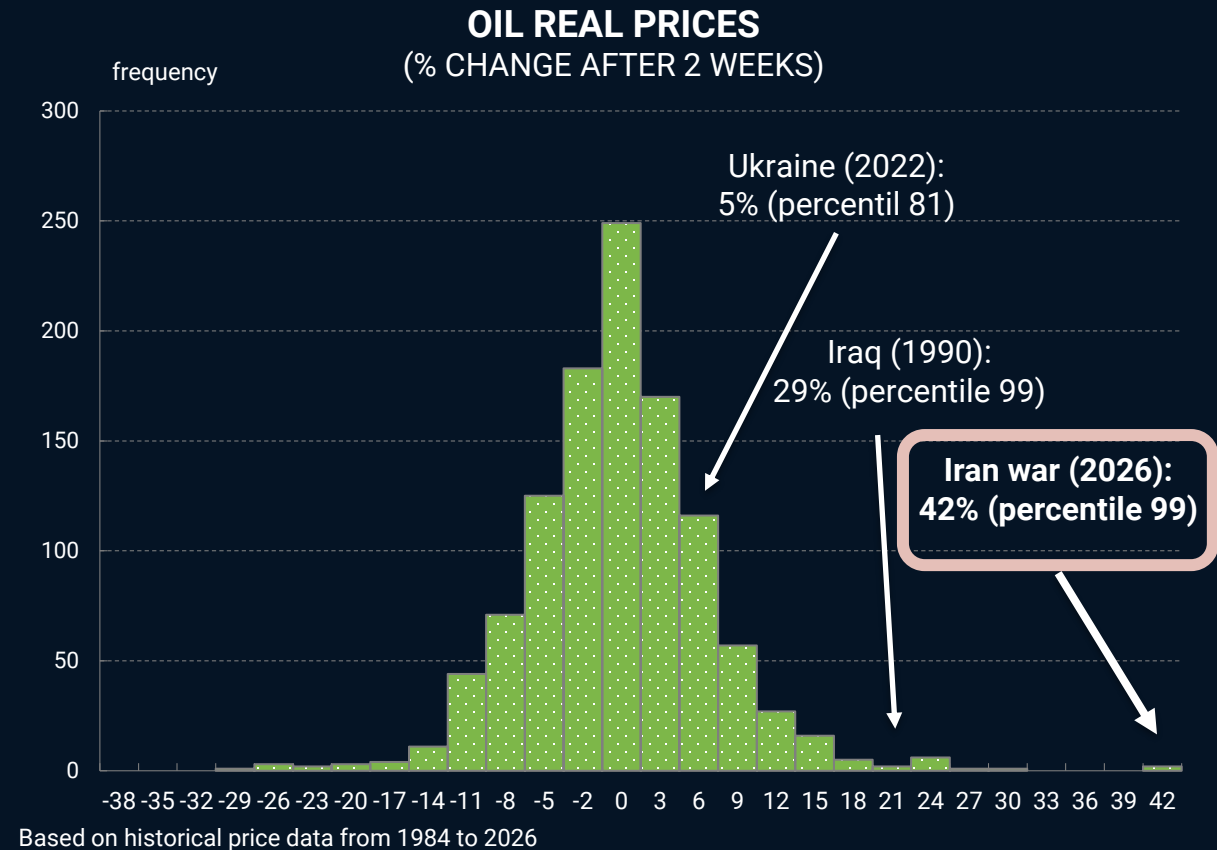
ROBUST MONETARY POLICY UNDER HIGH UNCERTAINTY

SCENARIOS: A TOOL OF DISCUSSION & COMMUNICATION

Why do we need them?

- **Knightsian Uncertainty** → modal projections likely *misguided*.
- Under **fat-tailed** risks → **balance of risks** and **asymmetry** of policy mistakes are crucial.

CURRENT ENERGY SHOCK IS A HISTORICAL TAIL EVENT



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We face three trade-offs:

- **Internal governance:** role of staff vs GovC
- **Number of scenarios:** richness vs complexity
- **External communication:** Openness vs prudence

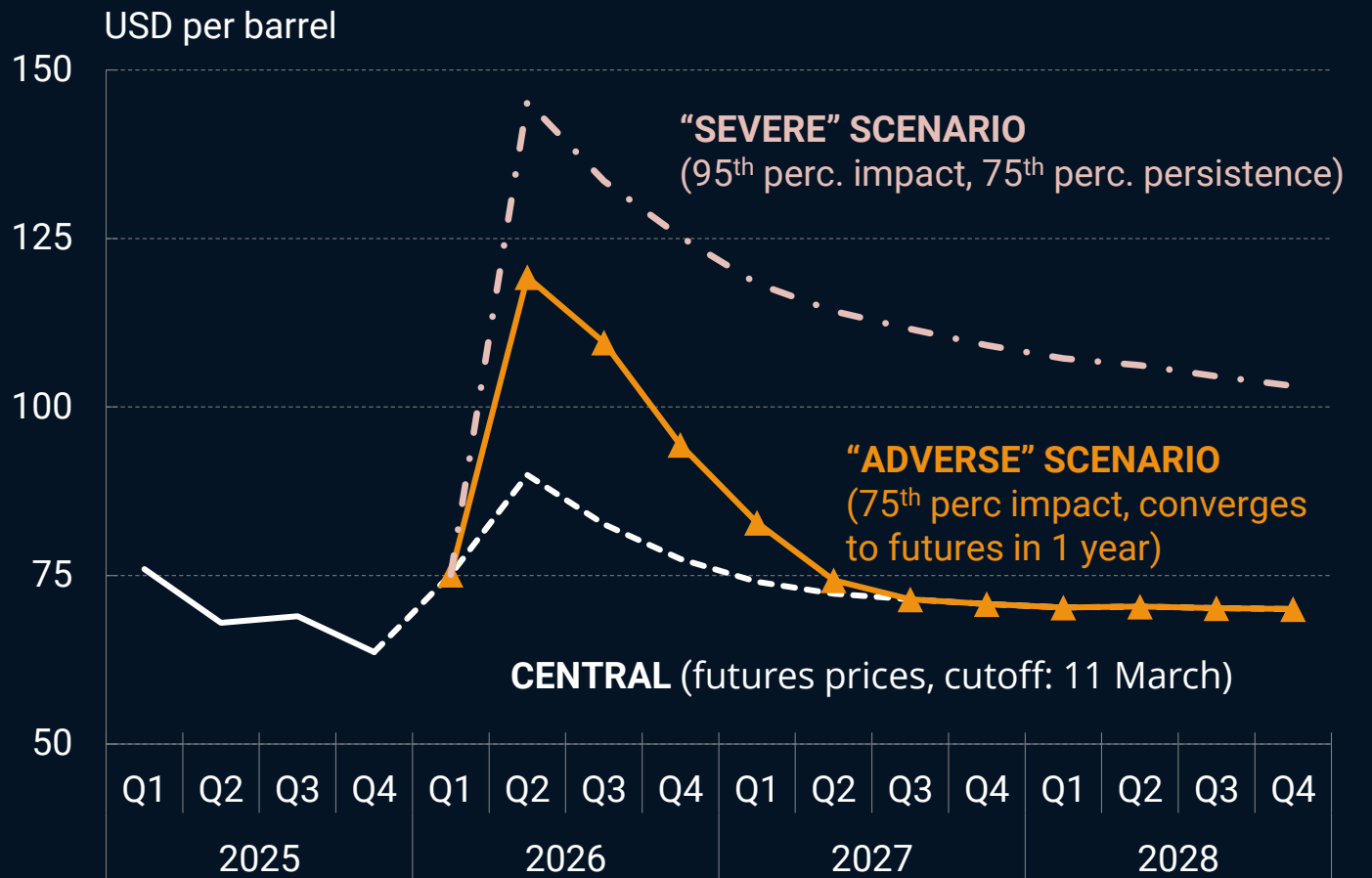
and a challenge:

- **How to construct them:**

CHALLENGE - DEFINE SCENARIOS: MUST COVER FULL RISK SPACE

Scenario	Narrative
CENTRAL	Market-based
ALTERNATIVE ("ADVERSE")	More intense shock
TAIL ("SEVERE")	Significantly more intense & persistent, + additional shocks

OIL PRICE SCENARIOS IN MARCH ECB FORECAST



INCLUDE ADDITIONAL CHANNELS AT TAILS

Scenario	Narrative	Agents' reaction
CENTRAL	Market-based	Regular elasticities
ALTERNATIVE ("ADVERSE")	More intense shock	Stronger impact via traditional channels
TAIL ("SEVERE")	Significantly more intense & persistent, + additional shocks	Add asymmetries, non-linearities

POLICY REACTION MAINLY FOR INTERNAL DISCUSSIONS

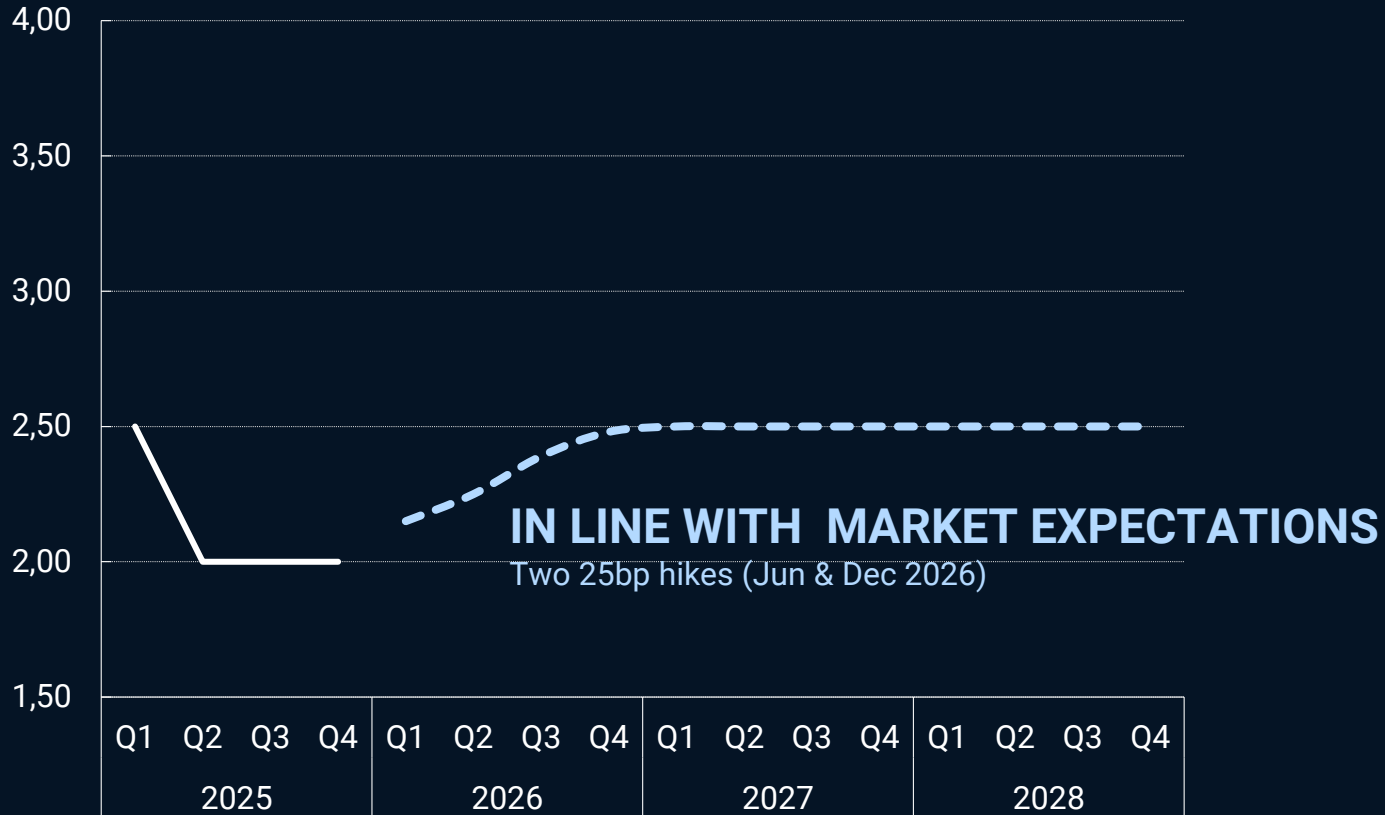
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Monetary/fiscal policy reaction:

FOR INTERNAL DISCUSSION:
analyze alternative policy reactions in all scenarios

POLICY REACTION FOR INTERNAL DISCUSSION ONLY

INTEREST RATE



Monetary/fiscal policy reaction:

FOR EXTERNAL COMMUNICATION:

**No monetary policy change assumption
beyond technical assumptions**

**When feasible, a well-designed fiscal
policy reaction**

SCENARIOS AS A GUIDE TO NAVIGATE THE POLICY DILEMMA

	ADVANTAGES	RISKS
Early, gradual tightening	<ul style="list-style-type: none">- Anchors expectations- Smoother paths	<ul style="list-style-type: none">- Increases type I error- Unnecessary drag
Wait-and-see, then decisive action	<ul style="list-style-type: none">- Reduces type I error- Gather info	<ul style="list-style-type: none">- Behind-the-curve risk- Larger hikes later

HOW TO CONFRONT THE DILEMMA IN PRACTICE?

Quickly changing situation



Monitor with real time data

Does it validate the baseline?

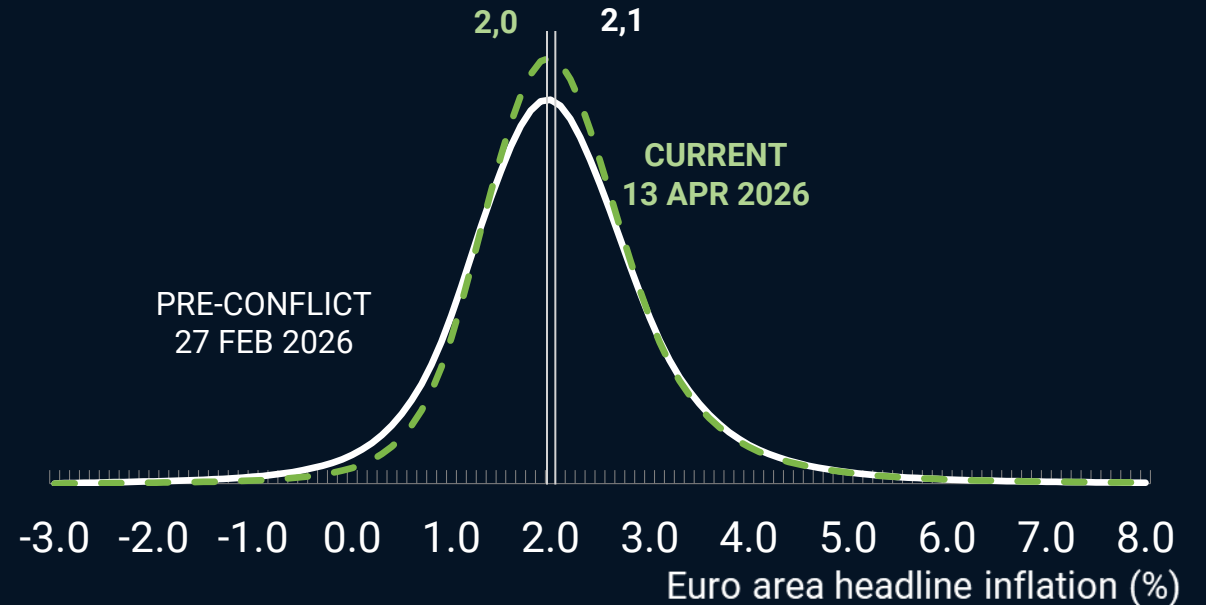


Broadly

Continue monitoring
real time data



BROADLY UNCHANGED LONG-TERM INFLATION EXPECTATIONS
(5y5y swaps)



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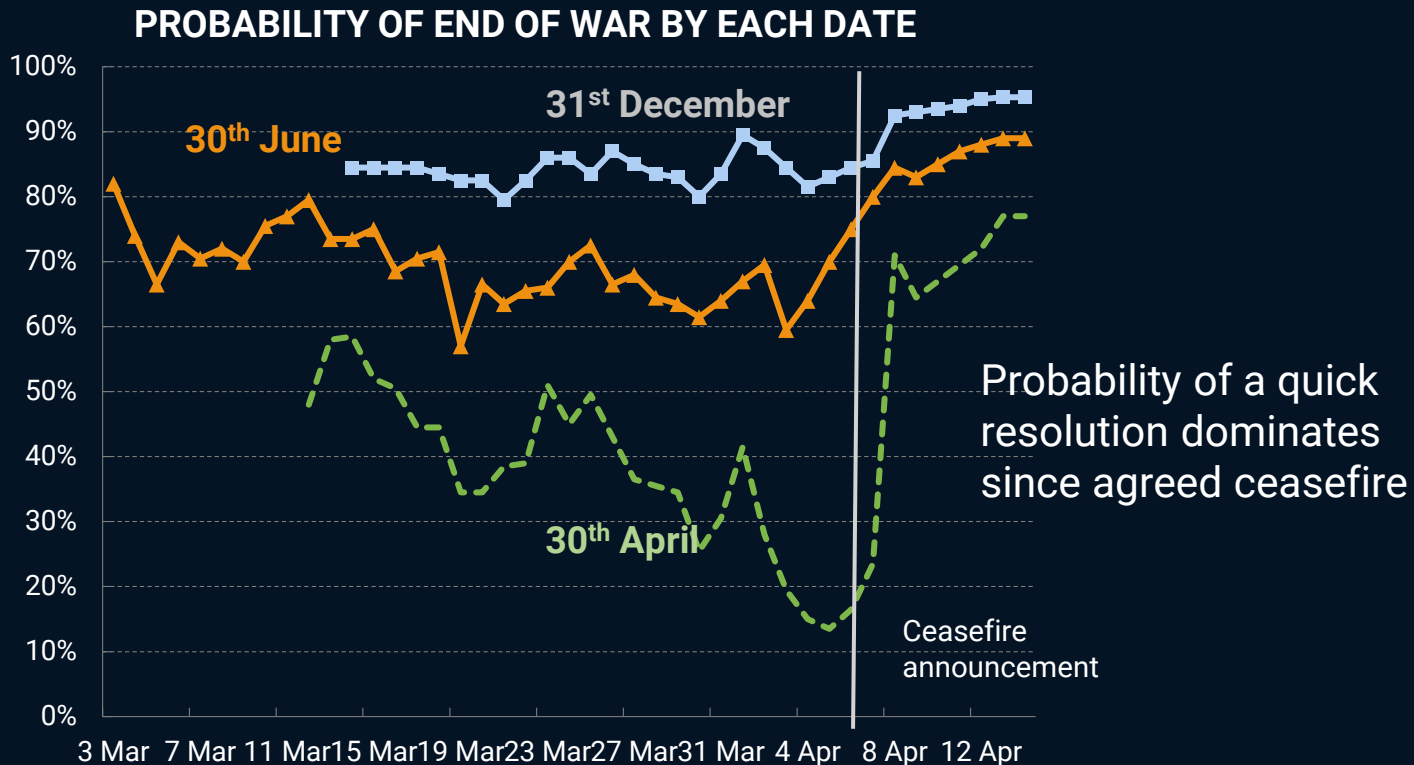


Unclear

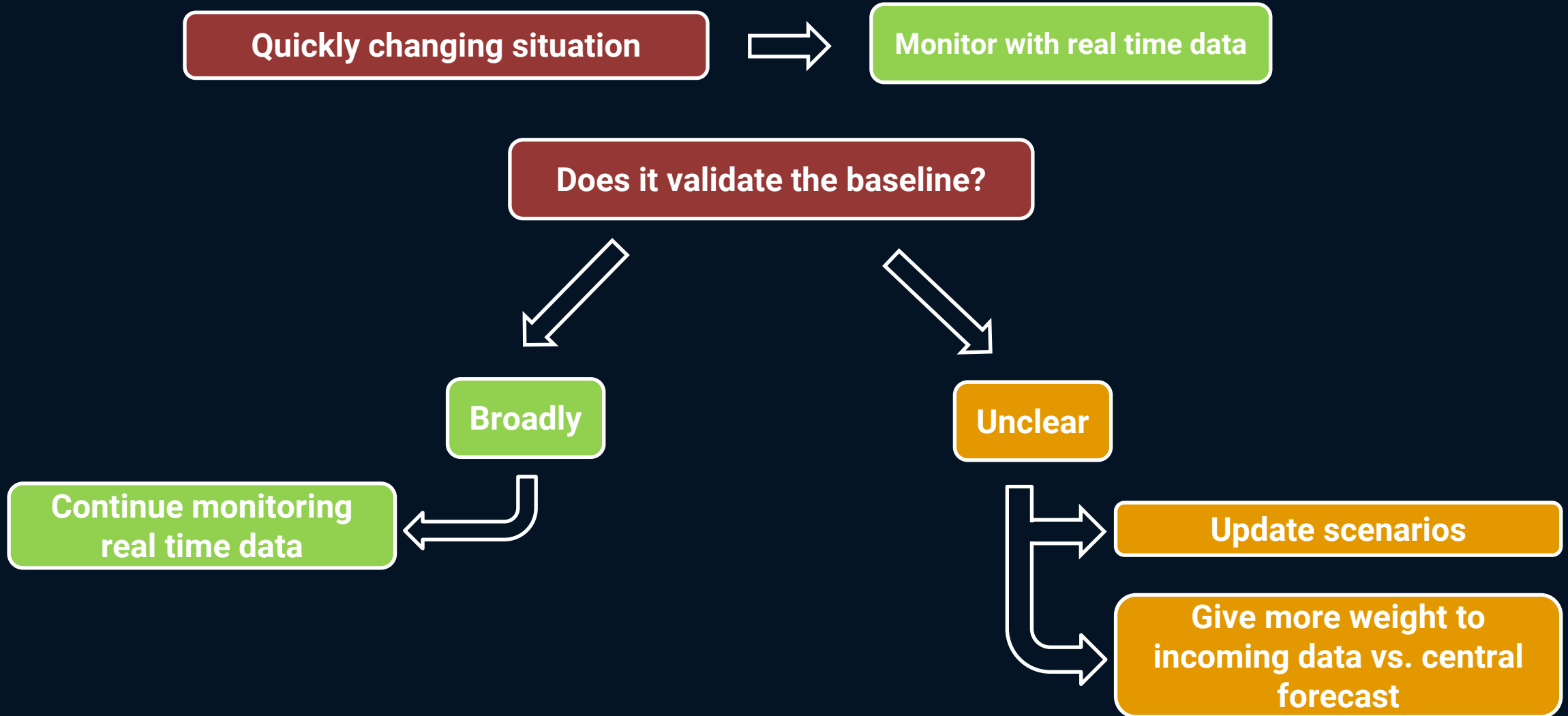


Update scenarios

Give more weight to incoming data vs. central forecast



HOW TO CONFRONT THE DILEMMA IN PRACTICE?



SCENARIOS: BALANCING UNCERTAINTY AND CLARITY

A GOOD SCENARIO DESIGN MUST REFLECT UNCERTAINTY
AS PERCEIVED BY THE DECISION-MAKING BODY

HOW TO COMMUNICATE TO THE PUBLIC?

Too FEW scenarios

- ❑ Underrepresent the risk distribution
- ❑ Create false precision
- ❑ Policy adjustments may appear as surprises
- ❑ Credibility may suffer if outcomes move outside the narrow scenario set

Too MANY scenarios

- ❑ The main narrative is hard to identify
- ❑ More perceived indecision
- ❑ Overwhelm non-expert audiences
- ❑ Complicate expectation formation

INTERNAL DETAIL MUST BE FILTERED FOR EFFECTIVE COMMUNICATION.
SCENARIOS SHOULD BE CLEAR AND ACTIONABLE, NOT OVERWHELMING

Thank you for your attention