An Examination of "Whatever it Takes" Policymaking

Kathryn Dominguez, University of Michigan and NBER

Former ECB President Mario Draghi is credited with resolving the euro crisis based on his promise of "doing whatever it takes" to preserve the euro. The Bank of England recently echoed the phrase in its announcement that it would purchase long-dated UK government bonds on whatever scale necessary to restore orderly conditions in the gilt market. Likewise, during both the global financial crisis and the pandemic many central banks established facilities to restore funding liquidity and market liquidity with explicit no-limit-on-scale provisions.[1] This paper examines whether it is essential for credibility that market participants believe that policymakers are effectively unconstrained in their ability to intervene.

Central banks have the unique ability to create domestic base money, but they cannot create foreign currency legal tender. This means that counties with fixed exchange rates may be subject to greater constraints on their ability to do whatever-it-takes, for fear of triggering a run on the currency. It is also the case that central bank's solvency can be at risk if they suffer substantial losses from intervention-related operations, suggesting that balance sheet exposure and restricted access to fiscal support may also influence the credibility of a whatever-it-takes pronouncement.

Central banks across the globe introduced extraordinary policies to address the extraordinary circumstances experienced during the global pandemic. The first stage of this project will categorize these central bank pandemic-related policy announcements as unlimited or limited in scale. It seems likely that countries were influenced by the types of policies and announcements made by other countries, so this initial analysis will provide a cross-country mapping of the extent (and timing) of whatever-it-takes policy during the pandemic as well as measuring ex ante credibility conditions for each of these central banks (exchange rate regime, margin of solvency, access to a fiscal backstop, level of foreign exchange reserves, access to swap lines). The empirical strategy in the second stage of the project will involve measuring the impact and medium-term effects of pandemic-related central bank policy announcements on exchange rates. Event study analysis will be used to identify occurrences of abnormal returns in foreign exchange markets using dollar bilateral rates and controlling for Fed policy announcements. The underlying hypothesis is that, conditional on initial levels of central bank credibility, whatever-it-takes policies will have stronger effects on cumulated excess returns, suggesting that explicit communication of potential policy scale matters.

References

Buiter, Willem, Stephen Cecchetti, Kathryn Dominguez, and Antonio Sanchez-Serrano, "Stabilising Financial Markets: Lending and Market Making as a Last Resort," Reports of the Advisory Scientific Committee, No 13 / forthcoming 2022.

Cantú, Carlos, Paolo Cavallino, Fiorella De Fiore, and James Yetman, "A global database on central banks' monetary responses to Covid-19," BIS Working Paper No 934, March 2021.

Policy Responses to Covid-19, International Monetary Fund Policy Tracker.

Covid-19 Financial Response Tracker, Yale School of Management Program on Financial Stability.

[1] Examples of these types of facilities are described in detail in Buiter et al. (2022).