Monetary Policy and the Information Effect Under Macroeconomic Uncertainty

This paper utilises state-dependent local projections to explore the differential impacts of monetary policy shocks on the U.S. economy during periods marked by high macroeconomic uncertainty versus more tranquil conditions. Crucially, the analysis is extended to distinguish between two components of monetary surprises: the pure monetary policy component and the central bank information component, as identified by Jarocinski and Karadi (2020) from high-frequency surprises around Federal Open Market Committee (FOMC) meetings. Previous studies have noted a reduced effectiveness of monetary policy shocks under conditions of heightened uncertainty. This paper corroborates these findings, suggesting the novel insight that the information component is a driving force behind this diminished effectiveness. The findings indicate that the economy reacts more strongly to a positive information shock when uncertainty is high, thereby diminishing the overall impact of a contractionary monetary policy shock. These results provide important insights for existing theoretical models and carry significant implications for monetary policy considerations.