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FPAS: Evolution of the Framework

Symposium on the Prudent Risk Management
Approach to Monetary Policy

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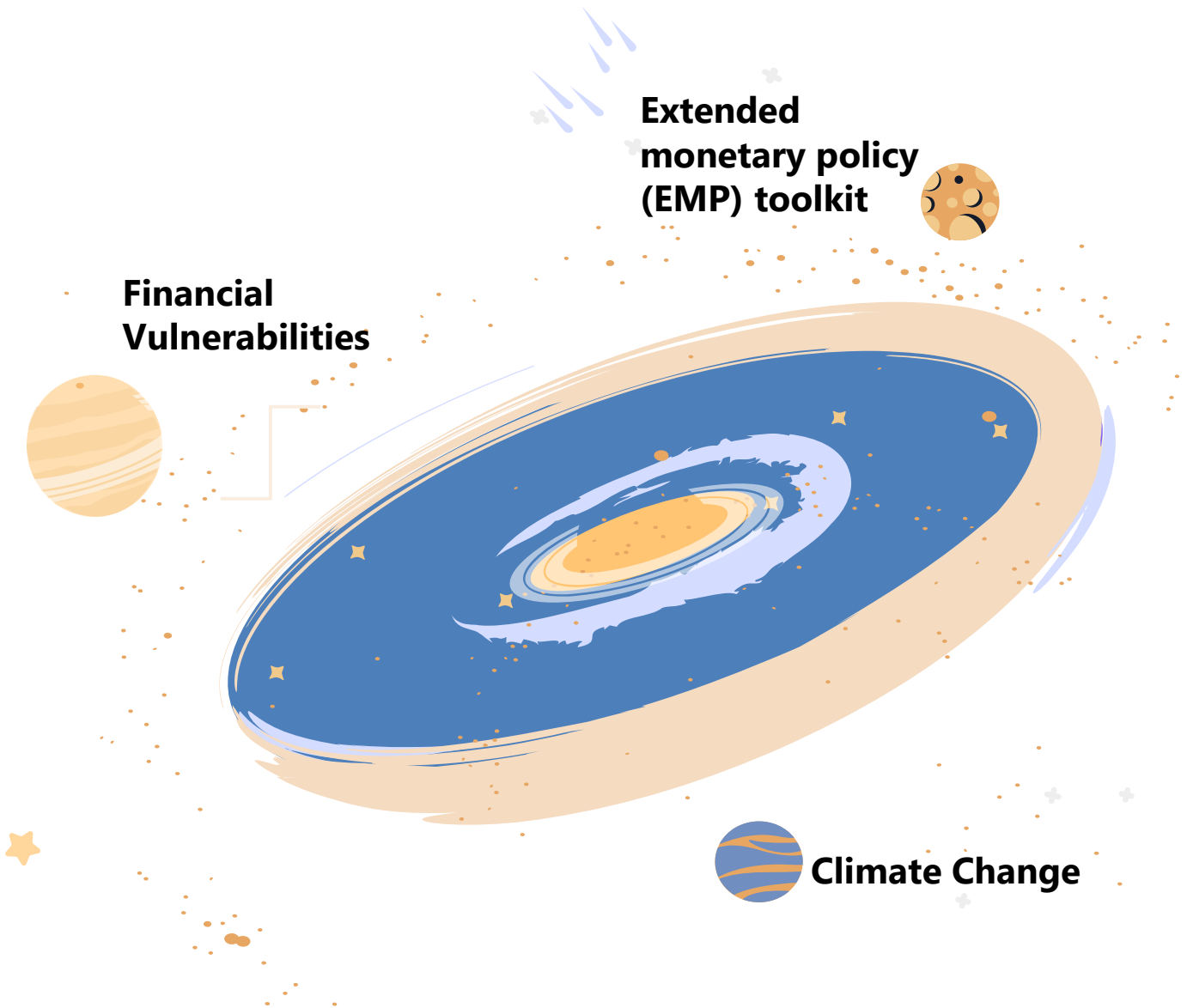
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The views expressed in this presentation are solely my own and may differ from official Bank of Canada views. No responsibility for them should be attributed to the Bank.

FPAS Mark II: Key evolutionary objectives

1. Elevate attention to uncertainty in policymaking so as to avoid “dark corners”
 2. Shift the focus of policymakers away from optimizing the policy path for the most likely scenario to one that ensures policy agility
 3. Remove (self-imposed) restrictions on sharp adjustments of the policy stance when needed
- This work has influenced my thinking and the design of a new suite Bank of Canada models.
 - [“A Blueprint for the 4th generation of Bank of Canada Projection and Policy Analysis models”](#)

NexGen: A risk management tool



Workhorse Model

Core DSGE

Variants

Question key behavioral assumptions central for inflation:

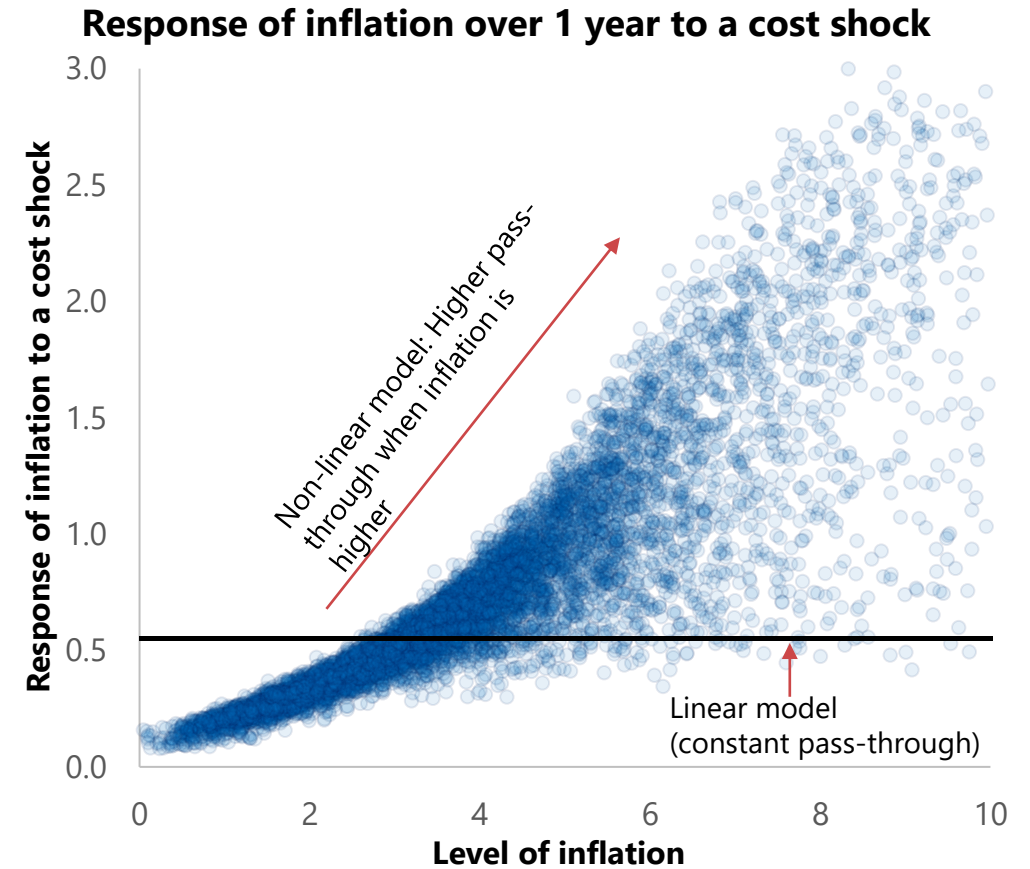
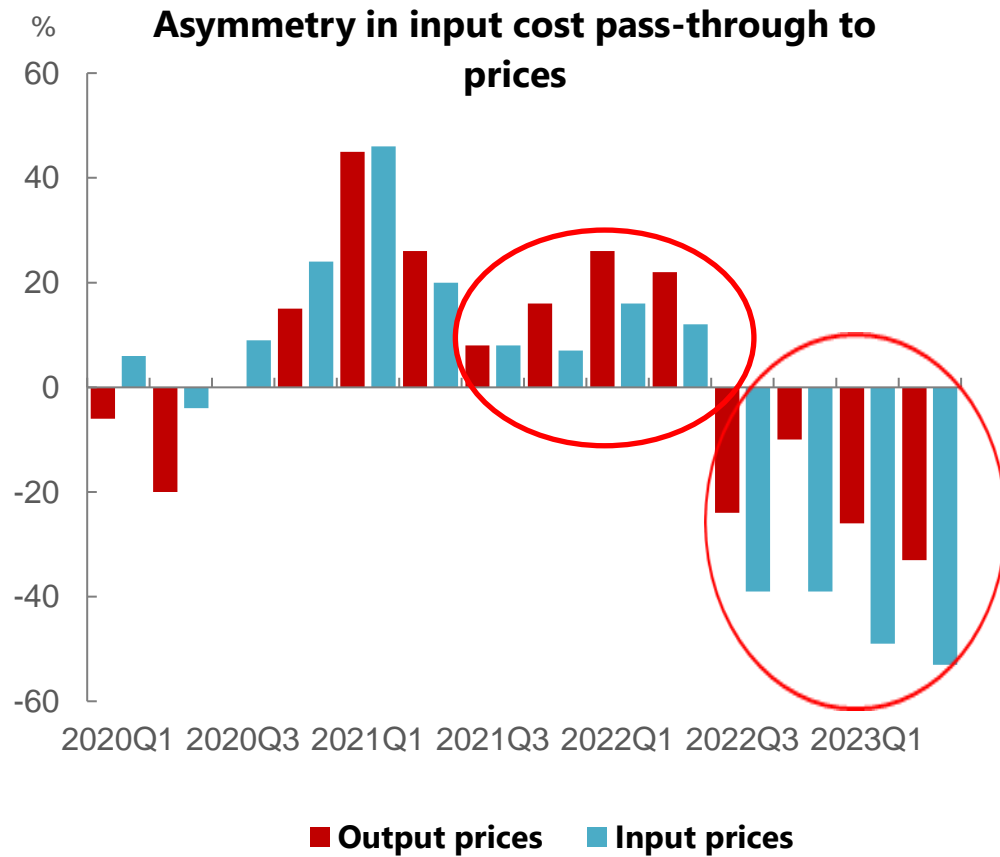
- Price setting behaviour
- Inflation expectations

Specialty models

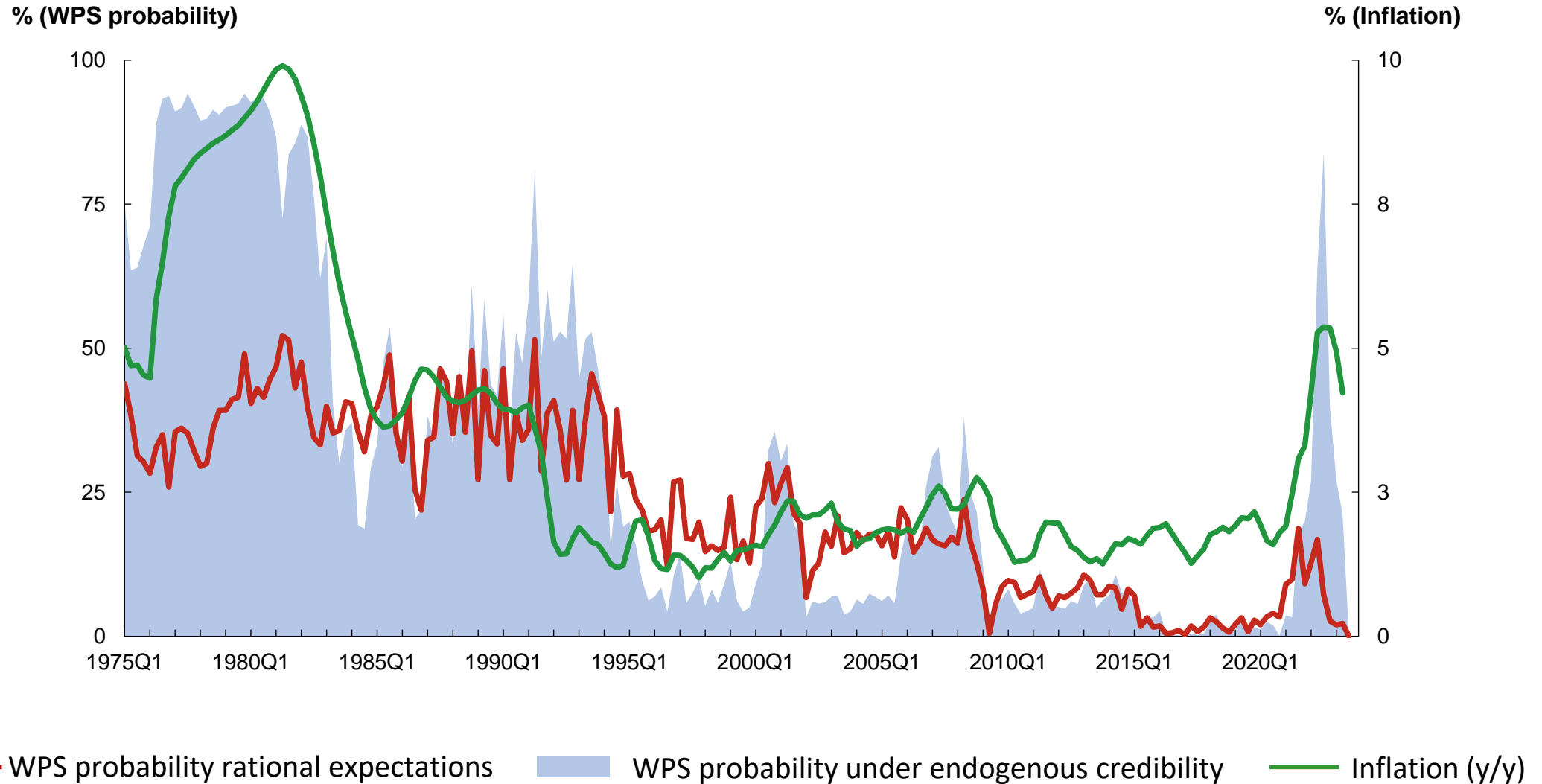
EMP
Climate change
Financial vulnerabilities



Asymmetry and state-dependent pricing

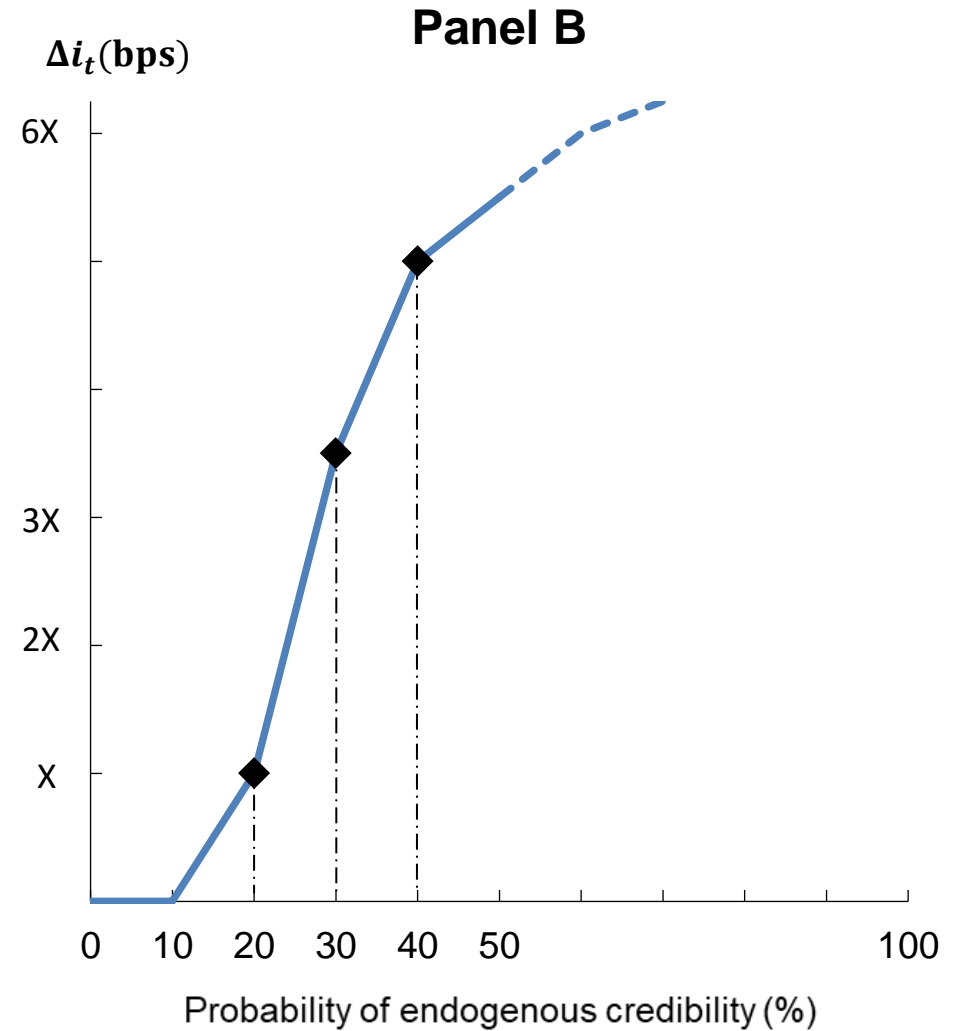
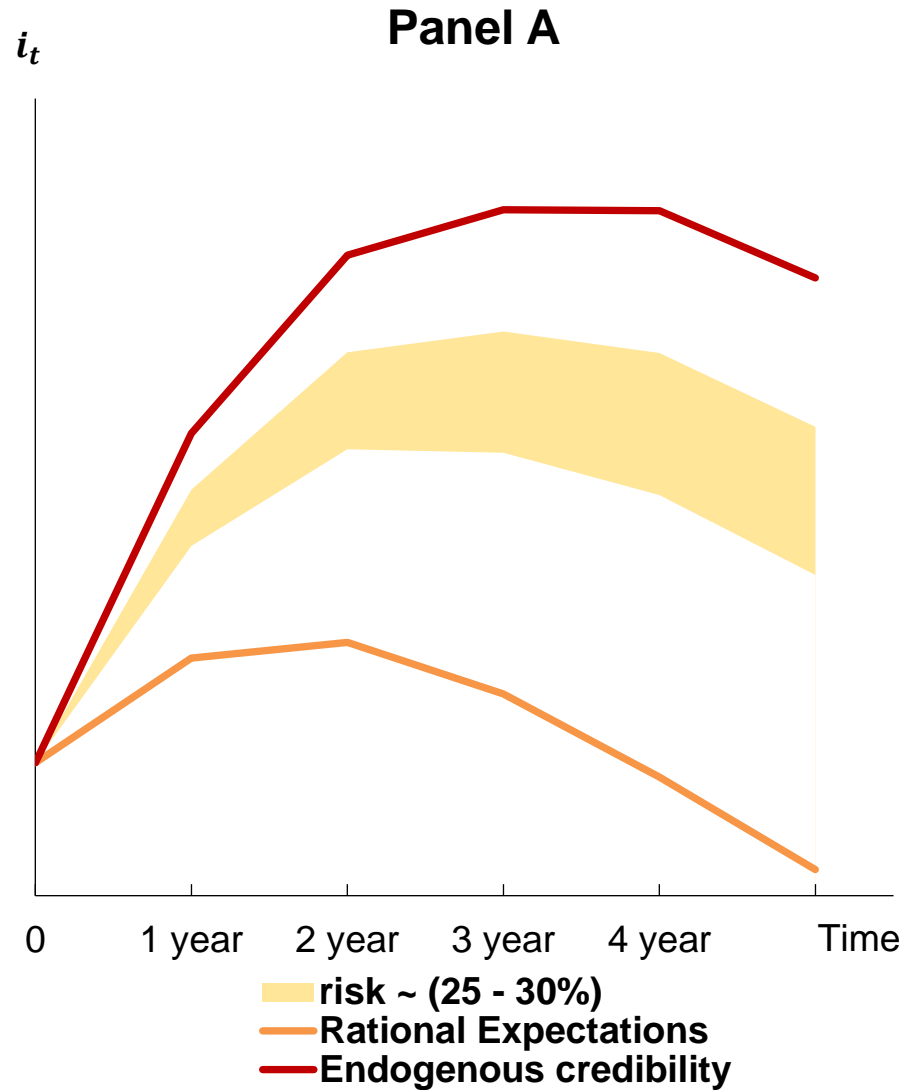


Endogenous Policy Credibility



Source: Kostyshyna, Ozden and Zhang (Bank of Canada Working Paper, forthcoming)

Uncertainty and non-linearities can have important policy implications



Another possible approach to frame policy discussions and communications

		Narrative	Policy path
FPAS I	Baseline	N0	R0
FPAS II	Scenario 1	N1	R1
	Scenario 2	N2	R2
Alternative	Hybrid	N0	$R' = f(R0, R1, R2)$

- Publish a **hybrid scenario** consistent with the baseline narrative (N0) but conditioned on the policy path (R') which balances risk
- Explain the narrative behind the baseline
- Identify most relevant alternative scenario(s)
 - ✓ How it differs from the baseline & why?
 - ✓ What 's the impact on policy rates?
 - ✓ Indicators that will be used to assess evolving likelihood of the scenarios