
A Tale of Two Tightenings

Simon Kwan*¹ and Ville Voutilainen²

¹Federal Reserve Bank of San Francisco – United States

²Bank of Finland – Finland

Abstract

Both the magnitude and the pace of monetary policy tightening in the euro area during 2022-23 were historically large and fast. Yet, the real economy proved to be resilient. In this paper, we analyze the pass-through of the ECB's changes in the policy rate to mortgage rates in Finland during the post-pandemic period of 2022-23, when the policy liftoff began at the negative interest rate territory, using the normal tightening cycle in 2006-08 as control. We use monthly data and three different empirical methodologies: event studies, high-frequency identification, and exposure-measure regressions. Our evidence suggests that the post-pandemic monetary policy transmission was significantly less effective than during the control period, implying that for the same amount of tightening in financial conditions, a bigger increase in the policy rate is needed. The loss in monetary transmission during the negative interest rate policy is also playing out when monetary policy changes course. Thus, while monetary policy remains effective in the negative interest rate territory, it creates headwind for policy normalization down the road.

*Speaker