

State-Dependent Monetary Policy Transmission under Monetary Policy Uncertainty: Evidence from U.S. Financial Markets

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Abstract: This study investigates how monetary policy uncertainty (MPU) shapes the state-dependent transmission of monetary policy shocks through U.S. financial markets. We employ a smooth-transition proxy structural vector autoregression model and identify monetary policy shocks using high-frequency monetary policy surprises as an external instrument. Using monthly data from 1985 to 2020, we find substantial state dependence in both the magnitude and composition of monetary policy transmission across Treasury and private credit markets. Following a contractionary monetary policy shock, market interest rates initially respond less strongly under high MPU. For longer-maturity Treasury yields and private borrowing rates, however, the responses under high MPU are more persistent and eventually exceed their low-MPU counterparts. Decomposition results show that the expected short-rate path responds systematically less under high MPU, while risk-premium responses are more persistent and become increasingly important with maturity, including in private credit markets. Thus, elevated MPU shifts the composition of monetary policy transmission away from the expectations channel toward the risk-premium channel. These findings are robust to controls for bad news and broader uncertainty, an alternative MPU measure, survey-based expectations, and an alternative sample period.

Keywords: Monetary policy uncertainty; Monetary policy transmission; Smooth-transition SVAR and external instrument; Risk premia; Expectation channel