Roundtable on Current Monetary Policy
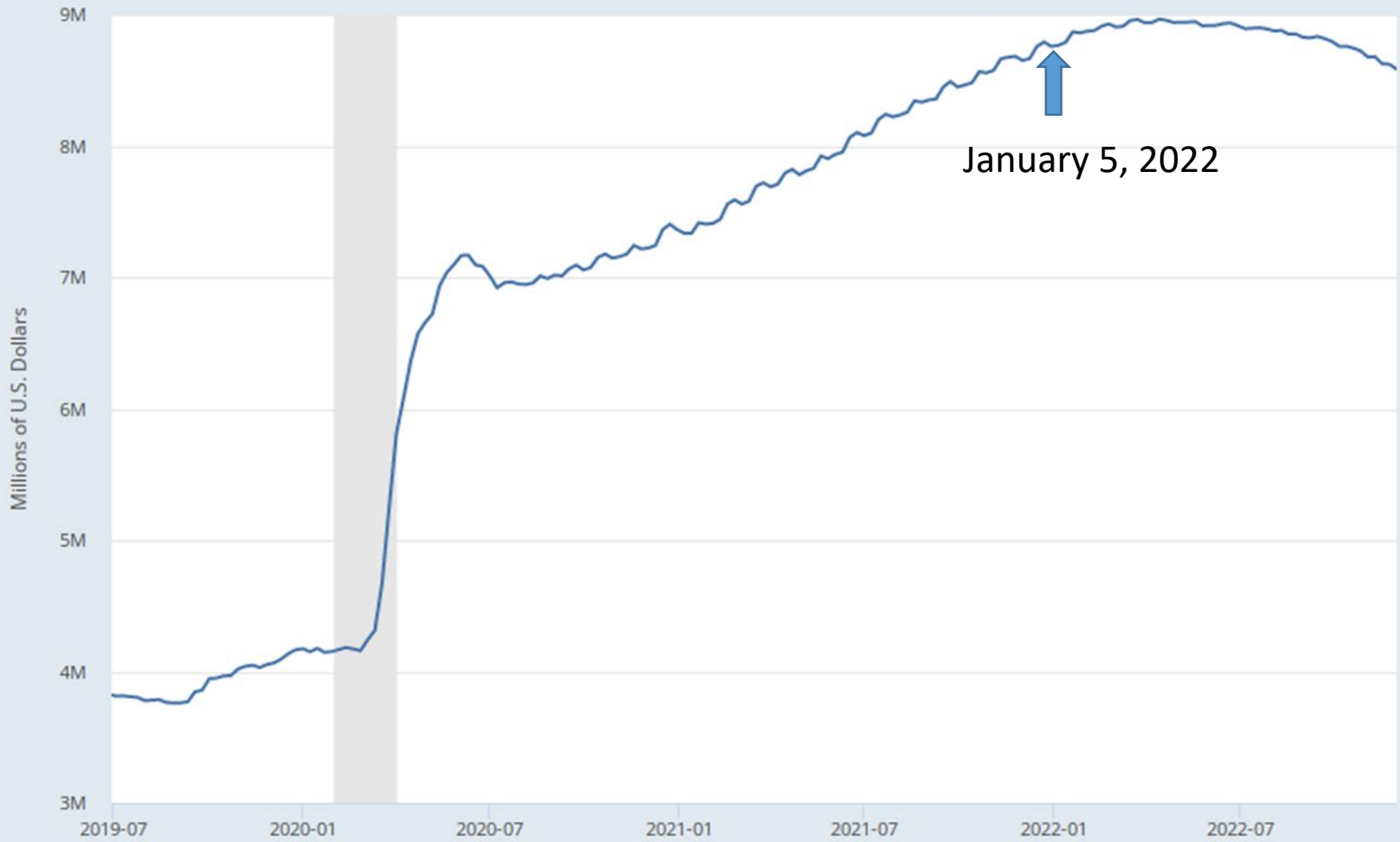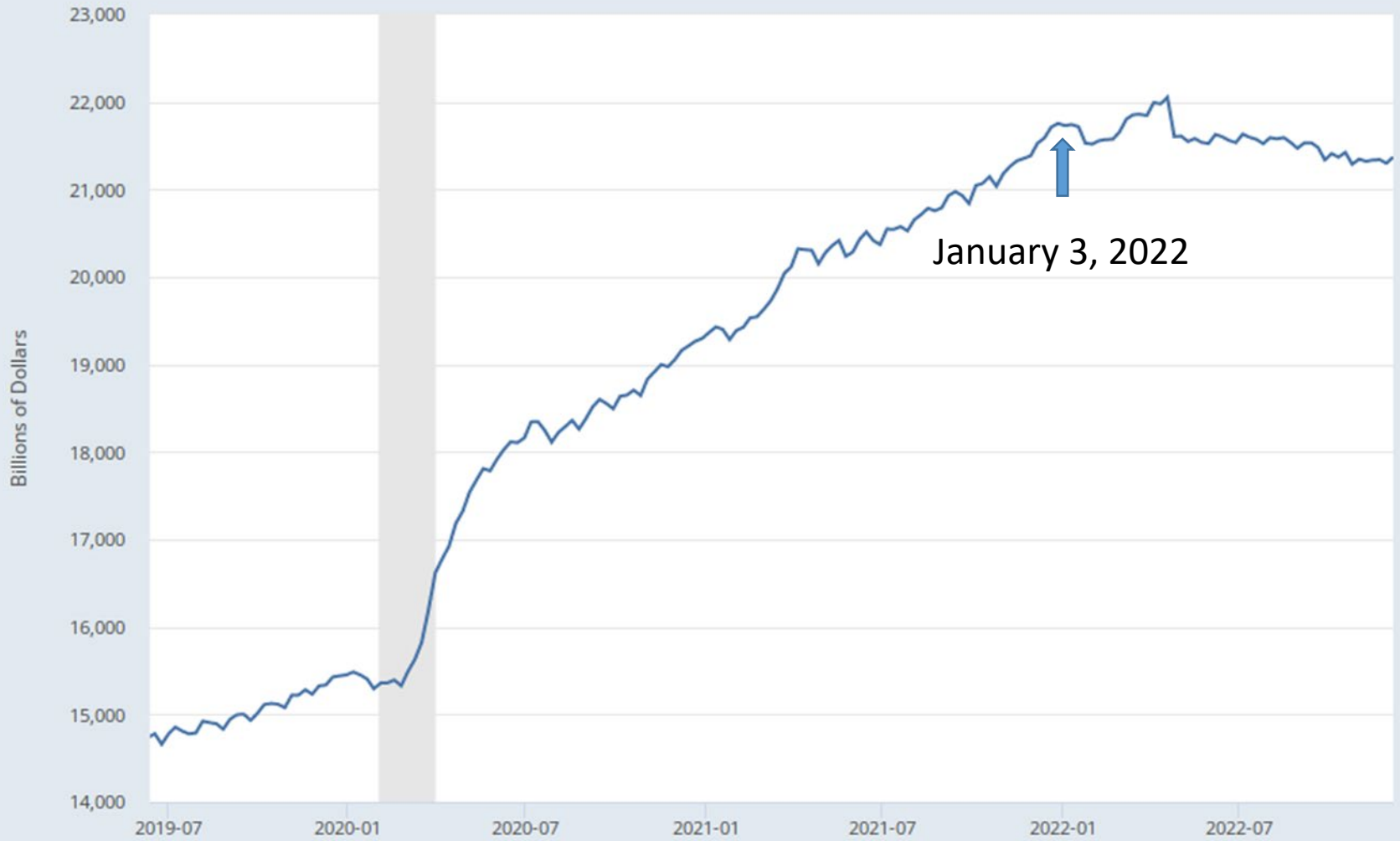
Hoover Institution
Economic Policy Working Group

John B. Taylor

January 4, 2023

FRED — Assets: Total Assets: Total Assets: Wednesday Level

January 5, 2022

Millions of U.S. Dollars

Source: Board of Governors of the Federal Reserve System (US)

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A. Monetary policy rules

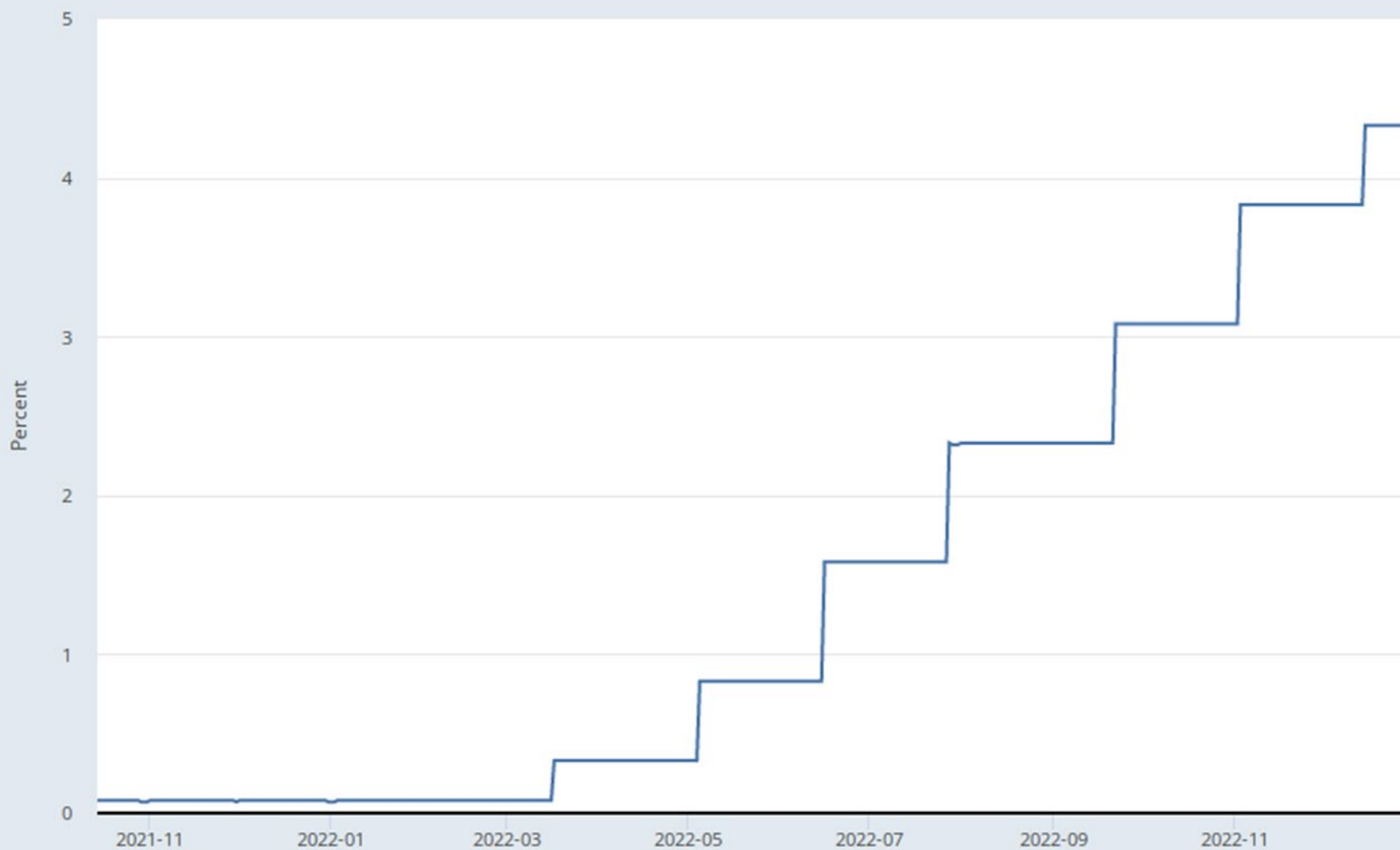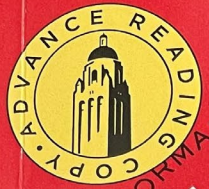|	
Taylor (1993) rule	$R_t^{T93} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t)$
Balanced-approach rule	$R_t^{BA} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + 2(u_t^{LR} - u_t)$
Balanced-approach (shortfalls) rule	$R_t^{BAS} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + 2min\{(u_t^{LR} - u_t), 0\}$
Adjusted Taylor (1993) rule	$R_t^{T93adj} = max\{R_t^{T93} - Z_t, \text{ELB}\}$
First-difference rule	$R_t^{FD} = R_{t-1} + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t) - (u_{t-4}^{LR} - u_{t-4})$

NOTE: R_t^{T93}, R_t^{BA}, R_t^{BAS}, R_t^{T93adj}, and R_t^{FD} represent the values of the nominal federal funds rate prescribed by the Taylor (1993), balanced-approach, balanced-approach (shortfalls), adjusted Taylor (1993), and first-difference rules, respectively.

Federal Funds Effective Rate

Source: Board of Governors of the Federal Reserve System (US)

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NORMAL WARNING ALARM

HOW MONETARY POLICY GOT BEHIND THE CURVE—AND HOW TO GET BACK

EDITED BY

Michael D. Bordo, John H. Cochrane, and John B. Taylor

$$r = p + .5y + .5(p - 2) + 2 \tag{1}$$

where

    r is the federal funds rate,
    p is the rate of inflation over the previous four quarters
    y is the percent deviation of real GDP from a target.

From "Discretion versus Policy Rules in Practice," Prepared for the November 1992 Carnegie-Rochester Conference on Public Policy, Carnegie Mellon University, Pittsburgh, Pennsylvania

Using this rule:
2+2= 4
1+2 = 3
1+ 3 + .5(3-2) = 4.5
1+4+ .5(4-2) = 6
Using the July 9, 2021, *Monetary Policy Report* "Taylor rule," and plug in:
- an inflation rate over the past four quarters of 4%,
- a target inflation rate of 2%,
- an equilibrium interest rate of 1%,
- a gap between GDP and its potential of about 0%,
you get a federal funds rate of 6%.

FRED ~ — Gross Domestic Product: Implicit Price Deflator

Source: U.S. Bureau of Economic Analysis

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FRED 〰 — Harmonized Index of Consumer Prices: All Items for Euro area (19 countries)

Source: Eurostat

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