Monetary Policy Rules

\[ \frac{\Delta M}{M} = f(\eta, U) \]

- Announce Monetary Policy as a function of conditions.
- Thus people know what you are doing.

The Taylor Rule

\[ \eta = \frac{\Delta P}{P} \approx \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V} \]
\[ U - U_n \approx \eta_c - \eta \]

Tradeoffs

\[ \eta = \frac{\Delta P}{P} \approx \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V} \]
\[ U - U_n \approx \eta_c - \eta \]

- Inflation too high? We cut it by decreasing money growth.
- BUT if we overdo that, we will get unemployment.

Publicity

\[ \eta = \frac{\Delta P}{P} \approx \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V} \]
\[ U - U_n \approx \eta_c - \eta \]

- And, no matter what we do, there are a number of people nervously looking over our shoulder. We can create anxiety and uncertainty.
A Possible Rule

\[ \frac{\Delta M}{M} = 4\% - 0.5(\eta - 2\%) + 1.5(U - U_n) \]

Make it Public!

What happens if you don’t stick to the rule?
Changing Conditions

\[ \frac{\Delta M}{M} = 4\% - 0.5(\eta - 2\%) + 1.5(U - U_n) \]

What happens if conditions change?

\[ \frac{\Delta M}{M} = 4\% - 0.7(\eta - 2\%) + 1.5(U - U_n) \]

The Friedman Rule

\[ \frac{\Delta M}{M} = 4\% \]

Make it Public!

Why the Friedman Rule?

Interventions
- Made the situation better (narrowed the gap between \( \eta \) and \( \eta^* \)) 7
- Made the situation worse (increased the gap between \( \eta \) and \( \eta^* \)) 3

Interventions
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The Greenspan Rule

\[ \Delta M \]

\[ \frac{\Delta M}{M} \]
The Greenspan Rule

A thorough analysis of economic conditions

\[ \frac{\Delta M}{M} \]

The Greenspan Rule

A careful throwing of darts

\[ \frac{\Delta M}{M} \]

Velocity

\[
\frac{\Delta P}{P} \approx \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V} \]

\[
\frac{\Delta V}{V} = \epsilon
\]

Initially Declines with \( \frac{\Delta M}{M} \)

End

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