Monetary Policy Rules

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

Monetary Policy Rules

- Announce Monetary Policy as a function of conditions.

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

- Thus people know what you are doing.

The Taylor Rule

$$\eta = \frac{\Delta P}{P} \cong \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V}$$

$$U - U_n \approx \eta_e - \eta$$

Tradeoffs

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$$U - U_n \approx \eta_e - \eta$$

Unemployment too high? We need to raise η, which we do by increasing money growth.

BUT if we overdo that, we will get inflation

Tradeoffs

$$\eta = \frac{\Delta P}{P} \cong \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V}$$

$$U - U_n \approx \eta_e - \eta$$

Inflation too high? We cut it by decreasing money growth.

BUT if we overdo that, we will get unemployment

Publicity

$$\eta = \frac{\Delta P}{P} \cong \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V}$$

$$U - U_n \approx \eta_e - \eta$$

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

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

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Make it Public!

A Possible Rule

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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?

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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	10
Made the situation better (narrowed the gap between η and η^e)	7
Made the situation worse (increased the gap between η and η^e)	3

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The Greenspan Rule

$$\frac{\Delta M}{M}$$

The Greenspan Rule

A thorough analysis of economic conditions $\longrightarrow \frac{\Delta M}{M}$

The Greenspan Rule

A careful throwing of darts $\longrightarrow \frac{\Delta M}{M}$

Velocity

$$\frac{\Delta P}{P} \cong \frac{\Delta M}{M} - \frac{\Delta Y}{Y} + \frac{\Delta V}{V}$$

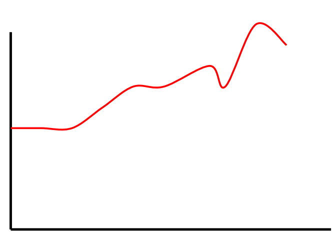
$$\frac{\Delta V}{V} = 0$$

Velocity

$$\frac{\Delta V}{V} = \varepsilon$$

$$\frac{\Delta V}{V} \text{ Initially Declines with } \frac{\Delta M}{M}$$

Velocity



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