

Lecture 4: Monetary Policy Goals and Implementation Reading: Chap21

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Goals of Monetary Policy

- Price stability
- High employment
- Economic growth
- Financial market and institution stability
- Interest rate stability
- Foreign-exchange market stability

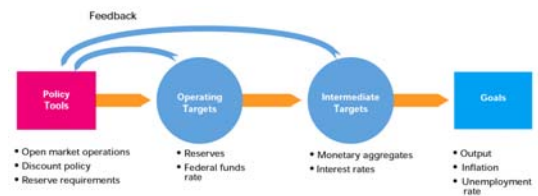
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Problems in Achieving Monetary Policy Goals

- All monetary policy goals may not be simultaneously achievable.
- The Fed's tools don't always allow it to achieve its monetary policy goals directly.
- The Fed also faces timing difficulties in using its monetary policy tools.
- The Fed uses targets to solve its problems in achieving monetary policy goals.

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Figure 21.1 Achieving Monetary Policy Goals



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Types of Targets

- Intermediate targets are financial variables that directly help the Fed achieve its goals.
- Operating targets are variables that the Fed controls directly with monetary policy tools.
- Operating targets must be closely related to intermediate targets.

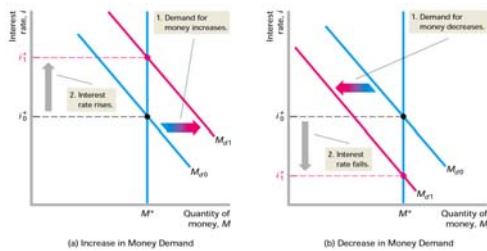
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Criteria for Selecting Intermediate Targets

- It must be measurable in a short time frame to overcome information lags.
- An effective intermediate target must be controllable.
- The Fed also needs targets that have a predictable impact on policy goals.

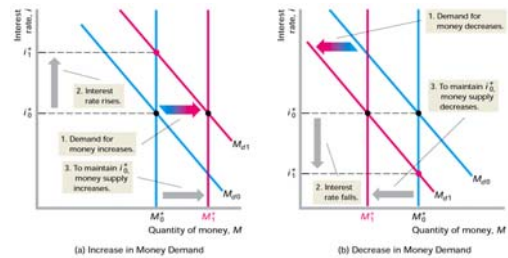
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Figure 21.2 Money Supply Targeting and Interest Rate Fluctuations



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Figure 21.3 Interest Rate Targeting and Money Supply Fluctuations



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The Monetary Policy Record

- After 1951, short-term interest rates and free reserves were intermediate targets.
- In the 1970s, money was the intermediate target and interest rate the operating target .
- For 1979-1982, nonborrowed reserves became the operating target.
- After 1982, the Fed began to pay more attention to the federal funds rate.

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The Monetary Policy Record

- Exchange rate changes shaped Fed policymaking more during the 1980s and 1990s than before.
- In early 2000's, the Fed took a "risk management" approach to monetary policy.
- Taylor rule provides a way to choose a target interest rate level.

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Figure 21.4 Fed Funds Rate and Money Supply Growth Rate, 1979-2002



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Reevaluating Fed Targeting Policy

- Critics of the Fed conclude variables other than money may be useful as indicators.
- Other indicators include the nominal GDP growth rate and the yield curve slope.
- Commodity prices are unlikely to be an effective indicator.
- Exchange rate movements are a useful indicator if combined with others.

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International Comparison on Monetary Policy Conduct

- Most central banks in industrial countries now use short-term interest rates as operating targets.
- Many central banks are focused more on ultimate goals such as low inflation than on intermediate targets.

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Reading Assignment

P. 495, Case Study

“Is Inflation Targeting a Good Idea?”

Q1: What are the four points some economists argued for inflation targeting?

Q2: What are the four points economists argued against inflation targeting?

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