

# Monetary Strategies in Practice



## 2019 Hoover Monetary Policy Conference

May 3, 2019

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President and CEO

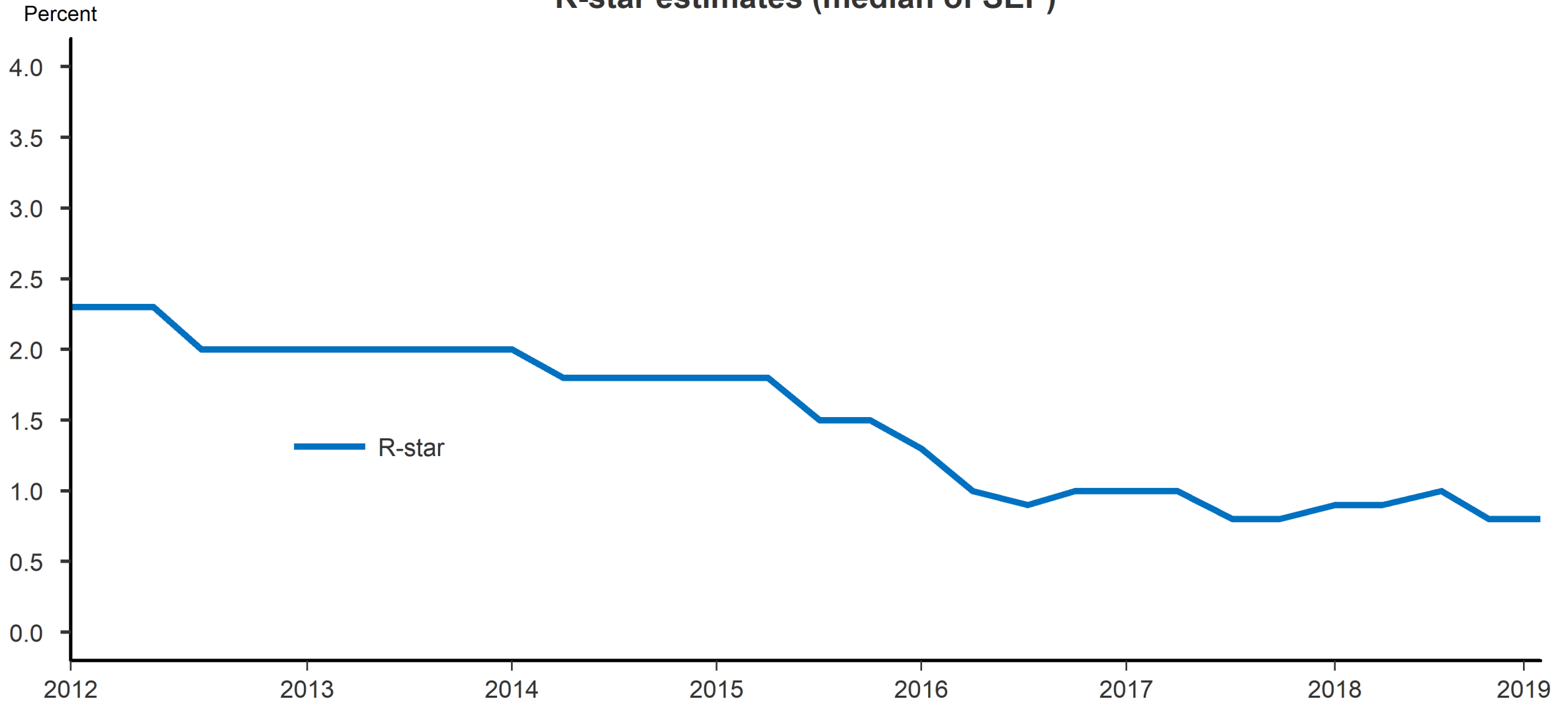
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# Why Review Our Framework?

- **Good practice to reassess our strategies, tools and communications** (Bank of Canada does this regularly)
- **More likely to hit effective lower bound in the future**
- **Frequently will be fighting inflation from below target**
- **Inflation expectations matter**

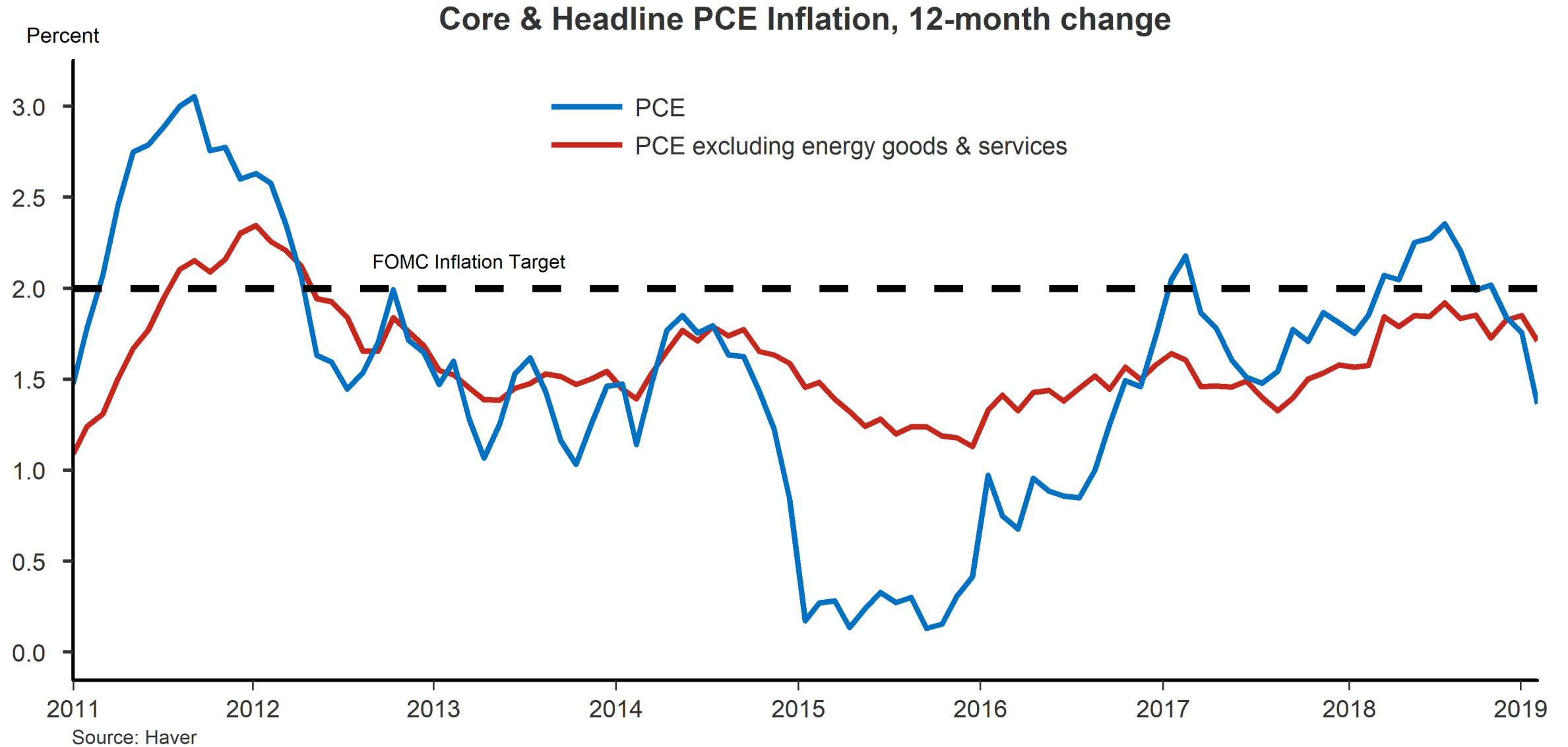
# More Limited Space for Funds Rate Cuts

R-star estimates (median of SEP)

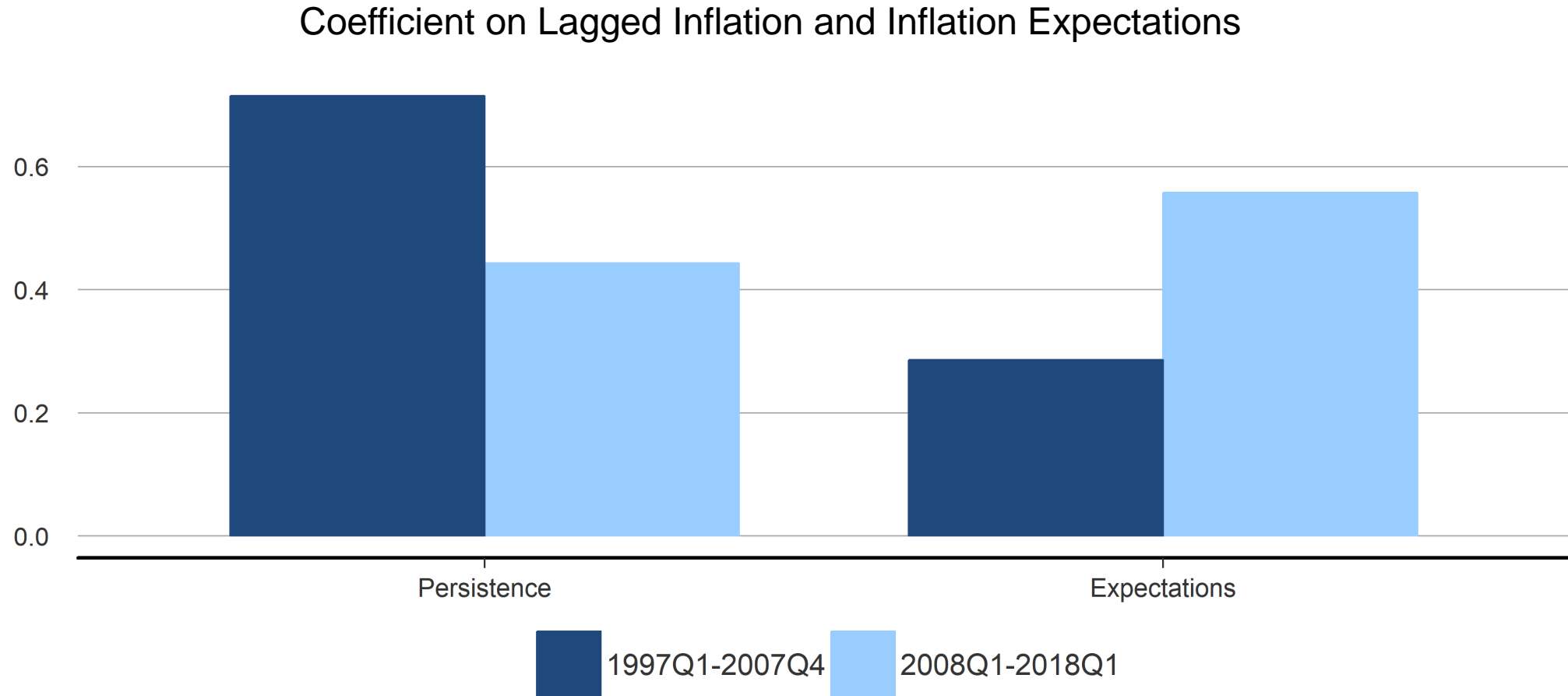


Source: Haver

# Inflation Consistently Short of 2% Target



# Inflation Expectations Matter More Now



Note: Specification uses headline CPI inflation. One-year ahead inflation expectations from the Survey of Professional Forecasters.

Source: Jordà, Marti, Nechio, and Tallman (FRBSF Economic Letter, 2019).

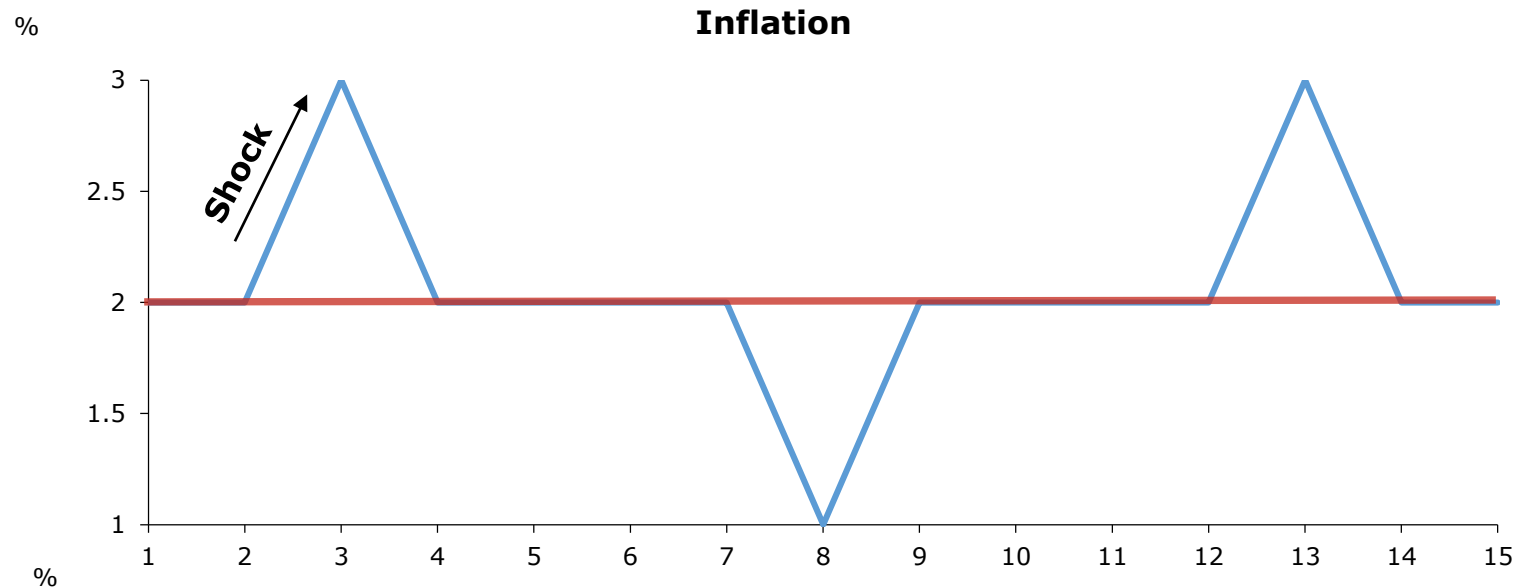
# Achieving Target Inflation in the Future

## Three viable alternative strategies at the ELB

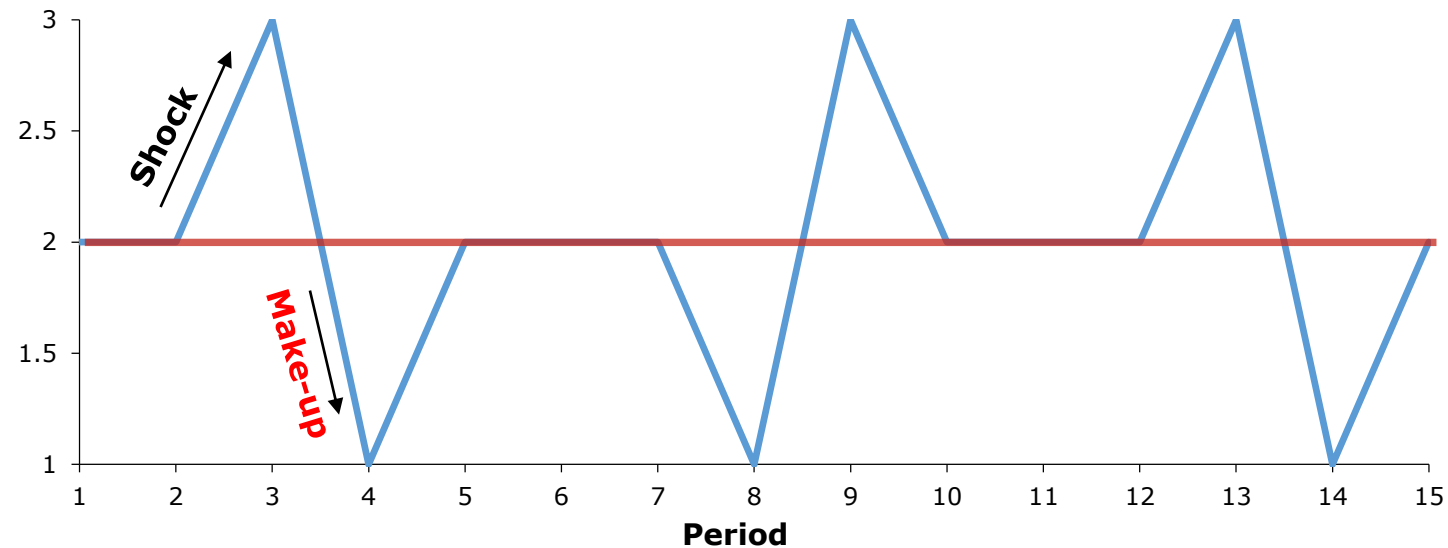
- Nominal income targeting
- Price-level targeting
- Average-inflation targeting

# All Designed to “Make Up” For Misses

**Symmetric  
Inflation  
Targeting**

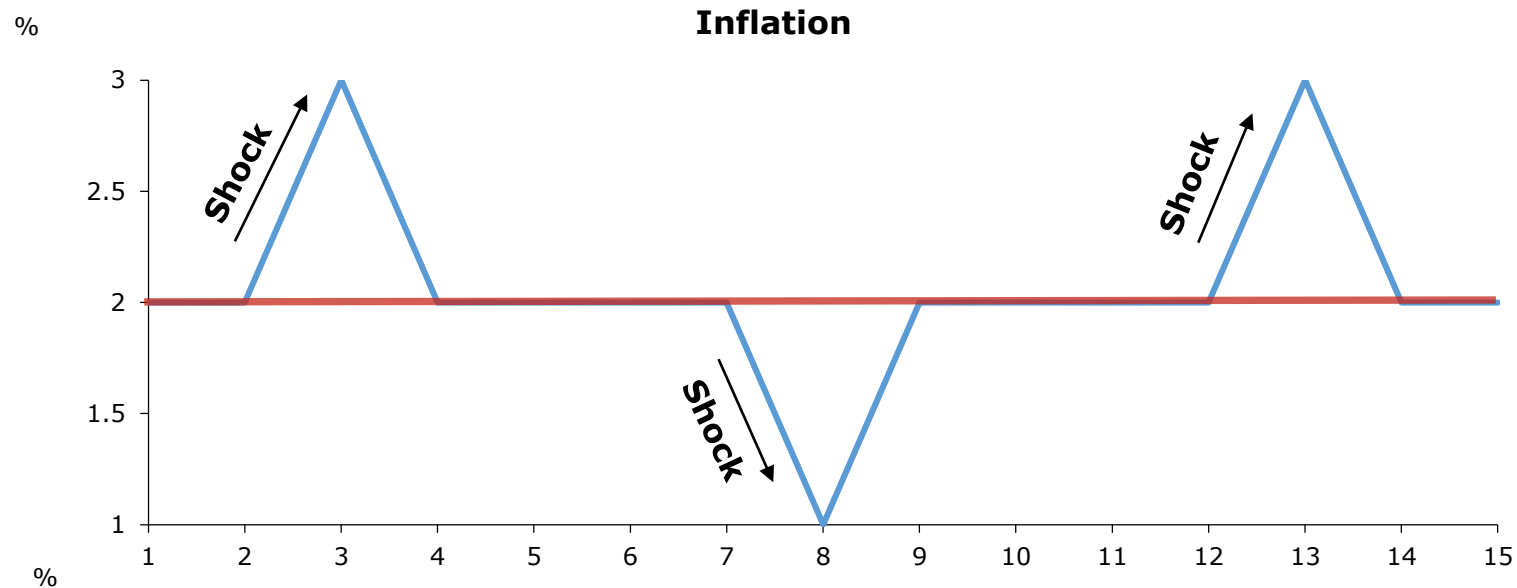


**Average  
Inflation  
targeting**

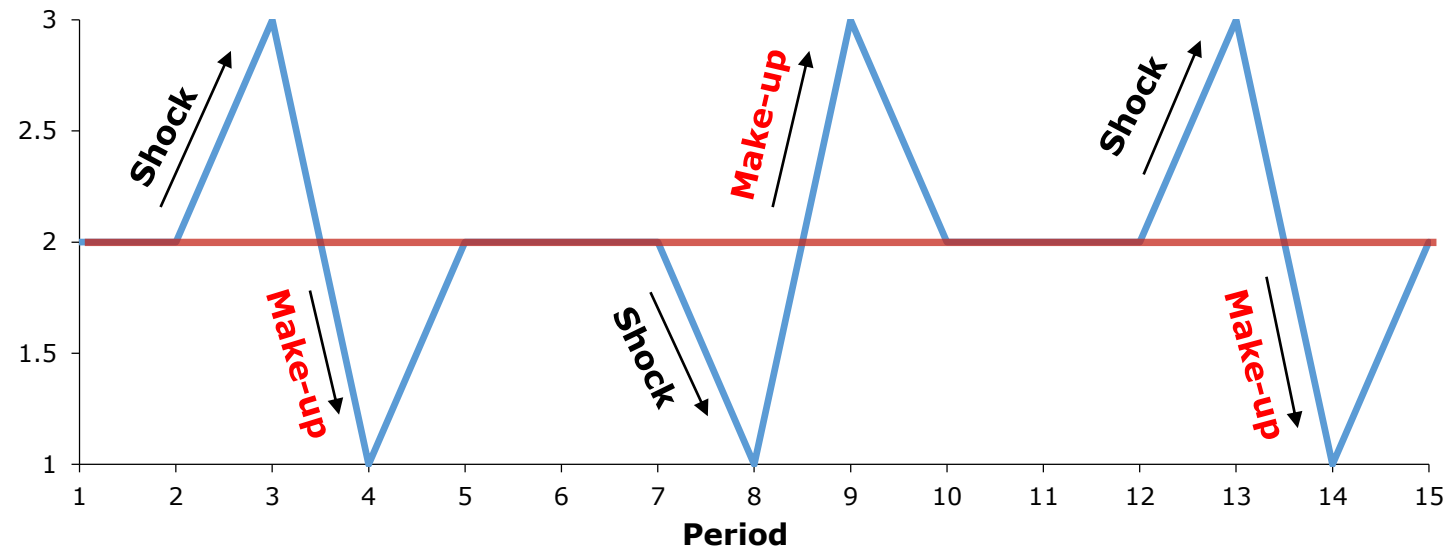


# All Designed to “Make Up” For Misses

**Symmetric  
Inflation  
Targeting**



**Average  
Inflation  
targeting**





# Focus on Average Inflation Targeting

- **Good make-up properties**
- **Easier to communicate than NIT or PLT**
- **But important questions remain:**
  - Is the required averaging window of “reasonable” length?
  - Is AIT effective if expectations are backward looking?
  - Does AIT work well if some households do not participate in financial markets?
  - Would AIT be credible?
  - Should it be a temporary policy at the ELB?

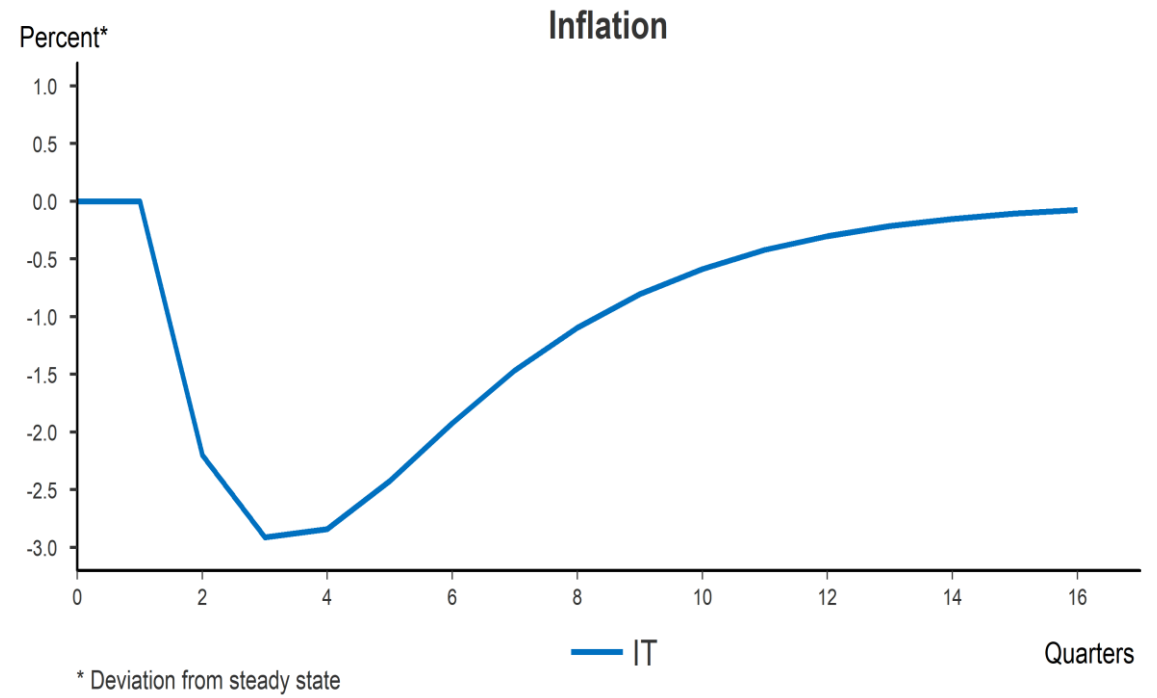
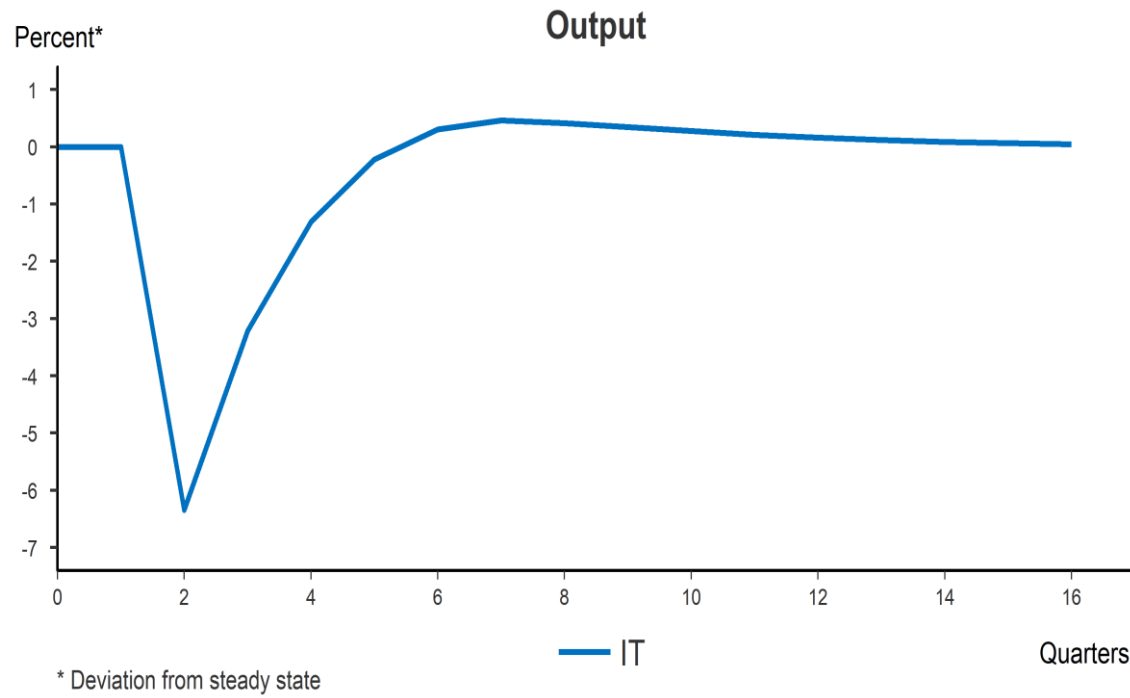
# A Framework to Assess AIT

- **New Keynesian economy (Amano, Gnocchi, Leduc)**
  - 20% of households with no access to financial markets
  - 75% of firms with backward-looking expectations
  - ELB binds 20% of the time
- **CB minimizes inflation and output gaps using rule:**

$$i_t = r_t + \phi \frac{1}{n} \sum_{k=0}^n (\pi_{t-k} - \bar{\pi})$$

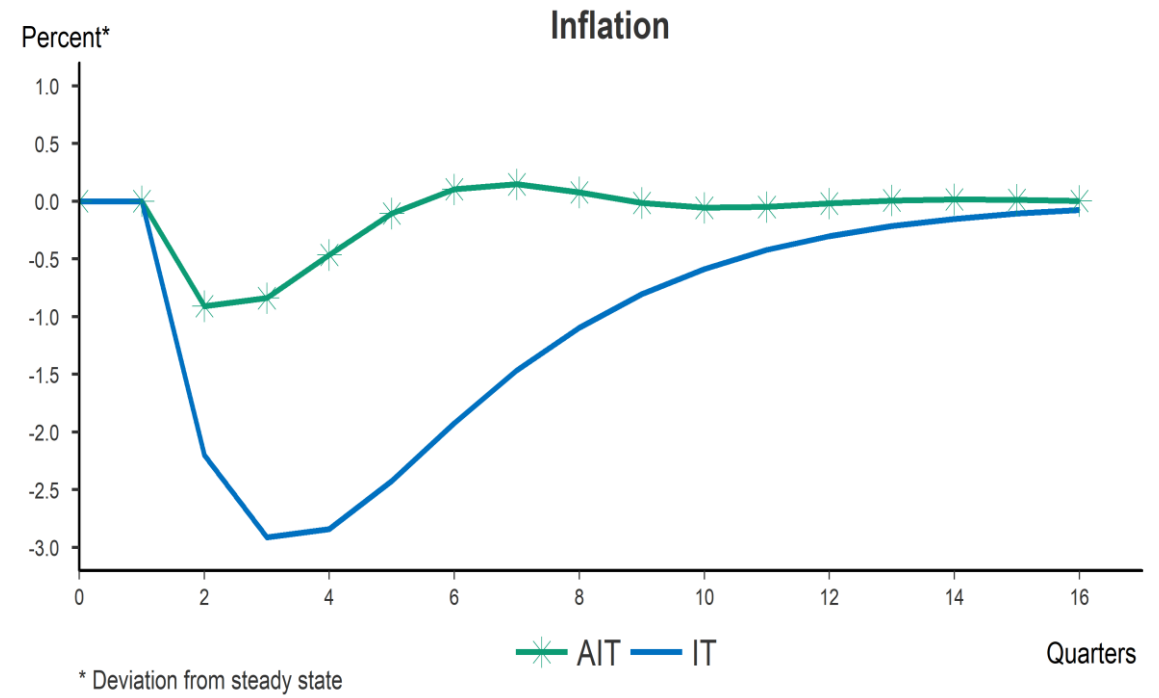
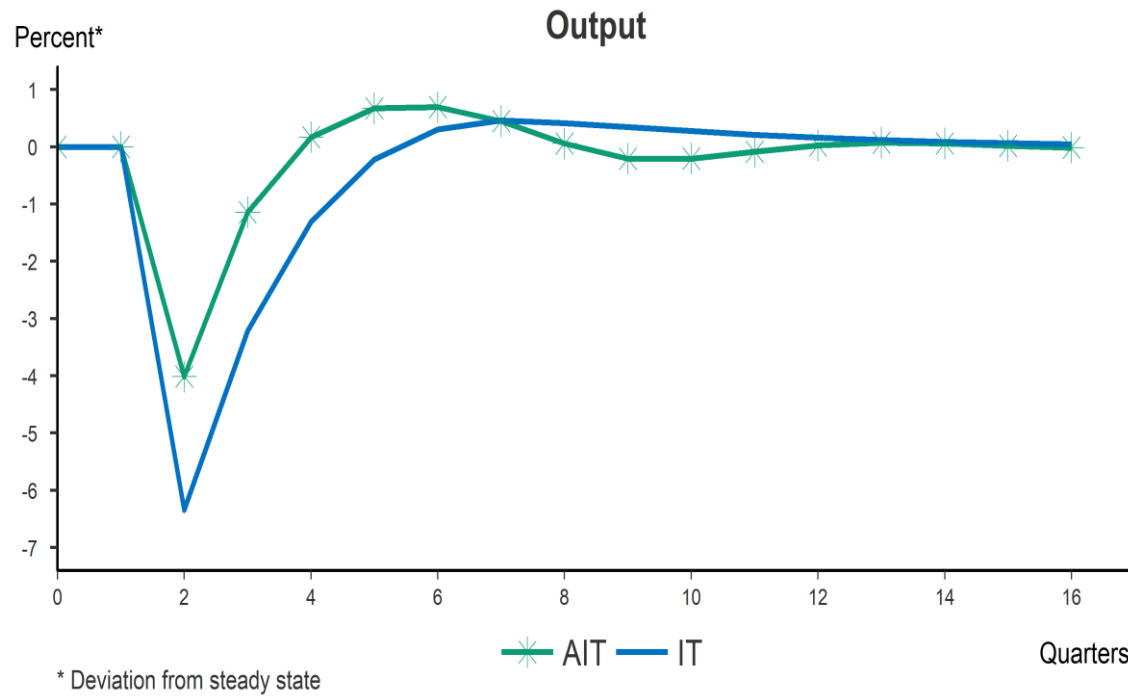
- **With  $\phi=1.5$ ,  $n=6$  quarters**

# Evaluating Monetary Frameworks



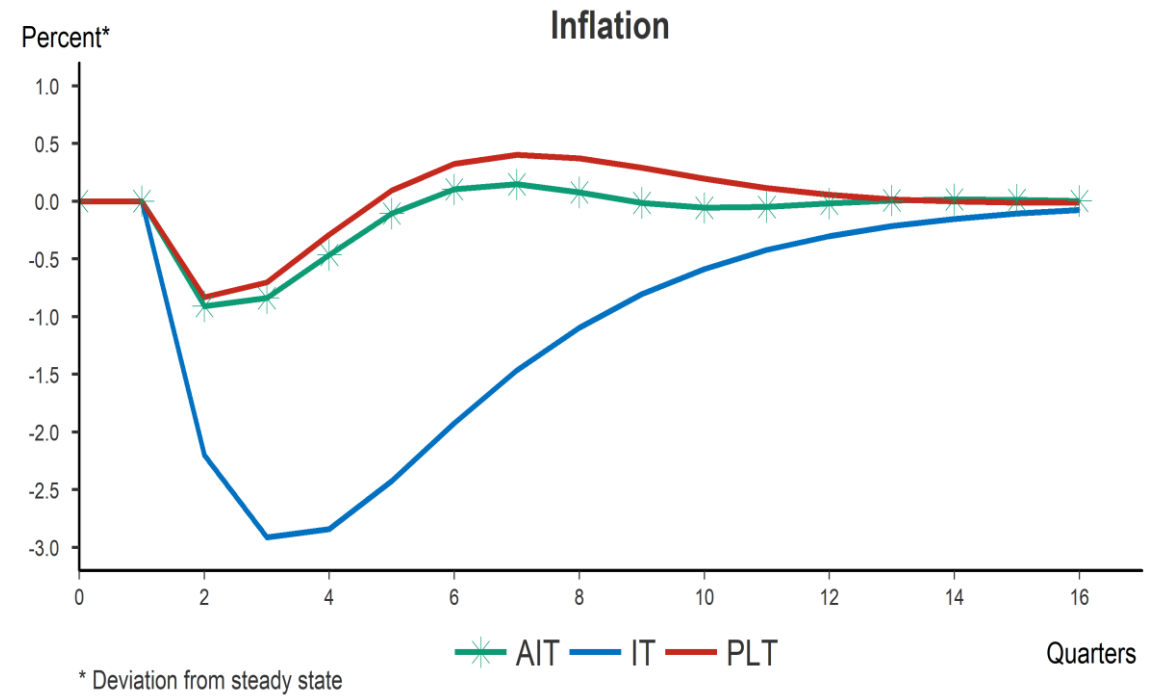
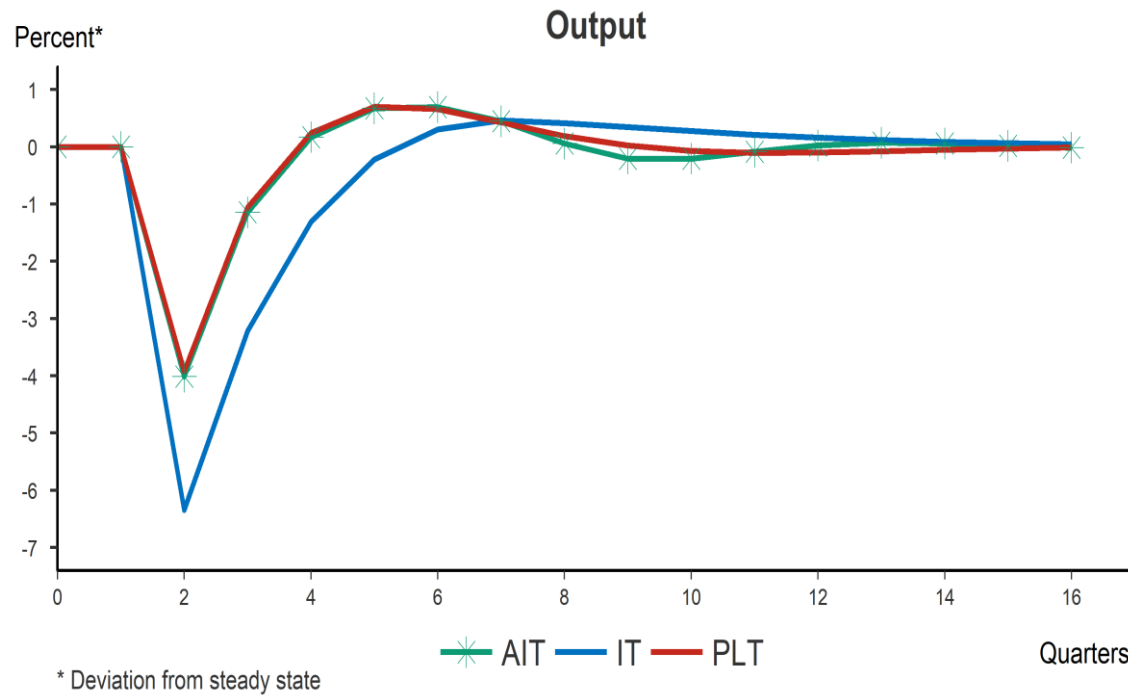
**Amano, Gnocchi, and Leduc (2019)**

# Evaluating Monetary Frameworks



**Amano, Gnocchi, and Leduc (2019)**

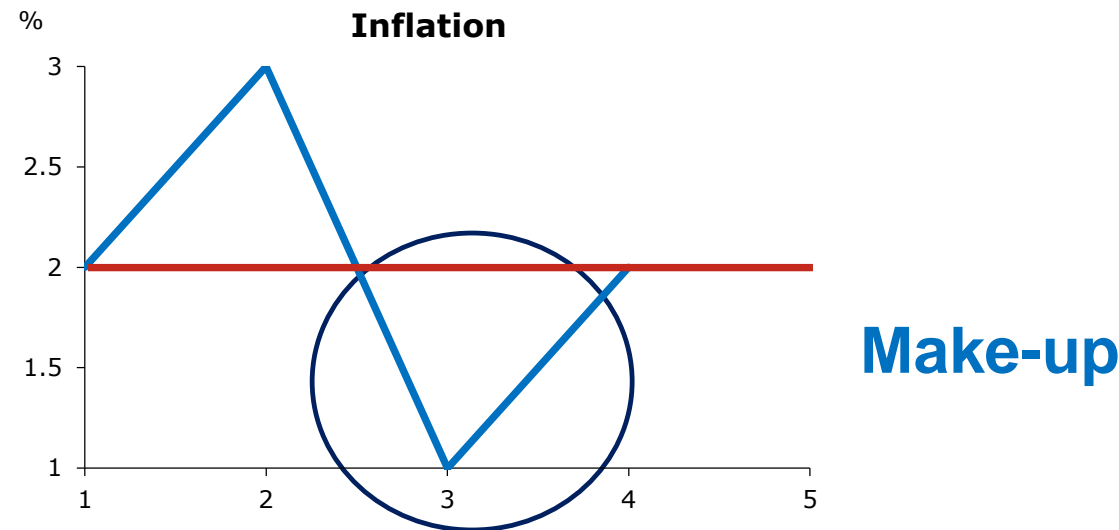
# Evaluating Monetary Frameworks



Amano, Gnocchi, and Leduc (2019)

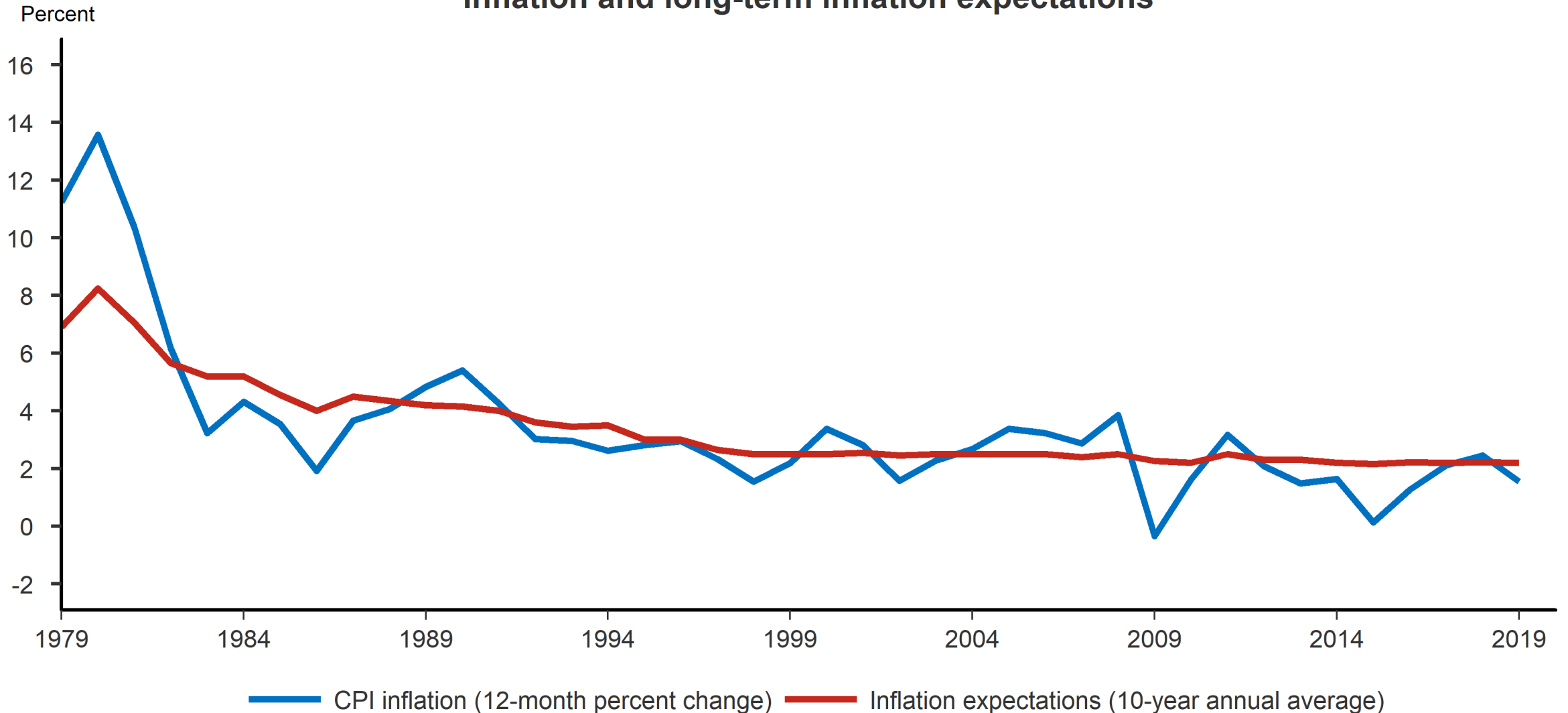
# Credibility: Make-up Work Both Ways

- **Credibility is critical**
- **Need to adopt regime before ELB episodes**
- **Implies a willingness to disinflate if necessary**



# Credibility of IT Regime Achieved Over Time

## Inflation and long-term inflation expectations



Source: Haver

# Summary

- **With Fed objectives met, good time to review framework**
- **AIT is an attractive option, but credibility would be key**
- **Still, bar for change is high**
- **A lot of analysis, discussion, and debate is still needed**