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Paper content

- Compares sticky-price (SP) and sticky-information (SI) models
- Empirical support
- Response to current and anticipated shocks, and the ZLB
- Effective monetary policies
  - Alternative instrument and targeting rules
  - Performance for different shocks, w/o and w/ ZLB
  - Policies (including forward guidance) under the ZLB
- Lessons for policy and future research
  - Many things similar for SI and SP: Price-level targeting good
  - Effects of anticipated shocks and ZLB different: Implications for forward guidance, missing disinflation, new shocks, etc.
  - More diversity among CB models desirable

Comments

- Forward- or backward-looking model matters: Not new
  - Policy preemptive or not matters
- SI hardly robust to new events and policies
  - Degree of forward-lookingness depends, and may vary over time
- CB learning may reveal SP vs. SI
- Conceptual framework
  - “Forecast targeting” rather than simple instrument rules
  - Most robust policy of all: Uses all relevant information, including judgment, model uncertainty, ZLB, etc.

Forward- or backward-looking model matters: Not new

Figure 1. Monetary Policy with and without Judgment: Backward-Looking Model

Forward- or backward looking model matters: Not new

Economy’s response to future shocks depends on FL/BL
Optimal policy is preemptive
Inferior outcome if policy responds mechanically to current variables
Applies to ZLB situations

Forward- or backward looking model matters: Not new

- Forward-lookingness/information collection, not only about aggregate supply
- Also aggregate demand, investment, long interest rates, exchange rate, asset prices, etc.

SI hardly robust to new events and policies

- Degree of forward-lookingness and information collection endogenous: Depends, and may vary over time
- Crises, CB communication, new policy of forward guidance, etc. may affect degree of forward-lookingness and information collection
- Also, for SP, Calvo parameter may be affected in some situations
Learning may reveal SI vs. SP

- CB learns from economy’s response; continuous re-estimation and updating
- SI and SP very different, should show
- But actual economies in between, a matter of degrees

Conceptual framework, classification, terminology

- Targeting rules, simple/optimal instrument rules, loss functions
- Inflation targeting \( L_t = (x_t - \pi^*)^2 + \lambda (y_t - y^*)^2 \) (1)
  - Strict: \( \lambda = 0 \)
  - Flexible: \( \lambda > 0 \)
- Price-level targeting \( L_t = (p_t - p^*_t)^2 + \lambda (y_t - y^*)^2 \) (2)
- Targeting rules: \( (x_t - \pi^*) + \lambda (y_t - y^*) = 0 \) (3) Qvigstad Rule!
  \( (p_t - p^*_t) + \lambda (y_t - y^*) = 0 \) (4)
- Nominal income (level) targeting:
  Loss function? \( L_t = [(p_t + y_t - g^*_t)^2] \) (5)
- Or targeting rule? \( (p_t + y_t - g^*_t) = 0 \) (6)
- (3) with \( \lambda = 1 \): “Strict IT”?
- (4) with \( \lambda = 1 \): “Flexible price-level targeting”?
- “Targeting” vs. “responding to”

“Forecast targeting” vs. (instrument) rules

- Paper examines performance for some simple instrument and targeting rules

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<tr>
<th>Sticky Prices</th>
<th>Sticky Information</th>
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<tr>
<td>( \delta )</td>
<td>( \sigma )</td>
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<tr>
<td>( \beta = 1.04 )</td>
<td>( \gamma = 0.43 )</td>
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<td>( \beta = 1.08 )</td>
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Table: Standard deviations of selected variables, under sticky prices and sticky information. \( \pi \): 4-quarter change in prices (annual rate). \( \delta \): output gap to flux price equilibrium. \( \beta \): federal funds rate (annual rate).

- Commitment to particular simple instrument rule, regardless of what happens?
- Disregards information, not optimal
- Does any CB behave that way? (Cf. Kohn, Woodford)

Actual policy is closer to “forecast targeting”

- Set policy-rate path such that corresponding forecasts of target variables (inflation and unemployment) “look good” (fulfill objectives)
- Forecasts are conditional on all relevant information, including inflation expectations, ZLB, model uncertainty (several models), judgment, etc.
- Policy responds to all new information that affects the forecasts of target variables
- Must be the most robust policy of all!
Forecast targeting: Monetary policy alternatives
(Riksbank Feb 2013 mtg). Not single-model forecasts

Policy rate
Mean squared gaps
Unemployment
CPIF inflation

Main scenario
Lower policy rate
Higher policy rate

Note: Long-run sustainable rate of unemployment: 6.25% (filled circles), 5% (unfilled circles).


Forecast targeting: Yellen (2012)