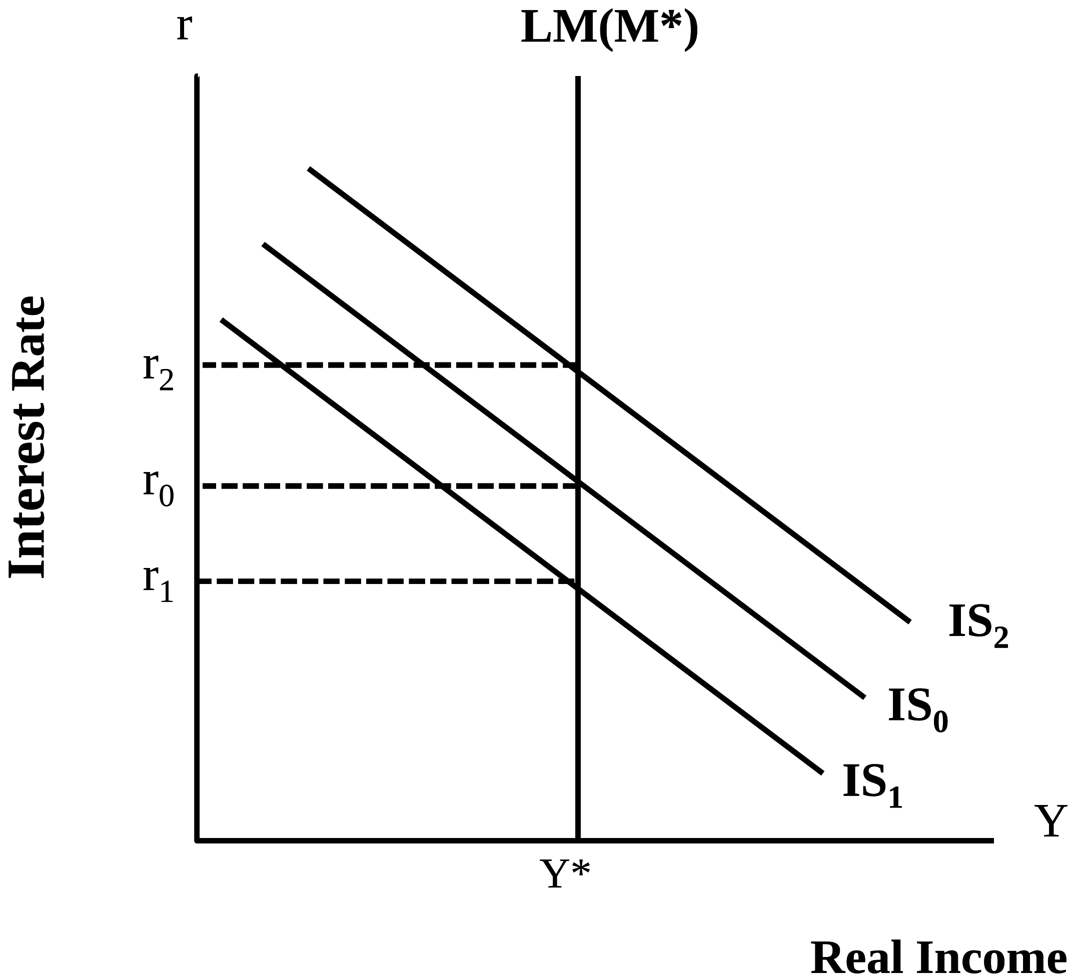
EE312:Macroeconomics Theory

Optimal Monetary Policy

"Uncertainty is not just an important feature of the monetary policy landscape; it is the defining characteristic of that landscape"

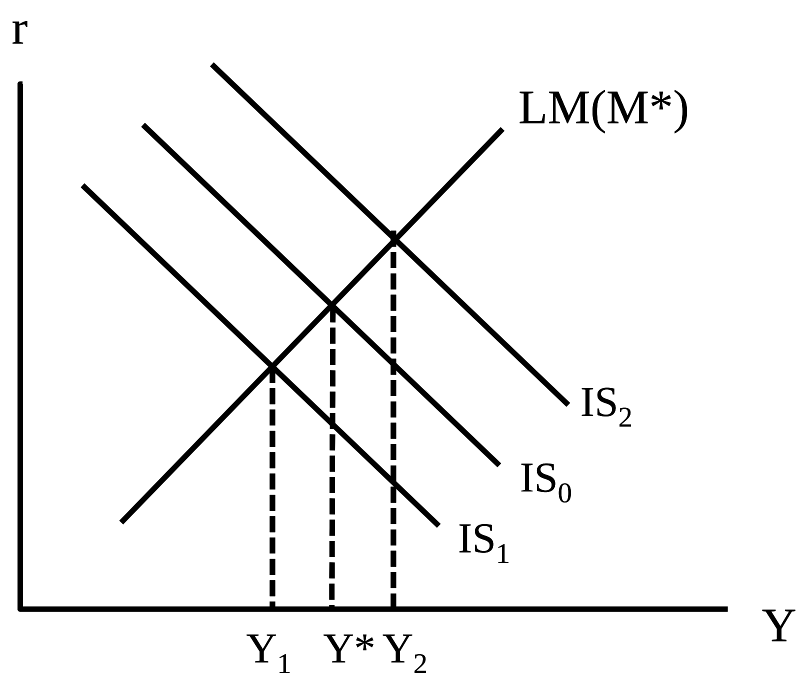
Alan Greenspan

Ideal Case for Targeting a Monetary Aggregate

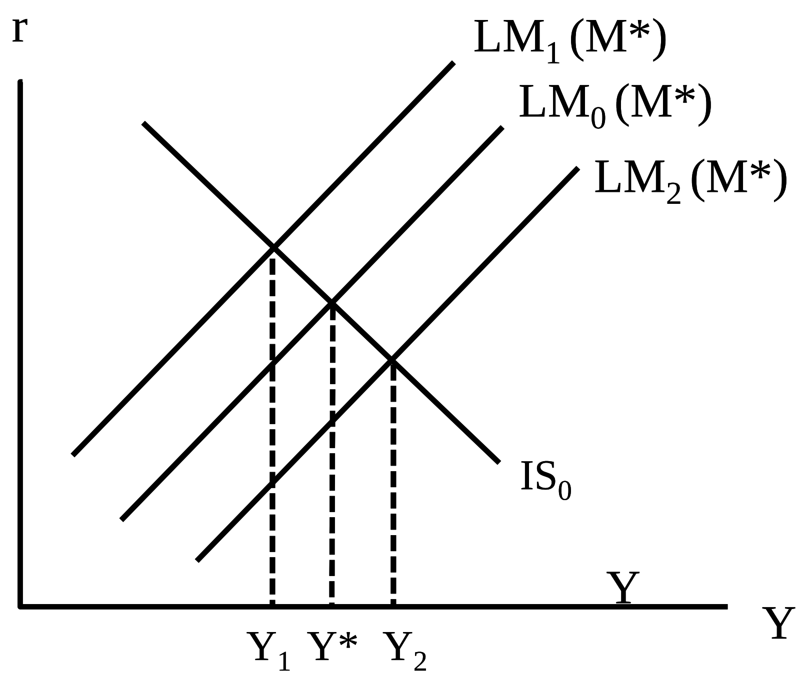


Less Than Ideal Cases for Targeting a Monetary Aggregate

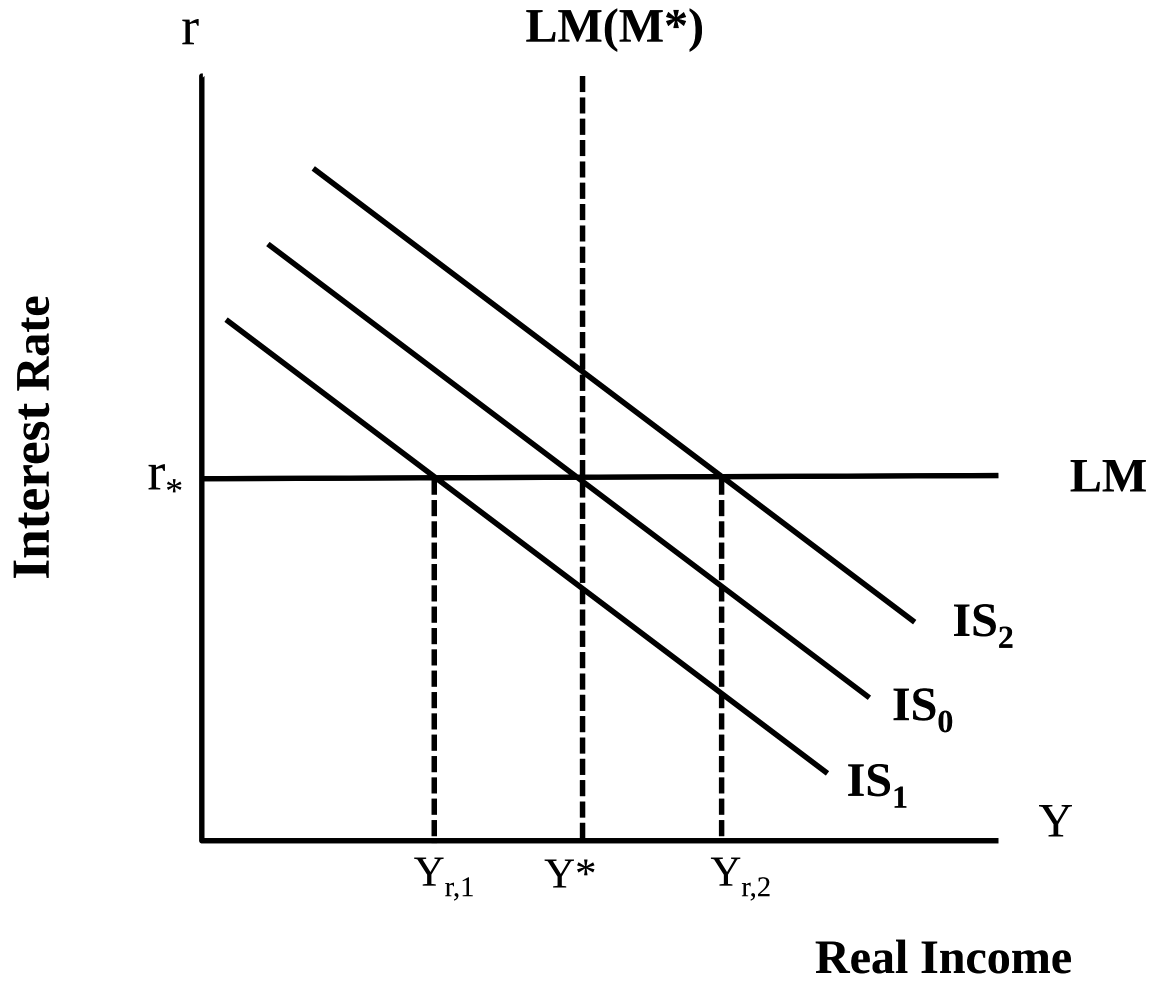
a. Nonvertical LM Schedule



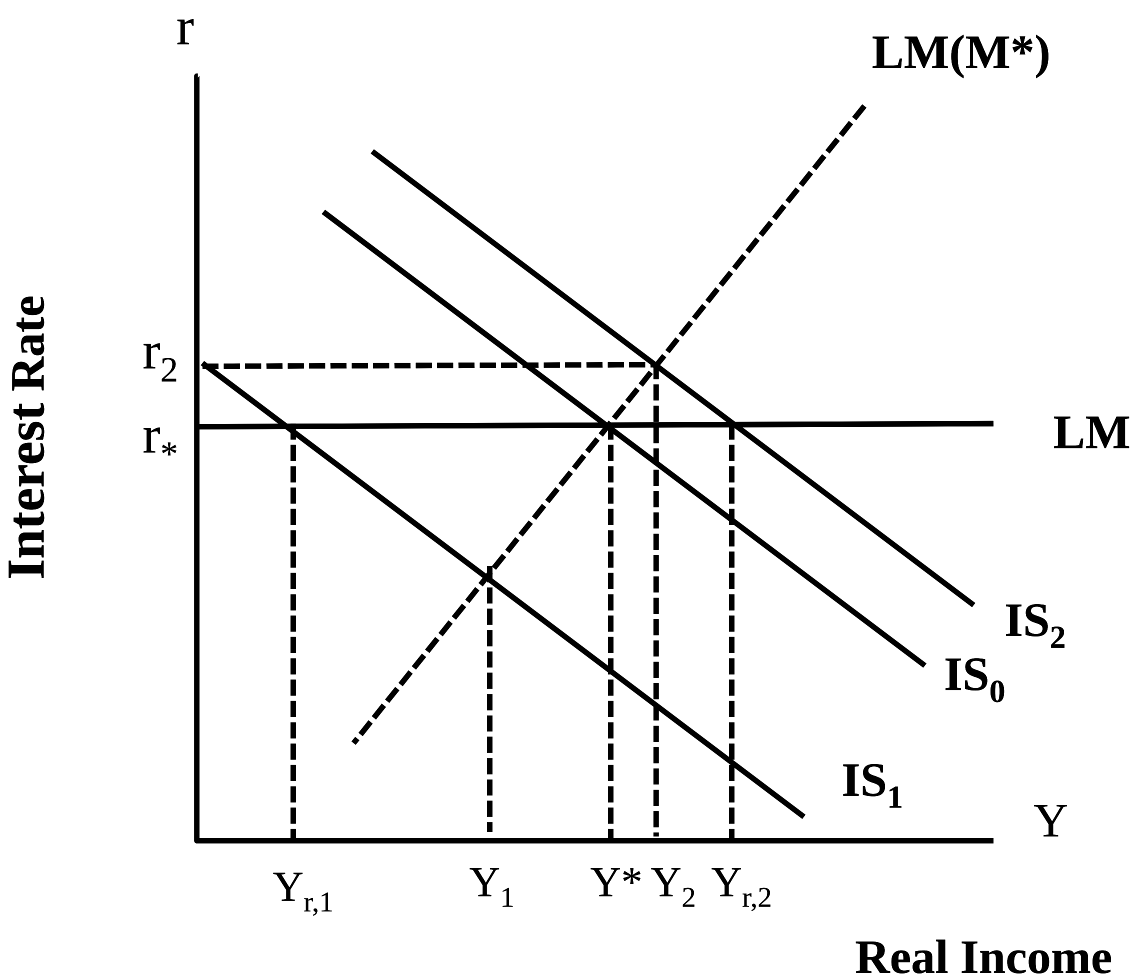
b. Unstable LM Schedule



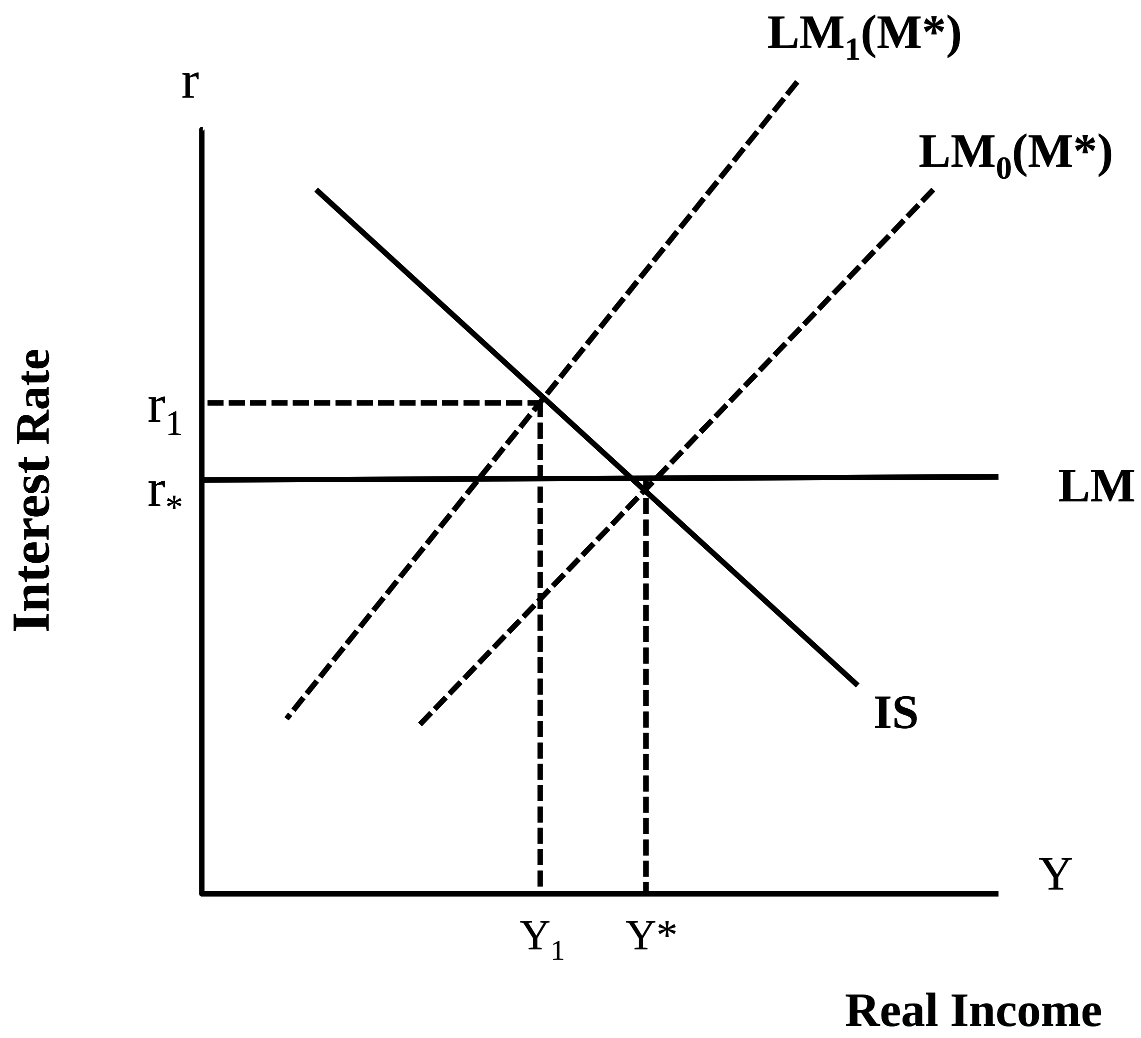
Targeting the Interest Rate with IS Uncertainty: Zero Interest Elasticity of Money Demand



Targeting the Interest Rate with IS Uncertainty: Nonzero Interest Elasticity of Money Demand



Targeting the Interest Rate with LM Uncertainty



Time Inconsistency Problem

- *A time (or dynamic) inconsistency problem for policy arises when, as Stanley Fisher explains, a " future policy that forms part of an optimal plan formulated at an initial date is no longer optimal from the viewpoint of a later date, even though no new information has appeared in the meantime."*

- *Strategy of "inflation targeting"*

  - some economists see it as a way to reduce the effect of political pressure on central banks, more central bank independence and more transparency

  - some(Benjamin Friedman of Harvard University) does not agree that inflation targeting increases the transparency of monetary policy.