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How Has Monetary Policy Changed in the Last 25 Years?

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The setting: 1987

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- CPI Inflation had been reduced from 13.3 percent in 1979 to 4.4 in 1987
- Struggling to find “intermediate targets” to motivate policy decisions
- Federal Reserve not very transparent about policy

The “golden age”: 1988-2006

- **Flexible inflation targeting**
  - Policy decisions based on forecasts of inflation and output relative to objectives
  - Implicit or explicit priority to inflation, but “opportunistic disinflation”
- **Greater transparency about decisions and their rationale**
- **The Great Moderation**
  - Only two mild recessions since 1983
  - Inflation down to 2-1/2 percent in 2006
- **Periodic financial upheavals, but with limited economic impact**

The “golden age”: 1988-2006

- **Why the good results**
  - Economic structure and circumstances
  - Policy skills
    - Forward-looking
    - attention to expectations, especially inflation expectations
    - “risk management”
    - transparency
- **Build up of risk, complacency**

Monetary Policy in the crisis and aftermath: 2007-12

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- **Liquidity programs**
- **Short-term rates to zero**
- **Purchases of long-term bonds (LSAPs)**
  - Treasuries, agencies, and MBS financed by:
    - Bank reserves (QE)
    - Sales of T bills (Twist)
  - Logic
  - Effectiveness

Challenges ahead

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- **Attaining "maximum employment and stable prices"**
  - Further action?
  - Timely and effective exit
- **Adjusting objectives?**
  - Prioritize price stability legislatively?
  - Weight to financial stability in monetary policy?
  - Take account of global spillovers?
- **Preserving Independence**