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Comments of “Monetary Policy, Incomplete Information, and the Zero Lower Bound”

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Discussion of
**“Monetary Policy, Incomplete Information,
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Andrew Levin
Dartmouth College and NBER
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General Comments

- **Important and timely topic:** risk management at the ZLB
- **Clear analytical framework:** stylized New Keynesian model
- **Rigorous solution method:** parametrized expectations
- **Sensible policy implications:** uncertainty about the strength of aggregate demand warrants caution in determining the timing of liftoff from the ZLB

Items for Discussion

- **Intuition for key finding**
- **Magnitude of practical implications**
- **Robustness to model extensions**

The Driving Analogy

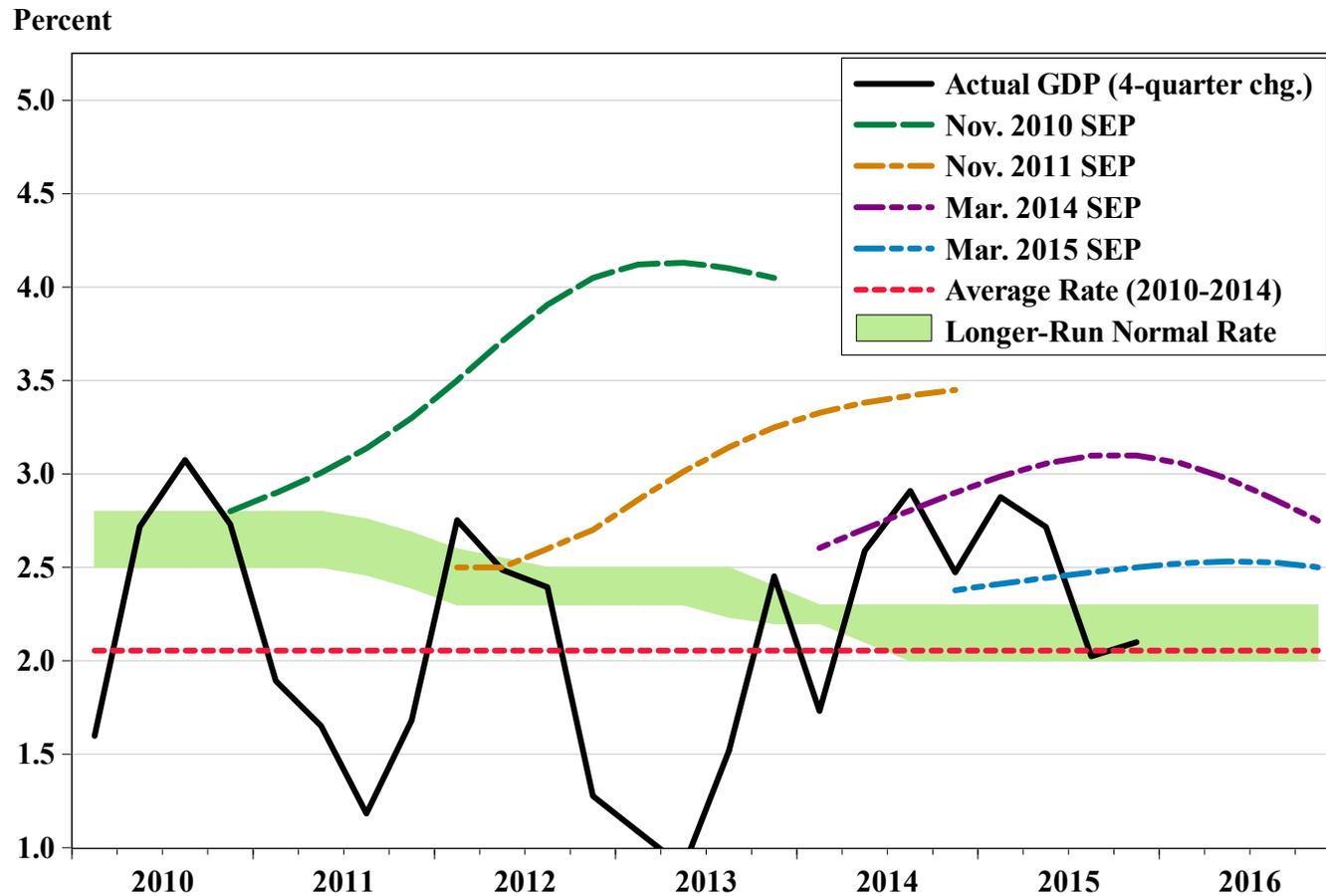
- **Perfect Foresight:** driving a familiar car on a flat rural highway with well-maintained pavement, approaching a stop sign that is clearly visible at a considerable distance.

==> Start applying the brakes well in advance and slow down gradually so that the car comes to a smooth stop.

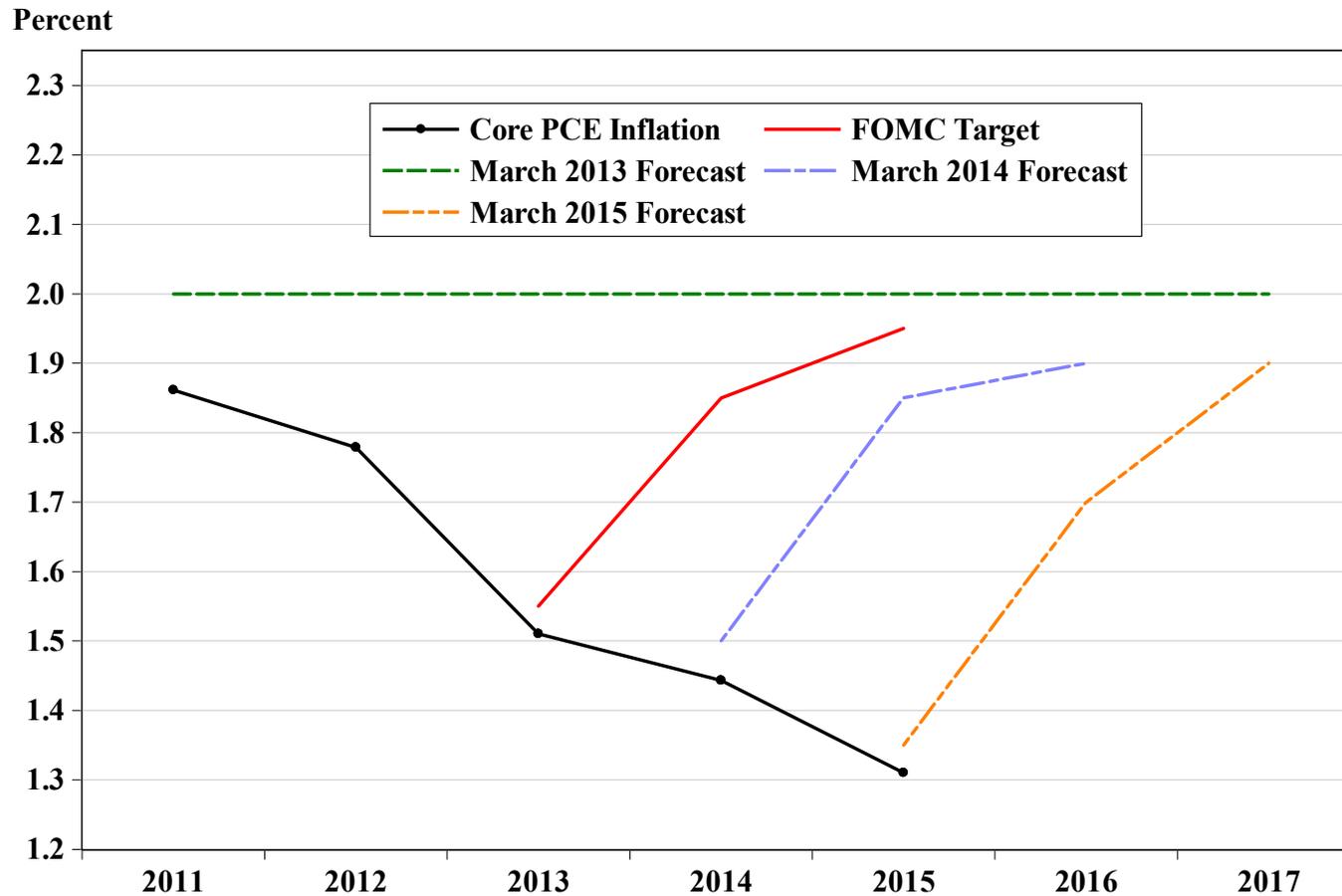
- **Imperfect Information:** driving an unfamiliar vehicle up a steep country road that has lots of curves and some muddy conditions, with a stop sign located at the top of the hill that is not yet visible.

==> Be careful to preserve momentum and be mindful that the accelerator will be useless if the car gets stuck in the mud.

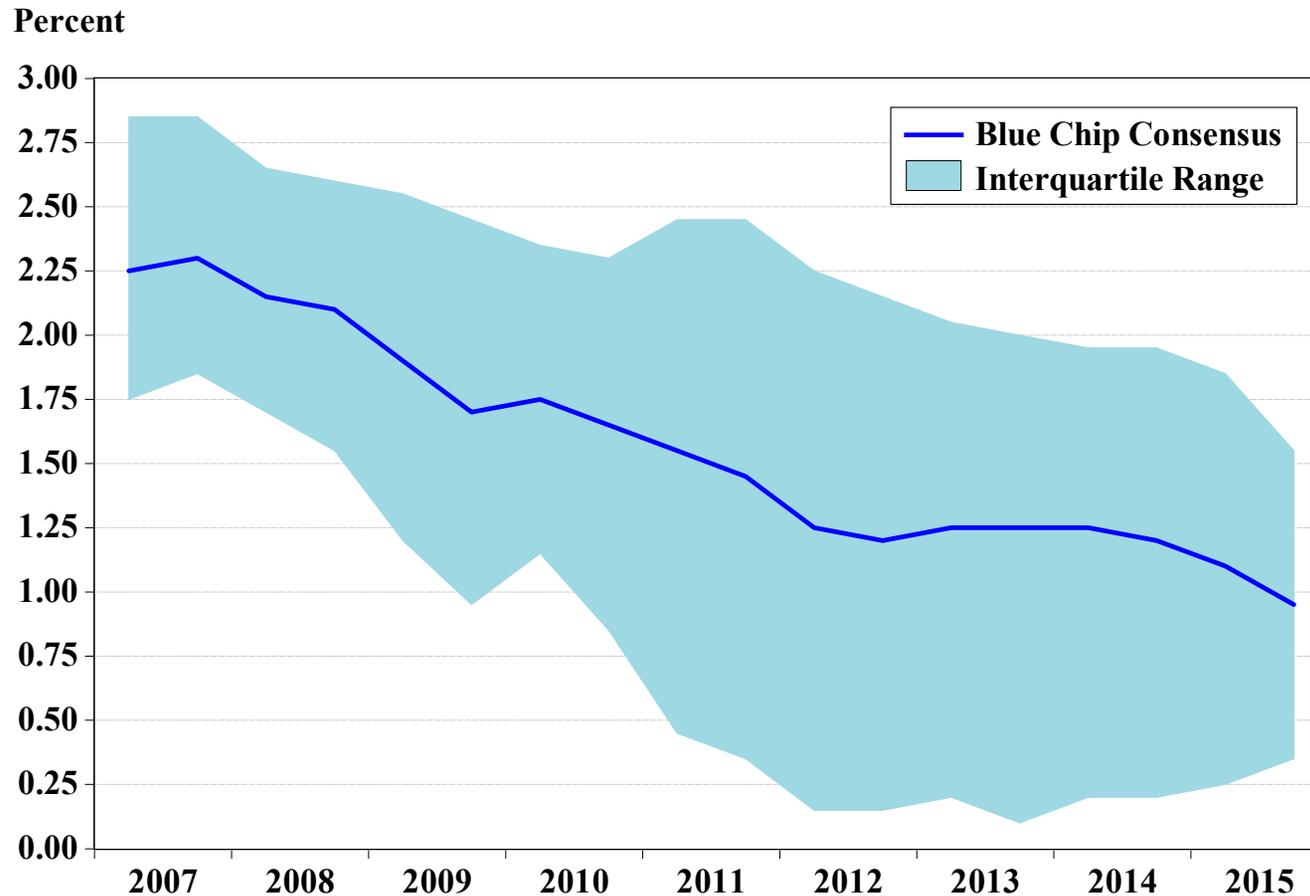
The Evolution of the FOMC's Outlook for Real GDP Growth



The Evolution of the FOMC's Outlook for Core PCE Inflation



Professional Forecasters' Assessments of the Equilibrium Real Interest Rate



Source: Blue Chip Economic Indicators. Copyright (c) Aspen Publishers

Two Approaches for Determining the Appropriate Stance of Monetary Policy

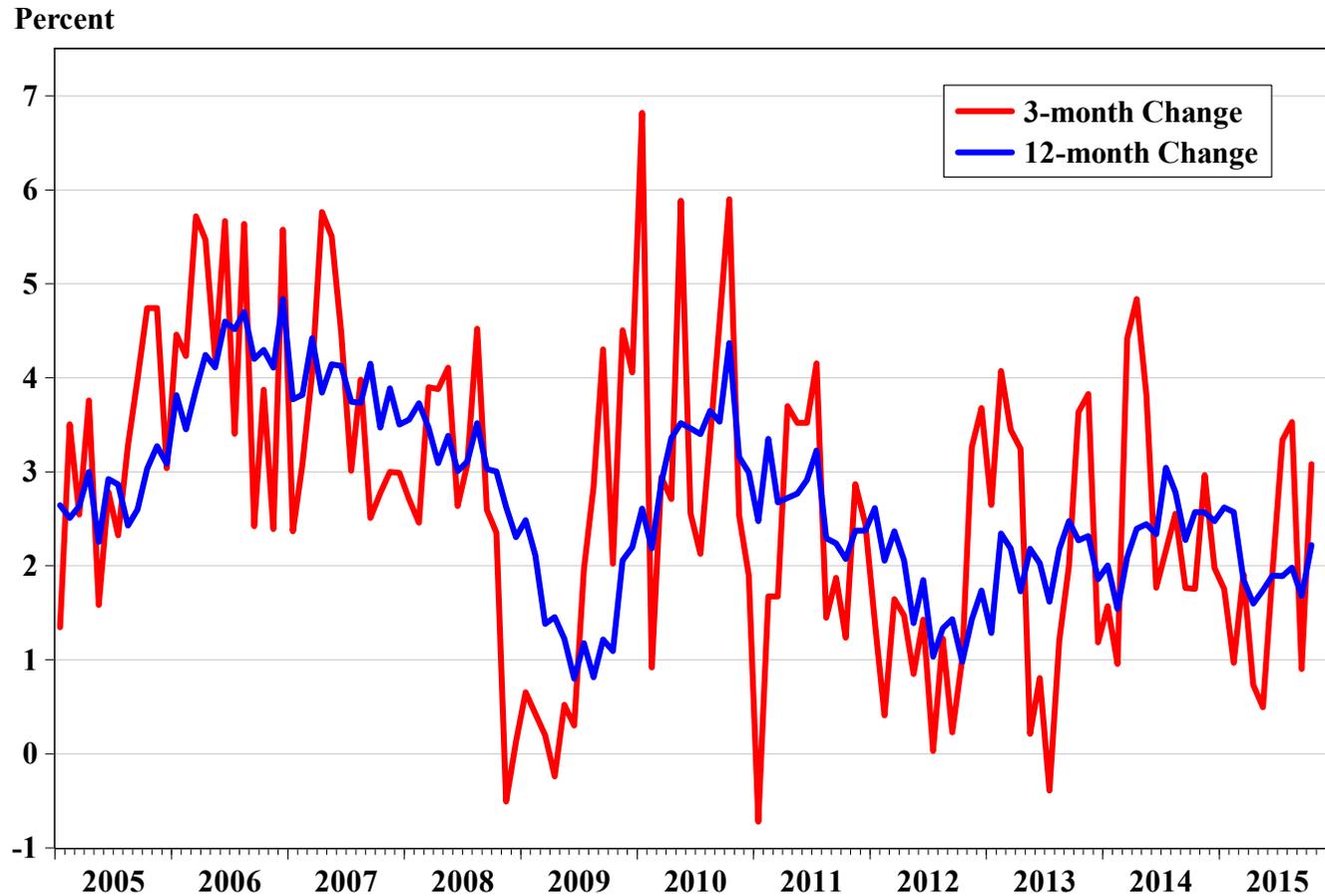
- **Forecast Targeting:** A specific macroeconomic model (usually with judgmental adjustments) is used to determine the policy path that is expected to generate the most appropriate outcomes for real economic activity and inflation over the forecast horizon.
- **Simple Policy Benchmarks:** A range of plausible macro models (along with lessons from practical experience) are used to identify simple benchmarks—such as variants of the Taylor Rule—that generate robust outcomes for economic activity and inflation.
 - ⇒ Each approach has distinct merits and pitfalls, and hence both approaches should inform the actual conduct of monetary policy.

Assessing Monetary Policy Implications using Simple Benchmarks

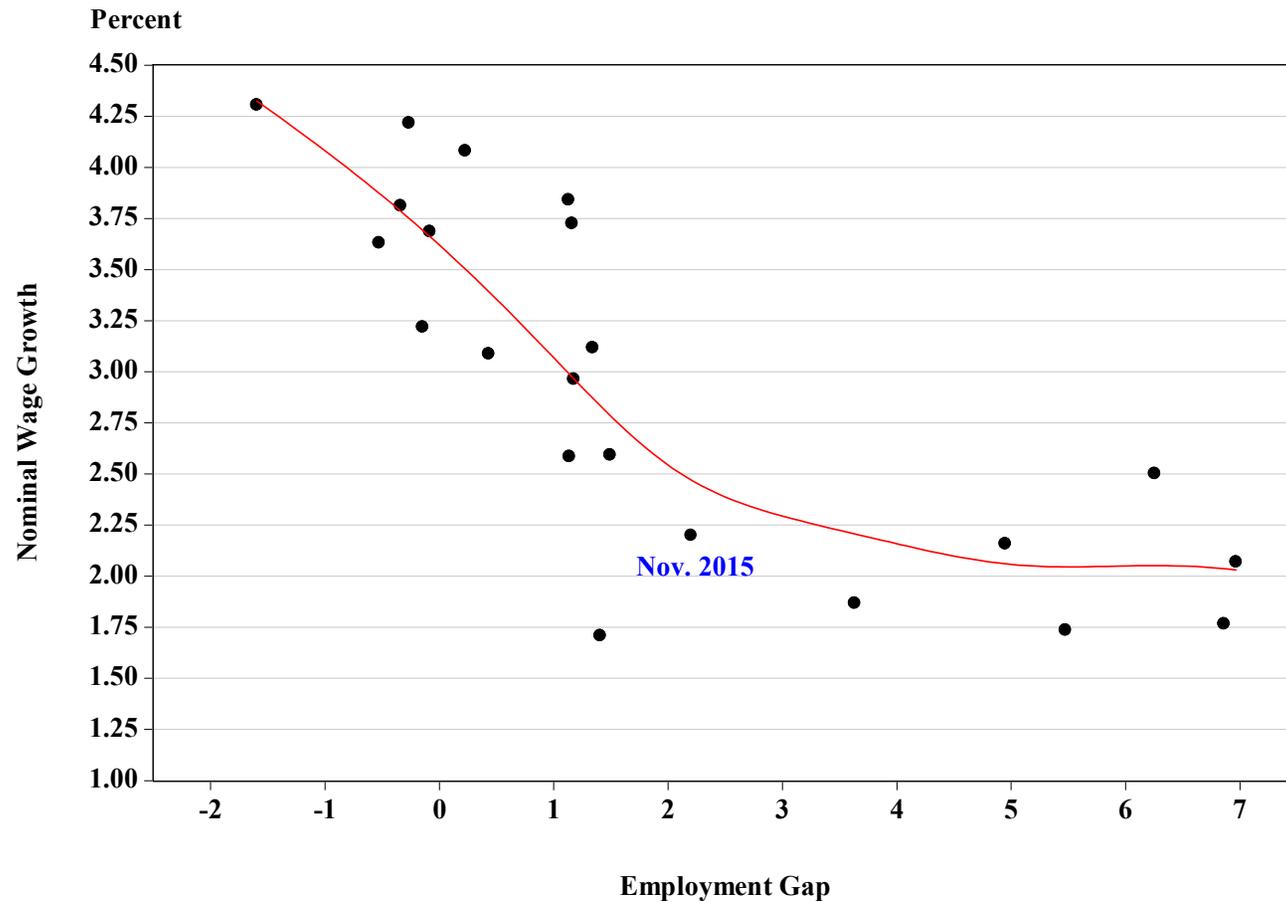
CBO Output Gap (2015:Q3) = -3.1 percent
Core PCE Inflation (12-mo. chg.) = 1.3 percent

	<i>Taylor Rule</i>	<i>“Balanced Approach” Rule (cf. Taylor 1999)</i>
<i>Fixed R*</i>	1.4	-0.2
<i>Time-Varying R*</i>	0.4	-1.2

Average Hourly Earnings of Production & Nonsupervisory Workers



The Wage Curve, 1985-2015



Source: update of Blanchflower & Levin (NBER WP, March 2015)