Based on lectures given as part of The Stone Lectures in Economics, this book discusses the problem of formulating monetary policy in practice, under the uncertain circumstances which characterize the real world. The first lecture highlights the limitations of decision rules suggested by the academic literature and recommends an approach involving, first, a firm reliance on the few fundamental and robust results of monetary economics and, secondly, a pragmatic attitude to policy implementation, taking into consideration lessons from central banking experience. The second lecture revisits Milton Friedman’s questions about the effects of active stabilization policies on business cycle fluctuations. It explores the implications of a simple model where the policy maker has imperfect knowledge about potential output and the private sector forms expectations according to adaptive learning. This lecture shows that imperfect knowledge limits the scope for active stabilization policy and strengthens the case for conservatism.

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Contents

List of figures and table  ix
Acknowledgments xi

Introduction 1
  Outline of the two lectures 7

Lecture 1: Monetary policy in uncharted territory 12
  1.1 Introduction 12
  1.2 Uncharted territory: unique historical events 15
  1.3 Achieving price stability 23
  1.4 Avoiding excess volatility in inflation, output, and the interest rate 38
  1.5 Pragmatic monetarism: the Bundesbank 47
  1.6 A stability-oriented strategy: the ECB 61
  1.7 Conclusions 74

Lecture 2: Imperfect knowledge, learning, and conservatism 77
  2.1 Introduction 77
  2.2 Time inconsistency, cost-push shocks and Rogoff’s conservatism 83
  2.3 Empirical output gap uncertainty 96
  2.4 Output gap uncertainty, learning, and conservatism 100
Contents

2.5 Different degrees of central bank knowledge and information 108
2.6 Conclusions 114

Notes 117
References 122
Index 136
Figures and table

Figures

<table>
<thead>
<tr>
<th>Figures</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>CPI Inflation, 1961–2001</td>
<td>48</td>
</tr>
<tr>
<td>1.2</td>
<td>Longer-term averages for German M3 and CPI developments, 1971–98</td>
<td>53</td>
</tr>
<tr>
<td>1.3</td>
<td>M3 in Germany, 1988–98</td>
<td>56</td>
</tr>
<tr>
<td>1.4</td>
<td>Annual rate of growth of M3 in Germany, 1988–98</td>
<td>58</td>
</tr>
<tr>
<td>1.5</td>
<td>M3 money growth and HICP inflation in the euro area, 1994–2004</td>
<td>72</td>
</tr>
<tr>
<td>1.6</td>
<td>Longer-term inflation expectations, 1999–2004</td>
<td>73</td>
</tr>
<tr>
<td>2.1</td>
<td>Informational assumptions</td>
<td>87</td>
</tr>
<tr>
<td>2.2</td>
<td>Rational expectations, observable shocks</td>
<td>90</td>
</tr>
<tr>
<td>2.3</td>
<td>Loss: rational expectations with observable shocks</td>
<td>91</td>
</tr>
<tr>
<td>2.4</td>
<td>Private sector learning; central bank has perfect information</td>
<td>94</td>
</tr>
<tr>
<td>2.5</td>
<td>Loss: private sector learning</td>
<td>95</td>
</tr>
<tr>
<td>2.6</td>
<td>Real-time and two-sided estimates for the HP filter, and different UC models, for the euro area, 1980–2000</td>
<td>97</td>
</tr>
<tr>
<td>2.7</td>
<td>Empirical properties of different estimates, euro area data, 1980–2000</td>
<td>99</td>
</tr>
</tbody>
</table>
List of figures and table

2.8 Central bank: imperfect information, private sector with fixed RLS coefficients 102
2.9 Loss: imperfect information, no private sector learning 103
2.10 Constant gain: learning and imperfect information 105
2.11 Losses with output gap uncertainty and private sector learning 106
2.12 From perfect to imperfect information 110
2.13 Loss functions: from perfect to imperfect information 111

Table

1.1 Monetary targets and their implementation 51
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