

# Presentation for Debate 3

## The ECB's Monetary Policy Strategy: Lessons From the Financial Crisis, Debt Crisis & Double Recession

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The ECB and Its Watchers XXI  
September 30, 2020

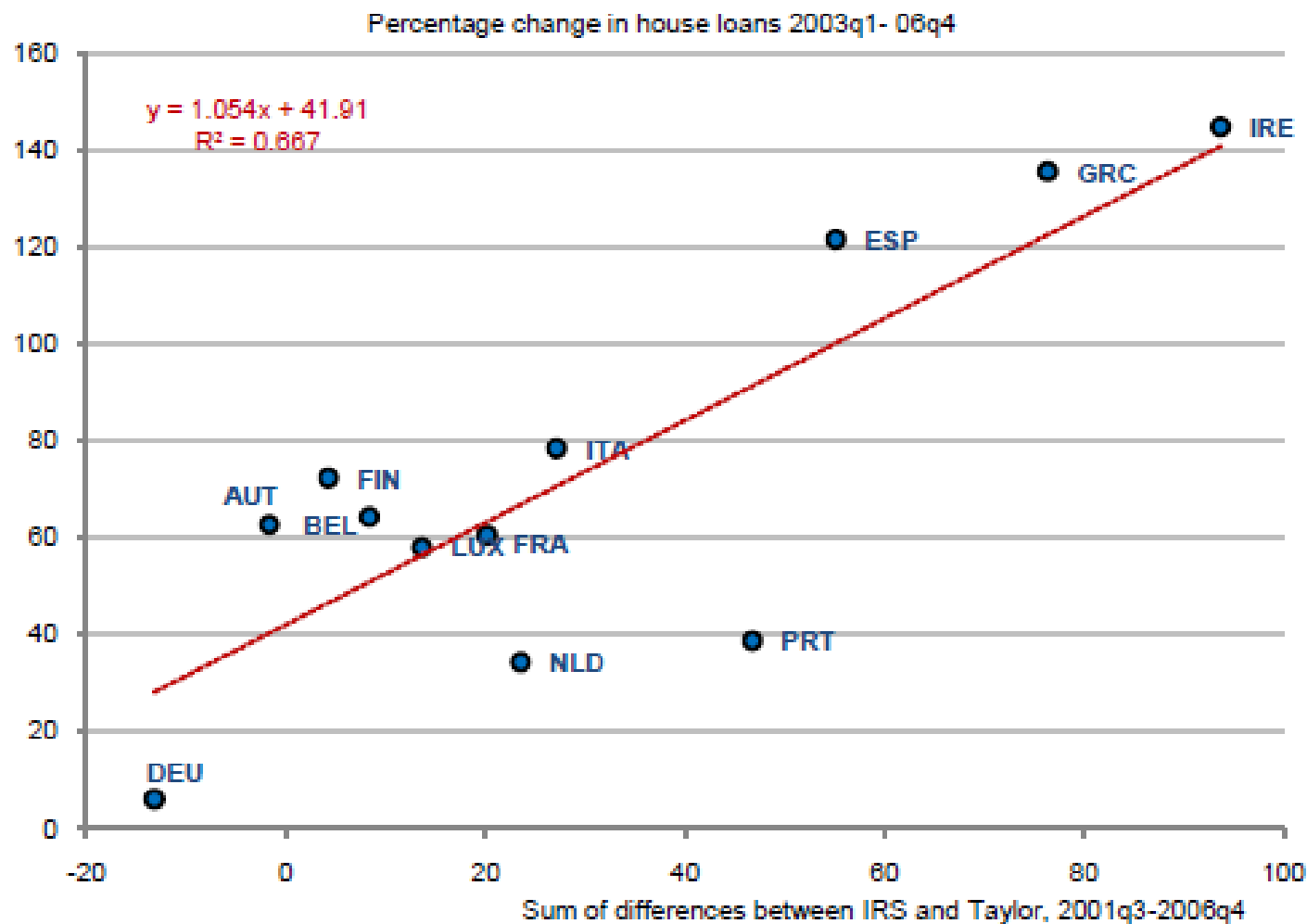
# Positive Aspects of ECB Policy Strategy

- Emphasis on transparency and clear communications about monetary policy
- Goal of price stability
- Frequent endorsement of structural and market-based reforms in member countries
- Principle that automatic fiscal stabilizers and sound budget policy are complementary parts of macro policy
- Encouragement of open capital markets
- That “We would all clearly benefit from...improving communication over our reaction functions” Draghi (2016)

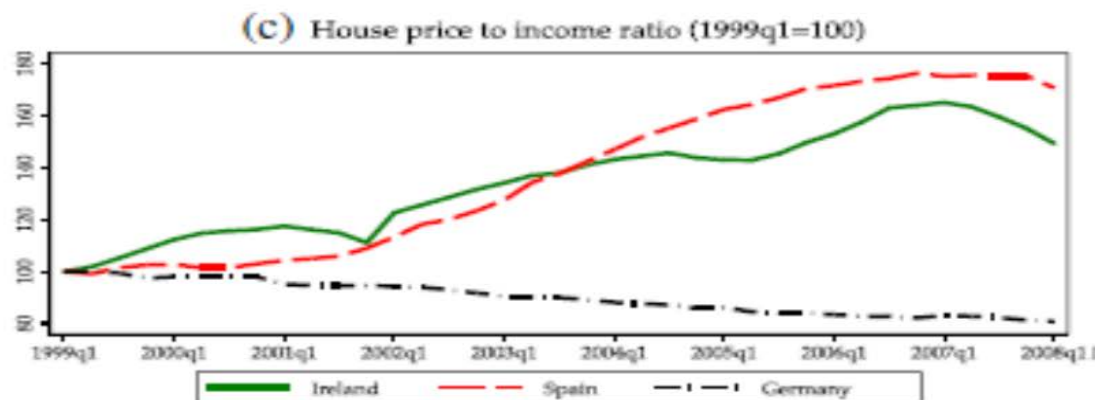
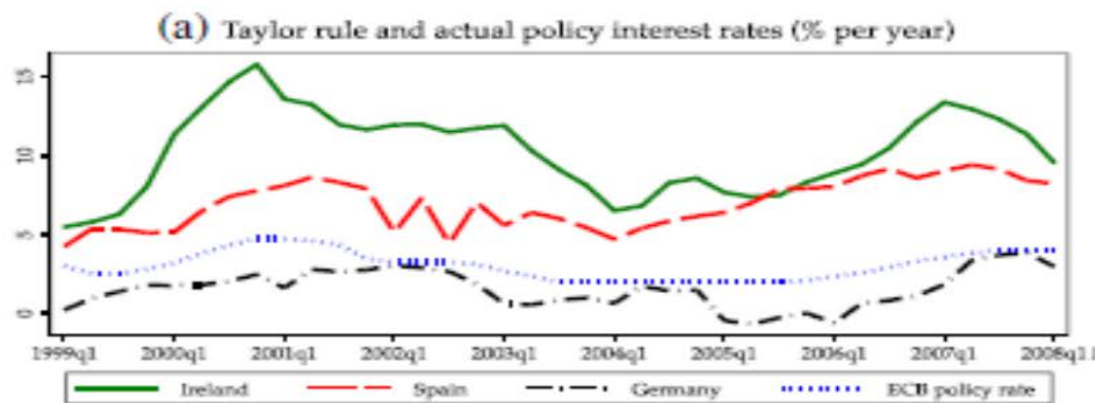
# Deviations from Strategy

- Focus on the years from
  - 2003-2006
  - 2014-2018
- Much empirical evidence
- Not referring to “Whatever it takes” comments, but rather to specific monetary policy actions.

## House loans versus deviation from Taylor

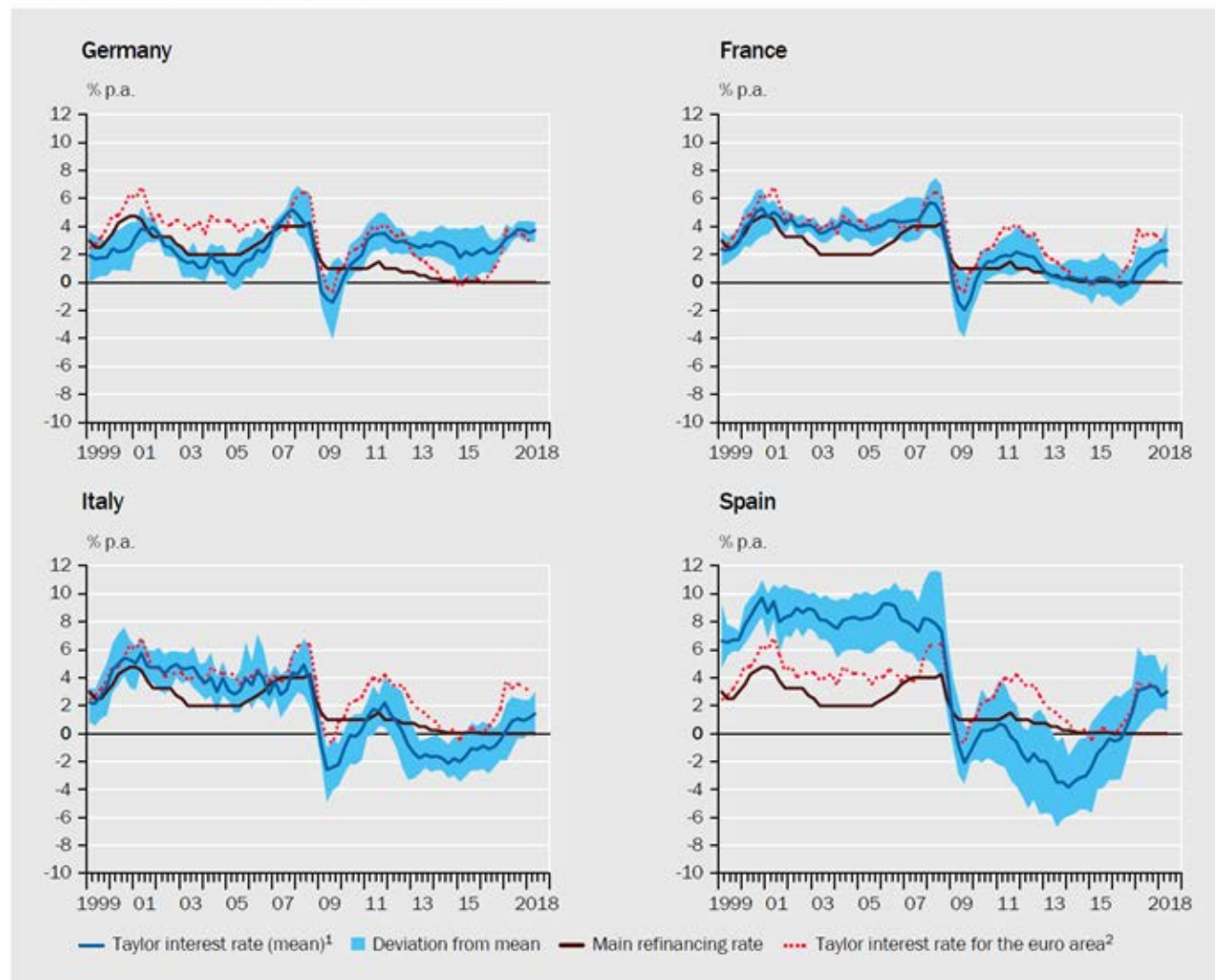


Source: Ahrend, Cournede, Price



Source: Jordà, Òscar, Moritz Schularick, Alan Taylor (2015)

# Taylor rules for selected euro area countries

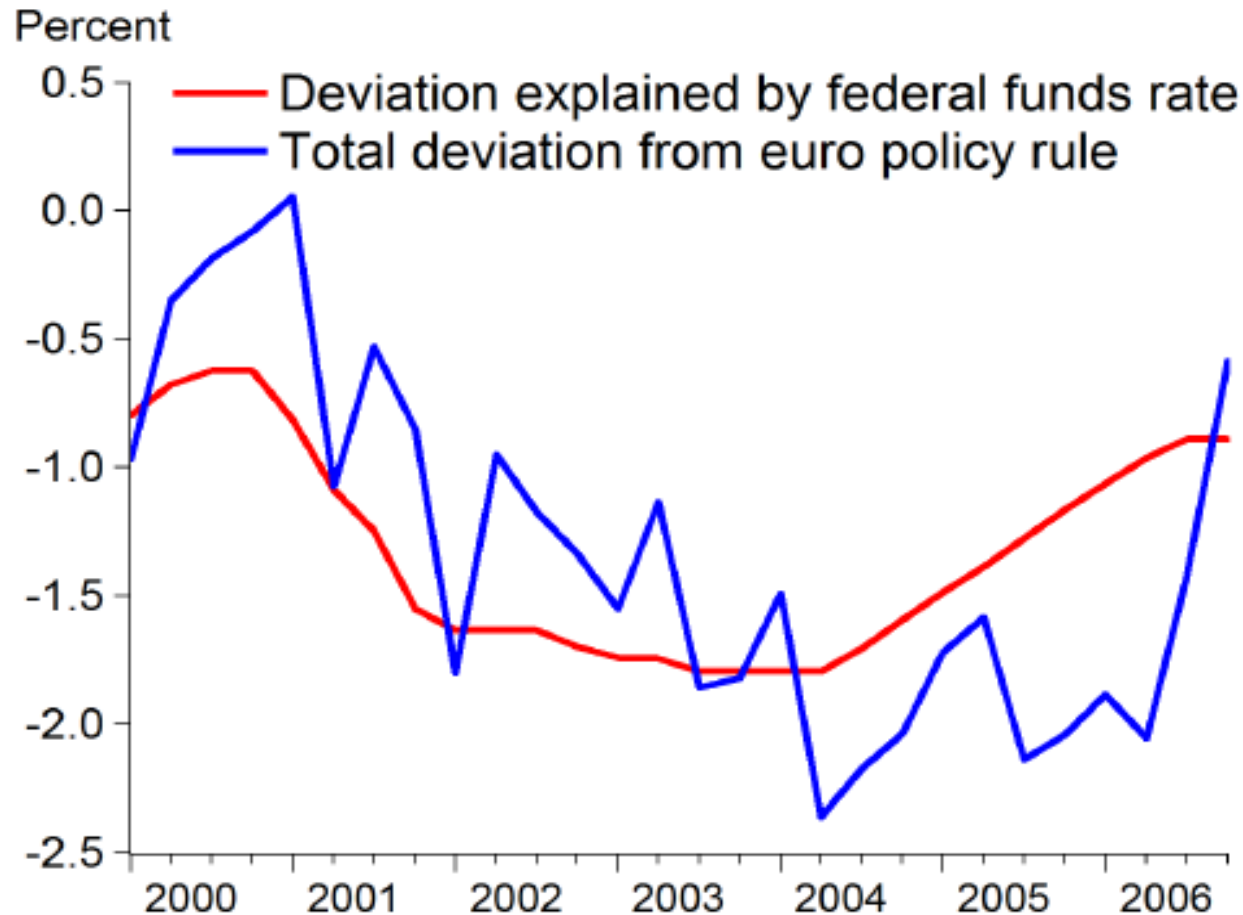


1 – The calculation is based on all combinations of four inflation measures (HICP, core HICP, GDP and consumption deflator) and four output gaps (AMECO, IMF, HP filter and segmented linear trend). Following Hofmann and Bogdanova (2012) and Taylor (1993), the respective long-term trend growth is used for the real equilibrium interest rate. This is estimated based on the respective output gaps (AMECO, IMF, HP filter and segmented linear trend). The segmented linear trend consists of a break-point during the financial crisis for each country which follows from a break-point unit root test based on Perron (1989). Following Hofmann and Bogdanova (2012), respective implicit inflation targets for the used inflation measures are calculated: The average deviation of each inflation measure from the HICP for the period between the first quarter 1999 and the second quarter 2018 is added to the 2 % inflation target of the ECB. 2 – Taylor rule equation:  $i = r^* + \pi + 0.5(\pi - \pi^*) + 0.5(y)$ .  $i$  is the implied Taylor rule interest rate for the money market; it is a function of the real equilibrium interest rate,  $r^*$ , of the current inflation rate,  $\pi$ , in deviation from the central bank target,  $\pi^*$ , and of the output gap,  $y$ .

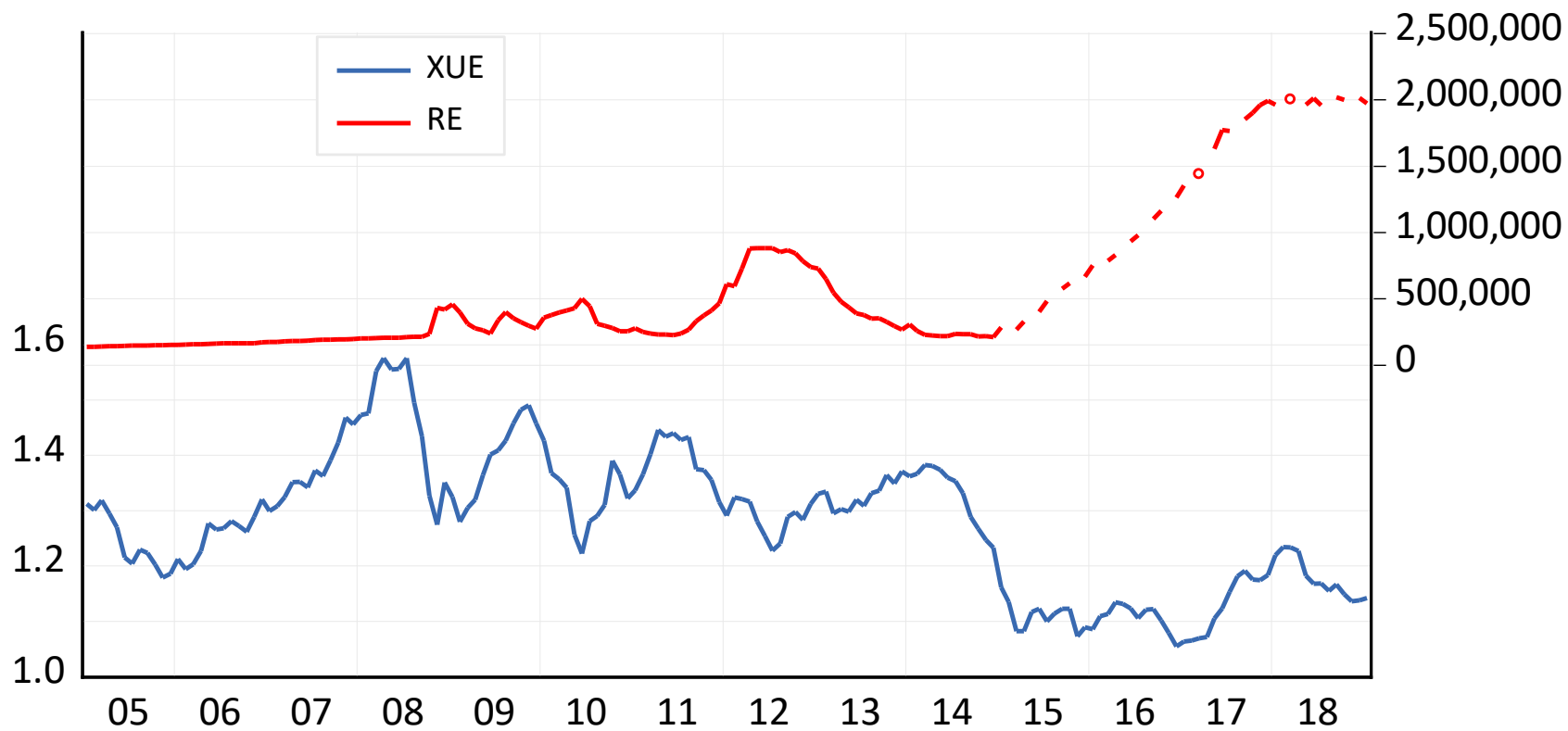
Sources: ECB, European Commission, IMF, own calculations

## Why? Interactions Between Central Banks

Example: Actual Deviations from Eurozone Policy Rule and Deviations Based on the Federal Funds Rate



Source: Taylor (2007)



Source: Taylor (2019), Updated

# Then a Revival of Focus on Monetary Policy Rules

- Bernanke, Kiley and Roberts (2019) examine ten different monetary policy rules using the FRB/US model
- Mertens and Williams (2019) evaluate different monetary rules with new Keynesian model.
- Sims and Wu (2019) evaluate different monetary policy rules with new structural model
- Whole new section on monetary policy rules in 5 of Fed's *Monetary Policy Reports* (2017-1920 Feb) with different policy rules presented & compared with actual policy.

# Rules Are In

*Monetary Policy Report, Fed*  
(Feb 2020, July 2019) →

## MONETARY POLICY REPORT

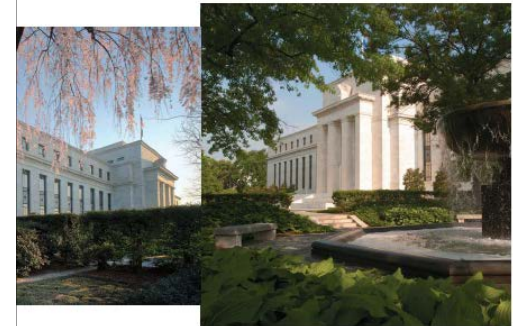
February 7, 2020



Board of Governors of the Federal Reserve System

## MONETARY POLICY REPORT

July 5, 2019



Board of Governors of the Federal Reserve System

### A. Monetary policy rules

Taylor (1993) rule

$$R_t^{T93} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t)$$

Balanced-approach rule

$$R_t^{BA} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + 2(u_t^{LR} - u_t)$$

Taylor (1993) rule, adjusted

$$R_t^{T93adj} = \text{maximum} \{R_t^{T93} - Z_t, 0\}$$

Price-level rule

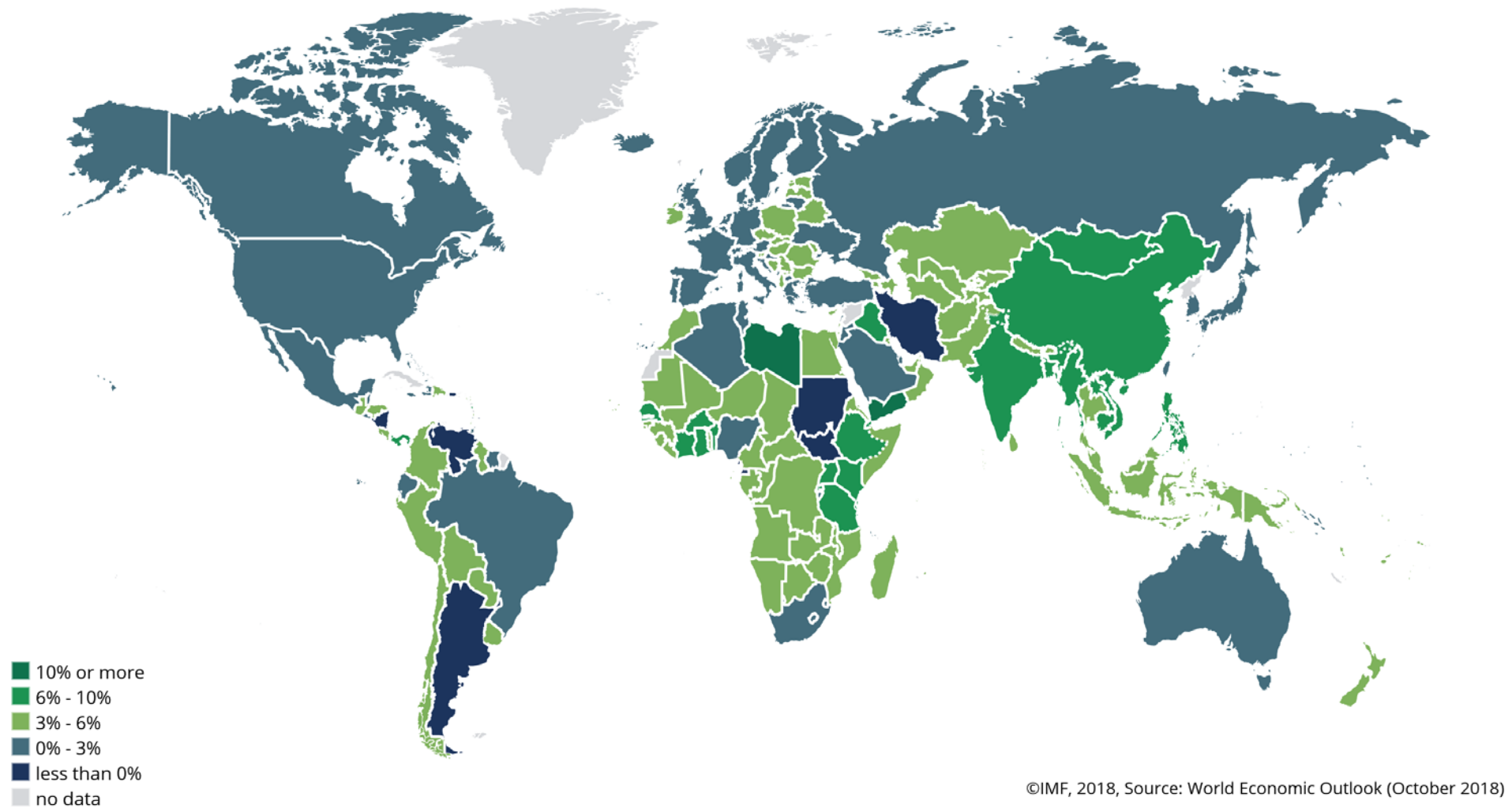
$$R_t^{PL} = \text{maximum} \{r_t^{LR} + \pi_t + (u_t^{LR} - u_t) + 0.5(PLgap_t), 0\}$$

First-difference rule

$$R_t^{FD} = R_{t-1} + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t) - (u_{t-4}^{LR} - u_{t-4})$$

# 2019

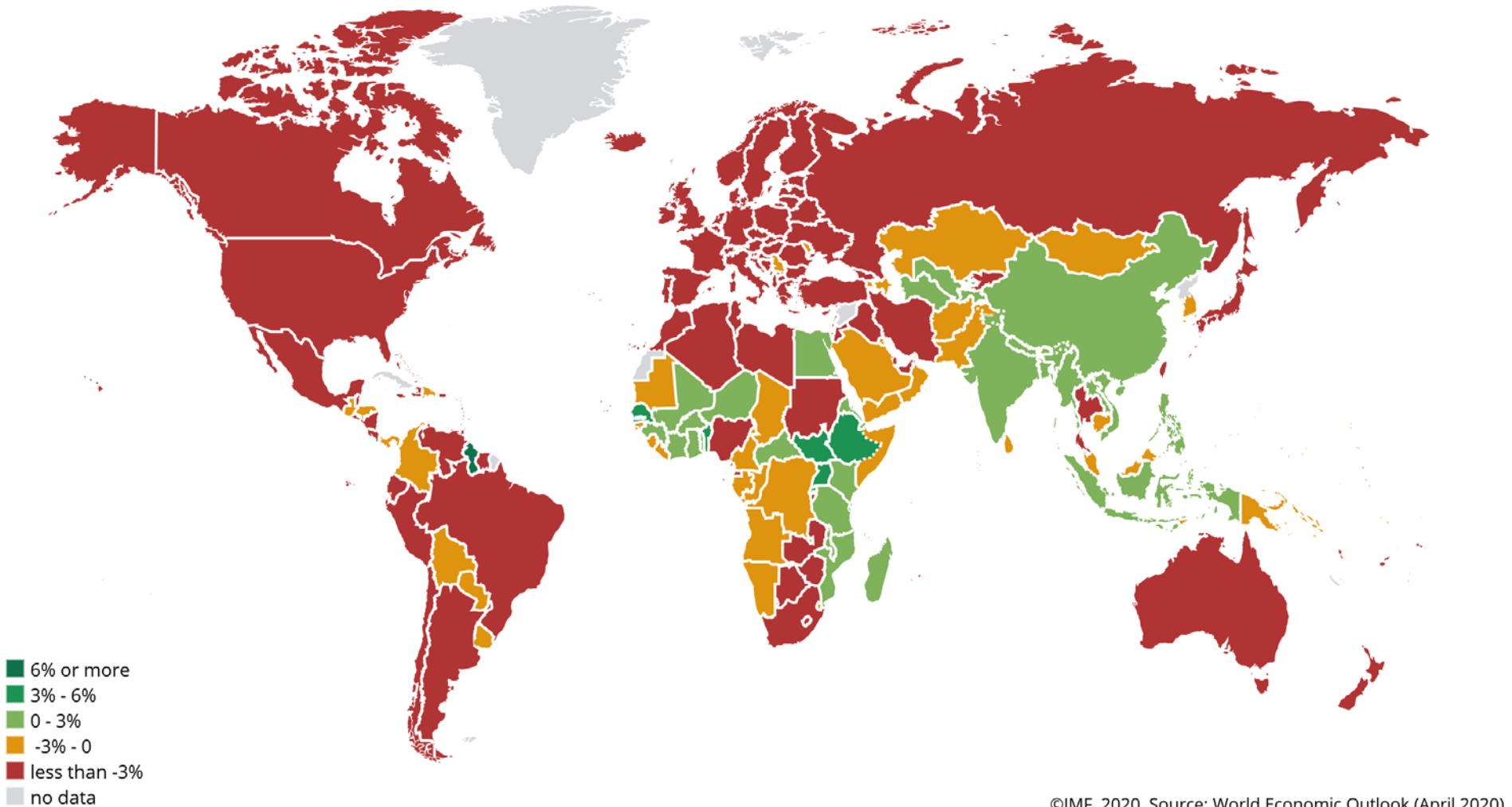
Real GDP growth (Annual percent change, 2019)



©IMF, 2018, Source: World Economic Outlook (October 2018)

# 2020

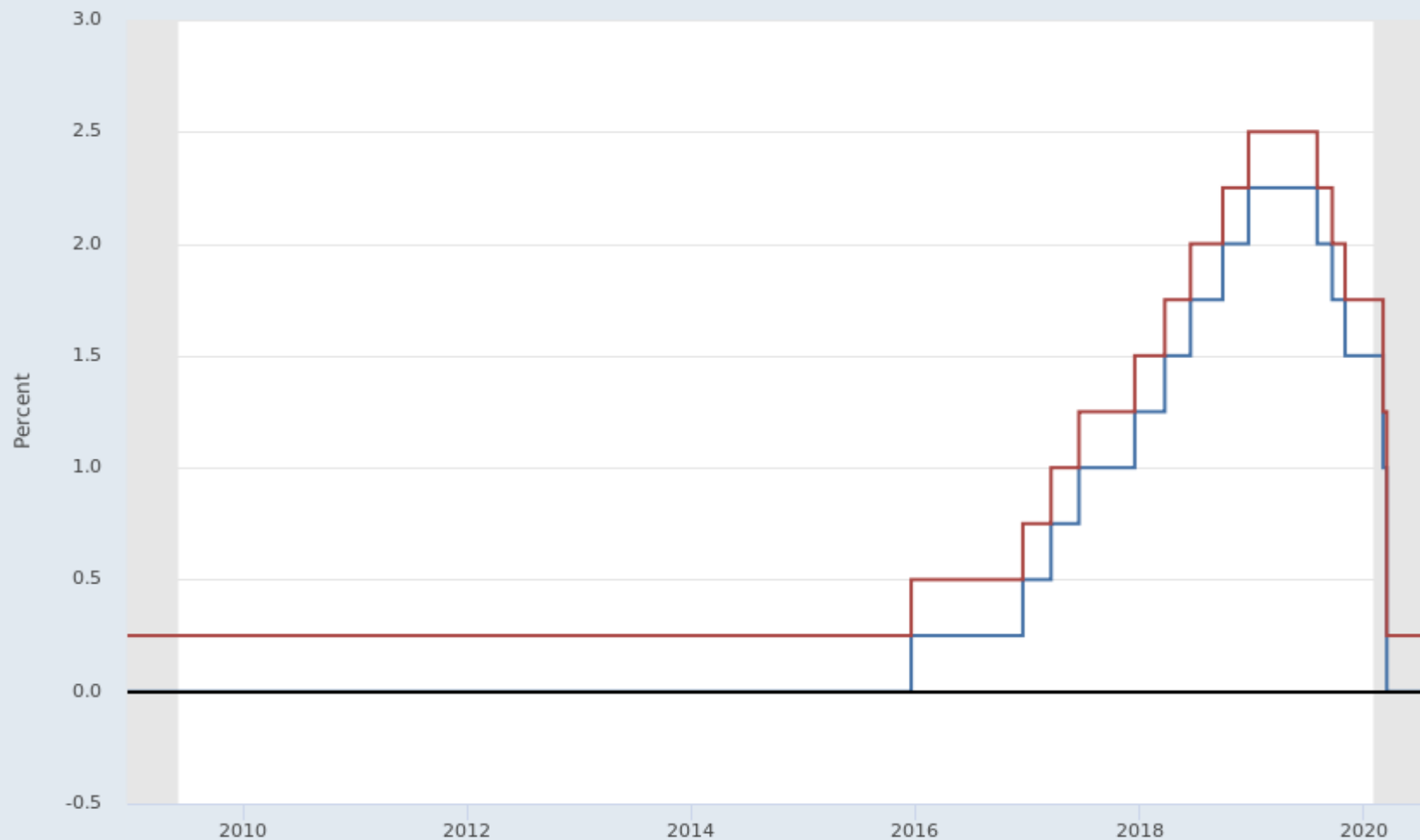
Real GDP growth (Annual percent change, 2020)



©IMF, 2020, Source: World Economic Outlook (April 2020)



Federal Funds Target Range - Lower Limit  
Federal Funds Target Range - Upper Limit



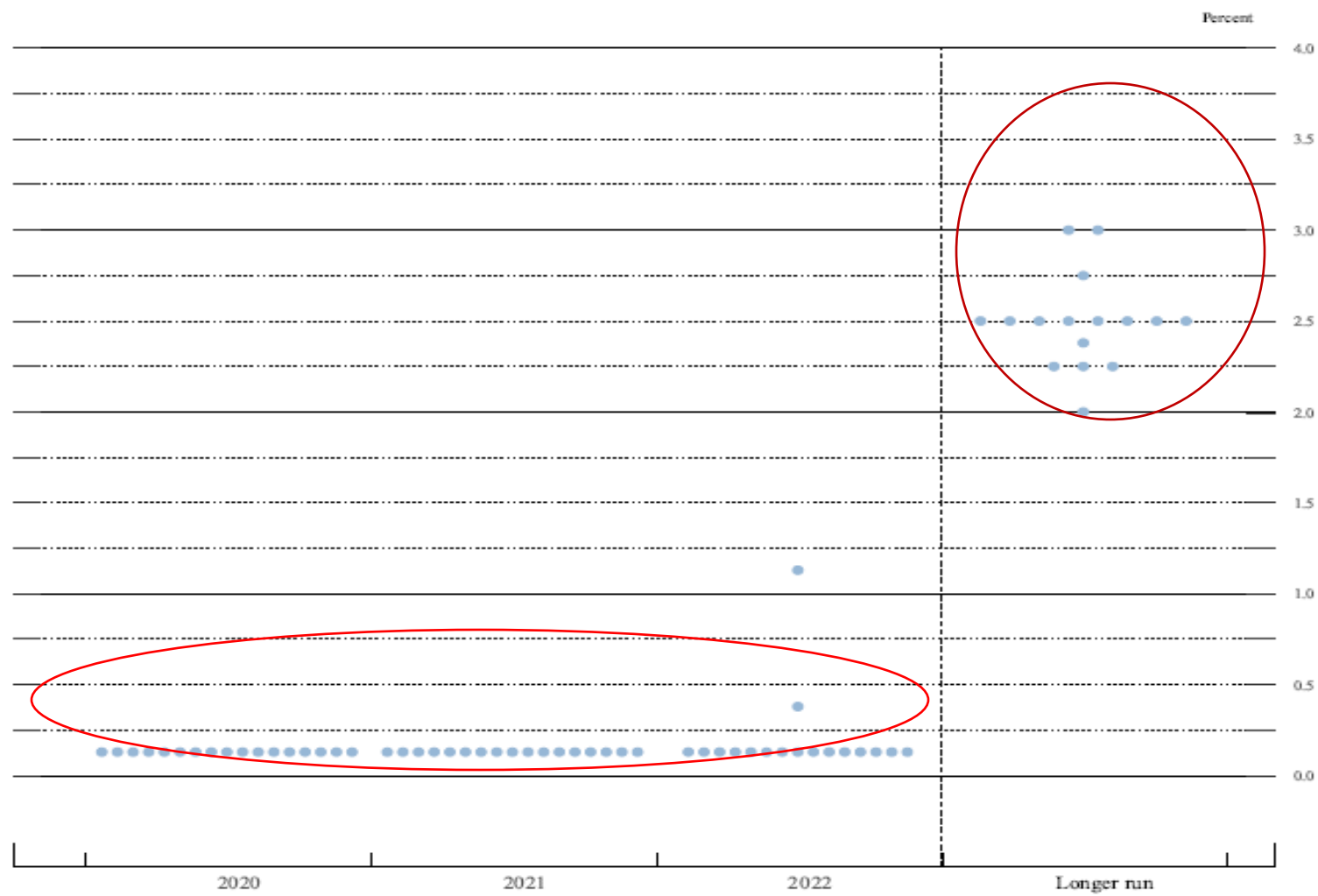
Source: Board of Governors of the Federal Reserve System (US)

[myf.red/g/ua3J](https://myf.red/g/ua3J)

June 10, 2020

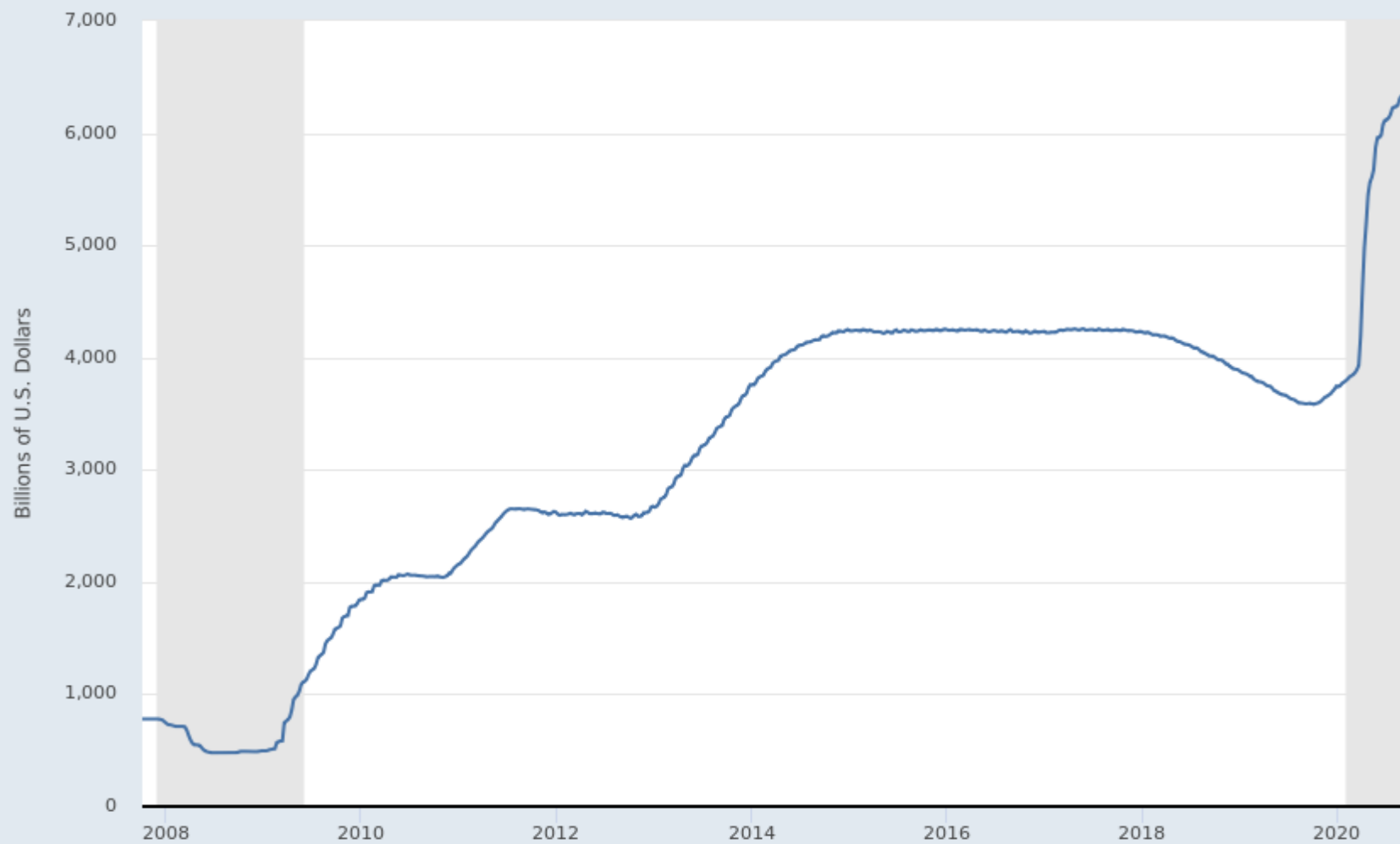
For release at 2:00 p.m., EDT, June 10, 2020

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate





Assets: Securities Held Outright: Securities Held Outright: Week Average



Source: Board of Governors of the Federal Reserve System (US)

[myf.red/g/wgA2](https://myf.red/g/wgA2)



— M1 Money Stock



Source: Board of Governors of the Federal Reserve System (US)

[myf.red/g/u5qr](https://myf.red/g/u5qr)



— M2 Money Stock



Source: Board of Governors of the Federal Reserve System (US)

[myf.red/g/u5qu](https://myf.red/g/u5qu)

# “flexible form of average inflation targeting”

-- Fed Chair, Jerome Powell, Jackson Hole, August 27, 2020

“following periods when inflation has been running below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time”

- “In seeking to achieve inflation that averages 2 percent over time, we are not tying ourselves to a particular mathematical formula that defines the average...”
- “Our decisions about appropriate monetary policy will continue to reflect a broad array of considerations and will not be dictated by any formula.”

# As Economy Recovers Need to Return to a Monetary Strategy that Works

- V-Shaped Recovery
  - Non-store retail sales rose by 20% this year
  - Telemedicine is also exploding
  - Videoconferencing has been rapidly expanding
  - Zoom Video Communications went from hosting 10 million meeting participants per day 1 year ago to 200 million today.
  - Within a decade, more than half of Facebook's 48,000 employees will be telecommuting.
- Monetary Policy and Must Return to Rules-Base Policy
- International Monetary Transmission is Part of the Reason