A Case for Monetary Policy Accommodation

Virginia Commonwealth University School of Business Foundation
2013 Investors Circle Dinner
Richmond, VA
April 2, 2013

Charles L. Evans
President and CEO
Federal Reserve Bank of Chicago
Long-Run Strategy for Monetary Policy (January 2012)

- $\pi^* = 2\%$ PCE inflation

- $U_t^* \sim 5.25\% - 6\%$ time-varying

SEP long-run central tendency

- **Balanced approach** to reducing deviations of inflation and employment from long-run objectives
Current and Expected Policy Losses

Loss Function
(percent)

\[ L = (\pi - \pi^*)^2 + 0.25 (y - y^*)^2 \]

\[ L = (\pi - 2)^2 + (u - u^n)^2 \]

2014 FOMC Forecast (March 20, 2013)

Current Value

September 2011 value
Recent Policy Actions

- **Open-ended Treasury and MBS purchases**
  - $85 billion per month
  - Until there is substantial improvement in labor markets

- **Low fed funds rate at least until:**
  - Unemployment < 6.5% or
  - Inflation forecast > 2.5%

- **Highly accommodative policy even after the recovery strengthens**
Taylor Rules:
\[ R_t = 2.0 + \pi_t + 0.5(\pi_t - 2) + \alpha \text{ gap}_t \]

Taylor 1999: \( \alpha = 1.0 \)
Taylor 1993: \( \alpha = 0.5 \)

Optimal Control:
\[
\min (\pi_t - 2)^2 + (u_t - u^*)^2 + \Delta R_t^2
\]

Source: Janet L. Yellen, “Perspectives on Monetary Policy,” Boston, June 6, 2012
Progress toward the Dual Mandate
Goals with Alternative Policies

Unemployment Rate
(percent)

PCE Inflation
(4-quarter percent change)

Source: Janet L. Yellen, “Perspectives on Monetary Policy,” Boston, June 6, 2012