<table>
<thead>
<tr>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>additive uncertainty 23</td>
</tr>
<tr>
<td>aggregate demand policy 63</td>
</tr>
<tr>
<td>aggregate price level, and stochastic price adjustment model 146</td>
</tr>
<tr>
<td>aggregate supply, shifts in schedule see supply shocks</td>
</tr>
<tr>
<td>Aizenman, J. 9, 10</td>
</tr>
<tr>
<td>Alesina, Alberto 129</td>
</tr>
<tr>
<td>alternative loss function 75–6</td>
</tr>
<tr>
<td>Anderson, Evan 27</td>
</tr>
<tr>
<td>Australia, Reserve Bank 223</td>
</tr>
<tr>
<td>average inflation targeting 222–33, 235</td>
</tr>
<tr>
<td>backward-looking Phillips Curve 283–5</td>
</tr>
<tr>
<td>delegation 227–30</td>
</tr>
<tr>
<td>discretionary targeting strategies, performance evaluation 230–33, 231</td>
</tr>
<tr>
<td>policymaker’s objective function and optimal policy 223–7</td>
</tr>
<tr>
<td>target rules 229</td>
</tr>
<tr>
<td>backward-looking Phillips Curve 160–61, 273–306</td>
</tr>
<tr>
<td>average inflation targeting 283–5</td>
</tr>
<tr>
<td>closed-economy models 275–80</td>
</tr>
<tr>
<td>direct vs indirect exchange rate channel 292–3</td>
</tr>
<tr>
<td>efficient monetary policy strategies 280–87</td>
</tr>
<tr>
<td>Taylor Rule 286–7</td>
</tr>
<tr>
<td>equations 275–6, 291–2</td>
</tr>
<tr>
<td>and forward-looking models 299–301</td>
</tr>
<tr>
<td>gradual inflation targeting 282–3</td>
</tr>
<tr>
<td>monetary conditions indices (MCI) 50, 275, 290, 294</td>
</tr>
<tr>
<td>potential problems 296–9</td>
</tr>
<tr>
<td>open economy model 290–96</td>
</tr>
<tr>
<td>monetary policy 293–6</td>
</tr>
<tr>
<td>optimal monetary policy 276–80</td>
</tr>
<tr>
<td>strict targets 281–2</td>
</tr>
<tr>
<td>target rule framework 287–90</td>
</tr>
<tr>
<td>Taylor Rule 277, 286–7, 301</td>
</tr>
<tr>
<td>time lags, importance 292–3</td>
</tr>
<tr>
<td>balance of payments shocks 90</td>
</tr>
<tr>
<td>see also BP schedule (balance of payments equation)</td>
</tr>
<tr>
<td>Ball, Laurence 5, 6</td>
</tr>
<tr>
<td>on backward-looking Phillips model 274, 275, 287, 290</td>
</tr>
<tr>
<td>on forward-looking Phillips model 180, 243</td>
</tr>
<tr>
<td>Bank of England 128, 130</td>
</tr>
<tr>
<td>bank reserves, and interest rates see interest rates</td>
</tr>
<tr>
<td>Barro, Robert J. 9</td>
</tr>
<tr>
<td>classical models 65</td>
</tr>
<tr>
<td>and conservative central banker 180</td>
</tr>
<tr>
<td>modified model see modified Barro and Gordon model</td>
</tr>
<tr>
<td>multi-period model see multi-period model (Barro and Gordon)</td>
</tr>
<tr>
<td>one-period model see one-period model (Barro and Gordon)</td>
</tr>
<tr>
<td>reputational equilibria 111</td>
</tr>
<tr>
<td>Benavie, Arthur 9, 57</td>
</tr>
<tr>
<td>best supportable rule 112–14</td>
</tr>
<tr>
<td>bias</td>
</tr>
<tr>
<td>inflation 117, 119, 120</td>
</tr>
<tr>
<td>stabilization see stabilization bias</td>
</tr>
<tr>
<td>Blanchard, Olivier J. 108</td>
</tr>
<tr>
<td>Blinder, Alan 108, 135</td>
</tr>
<tr>
<td>BP schedule (balance of payments equation) 80, 84, 86, 88, 95</td>
</tr>
<tr>
<td>Brainard, William 5, 22–5</td>
</tr>
<tr>
<td>Calvo, Guillermo 5, 144–5, 145–9, 151, 154</td>
</tr>
<tr>
<td>Campillo, M. 129</td>
</tr>
<tr>
<td>Canzoneri, Matthew B. 128</td>
</tr>
</tbody>
</table>
capital mobility
imperfect 80–81, 93–4
perfect 78–80, 94–8
CCBI (cost of central bank independence) 121, 122, 123
central banks
conservative central banker, appointment
degree of “conservatism” 121
with escape clause 119–23
overriding 121
time inconsistency problem, solution to 118–19
inflation rates, absence of perfect information 165
institutions 128–30
intervention of, in fixed exchange rate regime 80
performance contracts see performance contracts (central bankers)
price level vs inflation-targeting debate 214–17
stabilization bias, and conservative central banker
closed economy 179–80
open economy 254–6
and time inconsistency problem 118–19
certainty equivalence 13, 139
\textit{ceteris paribus} 90, 91
Chin, Menzie 97
Clarida, Richard 137, 165, 235, 243
closed-economy models
backward-looking Phillips Curve 275–80
forward-looking Phillips Curve 163–92
imperfect capital mobility 93
perfect capital mobility 98
Cobb-Douglas production function 54, 83, 100
combination policies
contemporaneous feedback rules 63, 81
defined 12
equations 18–20
examples 21
and information variables 45–6, 50
and Mundell-Fleming model 81
optimal 22, 61–3
commitment
vs discretion 178
optimal monetary policy 166–75, 243–53
timeless perspective 193–204
precommitment, policy with 117–18
simple see simple commitment
contemporaneous feedback rule, combination policy as 63, 81
cost-push shock
coefficients 177
optimal response of output gap and inflation rate to 173
persistent, variances of inflation 228
positive 178
serially correlated 172–5
white noise process 168–72, 196, 200, 207
CPI (consumer price index) 96
Craine, Roger 26
credibility of monetary policy see monetary policy credibility
credibility-sterilization trade-off 127–8
Cukierman, Alex 129
currency-to-deposit ratio 35
current observability, concept 43–5
Debelle, Guy 129
delegation, average inflation targeting 227–30
discretion, policy under
and commitment 178
expectations, treatment of 233–5
flexible price-level targeting 218
forward-looking Phillips Curve 175–8
modified Barro and Gordon model 116–17
multi-period model (Barro and Gordon) 110
one-period model (Barro and Gordon) 106
open policy framework 253–4
performance evaluation,
discretionary targeting strategies 230–33
policymaker’s objective function and optimal policy 205–9
average inflation targeting 223–7
speed limit policy 217–22
reaction functions 120, 123
speed limit policy 217–22
stabilization bias 118, 177
and conservative central banker 179–80, 254–6
and timeless perspective 212
see also timeless perspective
disinflation, failure to explain 108–9
Dornbusch, Rudiger 99
Driscoll, John C. 161, 162
enforcement
best supportable rule 113
performance contracts (central bankers) 126–7
reputational equilibria 111
zero inflation 112
equations
backward-looking Phillips Curve 275–6, 291–2
balance of payments (BP schedule) 80, 84, 86, 88, 95
cost-push shock 169, 173
extended Mundell-Fleming model
imperfect capital mobility 82–4, 100
perfect capital mobility 94–5
forward-looking Phillips Curve 164
information variables 46–7
IS curve 32, 34
Mundell-Fleming model 79
open economy policies 86–9
see also IS shocks; IS-LM model (basic model)
optimal policy, under commitment 166–7, 195
perfect capital mobility 78–9
price levels, flexible targets 206–8
quadratic price adjustment cost model (Rotemberg) 151
speed limit policy 219–20
staggered nominal wage contracts 152–4
sticky information model (Mankiw and Reis) 155–6
stochastic price adjustment model (Calvo) 145, 146, 148–9
target vs instrument rules 182–4, 258–62
targets and instruments framework 32
variable price model see variable price model
error terms, intermediate targets 37, 38, 39, 44
European Central Bank 128
charter 130
exchange rate regimes see pure policies
exogenous shocks 104
expectations
discretion, treatment under 233–5
Expectations-augmented Phillips Curve 157–8
predetermined 64–5
rational expectations concept 4
unconditional yields 158
expectations channel 193–4
Expectations-augmented Phillips Curve 157–8
extended Mundell-Fleming model
aggregate supply, specification 96
alternative policy rules, evaluation 97
with imperfect capital mobility 81–94
model equations 82–4, 94–5, 100
model solution 84–5, 101–2
optimal policy responses 95–6
optimal settings 95
with perfect capital mobility 94–8
see also Mundell-Fleming model
Federal Reserve
money market strategy, incomplete nature 29
Open Market Desk 43
policy shift (1979) 3
short-term rates, changes in 36
speed limit policy 217
financial market variables, as information variables see market variables as
Fischer, Stanley
on central banks 129
one-period contracts 71–2
on time inconsistencies 104
two-period contracts 73–4
fixed price model, simple 11
foreign interest rate shocks 90–91
foreign output (yf) shock 89
foreign price shocks 92
forward-looking (“New Keynesian”)
Phillips Curve 5, 136
and backward-looking models 299–301
closed economy 163–92
concept/definition 144
Natural Rate Hypothesis 158–9
“New Keynesian” nature 163
open economy 241–72
policymaker’s objectives 164, 165–6, 241–3
price setting 147–8
quadratic price adjustment cost model (Rotemberg) 151
real marginal cost and output gap 148
simple model 164
staggered nominal wage contracts 154
see also Phillips Curve
Frankel, Jeffrey 9, 10, 97
Friedman, Benjamin 4, 30, 50
on intermediate targets 37, 39
and Tinbergen 31
trigger strategy 111–12
Friedman, Milton 123, 125
Froyen, Richard 9, 57, 97
Fuhrer, Jeffrey 157, 161, 162, 301
full-information output
alternative loss function 75, 76
minimizing variance of output around 92–3
Gali, Jordi 137–8, 165, 235, 243
game theory, and Nash equilibrium 107
Gertler, Mark 138, 165, 235, 243
Giannoni, Marc P. 27
Gordon, David B. 105, 108, 109
and conservative central banker 180
modified model see modified Barro and Gordon model
multi-period model see multi-period model (Barro and Gordon)
one-period model see one-period model (Barro and Gordon)
reputational equilibria 111
Gramlich, Edward 217
Greenspan, Alan 3
Guender, Alfred 97, 297
Guttentag, J. M. 29, 31
Hansen, Lars P. 27
heuristic argument 10
HNIT (hybrid nominal income targeting strategy) 180–81, 285–6
Holden, Steinar 161, 162
hybrid nominal income target 180–81
backward-looking Phillips Curve 285–6
imperfect capital mobility
Mundell-Fleming model 80–81
extended 81–94
open-economy model with 87
summary of results 93–4
imperfect information, and sticky information framework 154
indicator variables see information variables
inflation
absence of perfect information 165
average targeting 222–33
bias 117, 119, 120
current rate of 144, 149, 157
direct effects 248
disinflation, failure to explain 108–9
and dismissal of workers 126
flexible rates, and sticky prices 164
future 141, 144, 149, 151, 195
“long-run” 294, 295
and output gap 161
and price levels see price levels vs inflation targets
and real output variability 209–14
strict targets 181, 258, 281–2
surprise 106
underlying/core rate 295
unexpected disturbances to rate 164
variability in rate of 205, 210, 211
zero 106, 110, 112, 117
information sets
lagged feedback rules 70–71
open economy policies 85–6
targeting rules vs instrument rules 187–9
and variables 47–8
Index

information variables
  current observability, concept 43–5
definition 30
  financial market variables as 42–6
information set 47–8
  informed policy setting, deriving 48–9
interpretation 49–50
model 46–7
money supply used as 41
and optimal monetary policy 46–50
  Poole’s combination policies, and information variable approach 45–6, 50
insider-outsider models 108
instrument
  interest rate as 56–8
meaning 11
money supply as 55–6
  problem of, with variable price level 55–61
  see also target vs instrument rules
interest rates
  vs bank reserves, as monetary policy instrument 33–6
  as endogenous variable 32, 34
  foreign interest rate shocks 90–91
  vs money supply 14–18, 58–9
nominal 11
  as policy instruments 56–8
smoothing 20
intermediate targets
  definition 30, 36
  error terms 37, 38, 39, 44
  intermediate targeting process 39–41
money supply, as intermediate target
  variable 36–42
role of money as intermediate target,
  model with 37–9
intertemporal loss function 110, 114, 139, 141
IS shocks
  alternative loss function 75
  imperfect capital mobility 80, 93
  instrument problem, variable price level 59–61
interest rate vs money supply 14–16, 18
  loss functions, comparison 35
perfect capital mobility 79–80
  positive 60, 69, 88, 172
prospective monetary policy 68
IS-LM model (basic model) 7–9
  aggregate supply function 8
  and Brainard’s model 22
  and information variable approach 45
IS shocks see IS shocks
limitations 8, 28
LM shocks see LM shocks
and optimal monetary policy 30
and Phillips Curve 164
and slippage 36
standard IS schedule 9
stochastic version 11

Jensen, Henrik 232
Kalman filter 48
Kalman gain matrix 49
Keynesian economists 117
  and new classical economists 63, 76
  see also new Keynesian monetary policy models
Keynesian IS-LM model see IS-LM model (basic model)
Kydland, Finn E. 4, 5, 104, 108
labor contracts, lagged feedback rules 71–5
  Fischer’s model 71–4
  one-period contracts 54, 71–2
  rationale for monetary policy effectiveness 74–5
two-period contracts 73–4
  see also staggered nominal wage model
lagged feedback rules 63–71
  alternative specifications 66–71
  information sets 70–71
  with multiperiod labor contracts 71–5
  predetermined expectations 64–5
  prospective monetary policy 66–8
  examples 69–70
LeRoy, Stephen F. 43, 46, 48, 63
LM shocks
  alternative loss function 75
  imperfect capital mobility 80, 93
instrument problem, variable price level 59–61
interest rate vs money supply 16–17, 18
loss functions, comparison 35
open economy policies 89–90
perfect capital mobility 98
prospective monetary policy 68
Lohmann, Suzanne 118, 119, 121
“long-run” inflation 294, 295
loss functions
alternative 75
comparison 35–6
expected 140
intertemporal 110, 114, 139, 141
multi-period model (Barro and Gordon) 109
one-period model (Barro and Gordon), problems 108
open economy policies 85
and optimal policy 202, 203
period 138, 140
Lucas, Robert 154, 157
M2 growth 29
Mankiw, Gregory M. 5, 145, 154–6
Matheson, Troy 297
McCallum, Bennett T.
and backward-looking Phillips Curve 274
on central banks 165
minimum state variable approach 56
Natural Rate Hypothesis 157
optimal monetary policy 200, 201
optimal policy rules, robustness 27
P-bar model 161
on target rules 182, 186
MCI (monetary conditions index) 50, 275, 290, 294
potential problems 296–9
minimum state variable approach 56
Miron, J. A. 129
modified Barro and Gordon model policy under discretion 116–17
policy with precommitment 117–18
state contingent rule 118, 120
monetarists 27, 50
monetary aggregates, as information variables see information variables
monetary conditions index (MCI) see MCI (monetary conditions index)
monetary dampener 35, 61
monetary policy
as aggregate demand policy 63
credibility see monetary policy credibility
institutional setting, as principal-agent problem 124
new Keynesian models 70–71
optimal see optimal monetary policy
prospective 66–8
rationale for effectiveness 74–5
reaction functions 120
strategy see monetary policy strategy
monetary policy credibility 104–31
central banker, appointment with escape clause 119–23
as solution to time inconsistency problem 118–19
central banking institutions 128–30
credibility-sterilization trade-off 127–8
modified Barro and Gordon model 115–18
multi-period model (Barro and Gordon) 109–15
one-period model (Barro and Gordon) 105–9
performance contracts (central bankers) 123–8
monetary policy strategy 29–52
backward-looking Phillips Curve 280–87
complete, example 30
efficient 180–81, 280–87
financial market variables, as information variables 42–6
interest rate vs bank reserves 33–6
intermediate targets 36–42
targets and instruments framework 31–2
monetary policy surprises 65
money demand equations 32
money supply equations 32
information content 41–2
as intermediate target variable 36–42
and New Keynesian economics 189
Index

as policy instrument 55–6
vs interest rates 14–18, 58–9
monopolies
  quadratic price adjustment cost model (Rotemberg) 150
  staggered nominal wage contracts 153
Moore, G. 161, 162
multi-period model (Barro and Gordon) 109–15
  best supportable rule 112–14
  enforcement 111
  policy under discretion and rules 110
  reputational equilibria 111–14 problems 114–15
  supply shocks 109–10
  temptation 111
  trigger strategy 111–12
  zero inflation rule 112
multiplier coefficient, and additive error term 25
multiplier uncertainty 22
Mundell-Fleming model
  combination monetary policies in 81 extended
    with imperfect capital mobility 81–94
    with perfect capital mobility 94–8
    imperfect capital mobility 80–94
    perfect capital mobility 78–80, 94–8
  see also open economy policies
Muth, John F. 9
Nash equilibrium 107, 110, 113, 115
Natural Rate Hypothesis 145, 156–61
Nelson, Edward 165, 200, 201
new classical policy ineffectiveness proposition 63
New Keynesian economics
  information sets 70–71
  on money supply 189
  optimal monetary policy 51
  stochastic price adjustment model (Calvo) 146
  target vs instrument rules 190
  see also Phillips Curve, “New Keynesian”
New Zealand
  Bank Act 1989 126
  Reserve Bank 128
Neyapti, Bilin 129
Nolan, Charles 128
one-period labor contracts 54, 71–2
one-period model (Barro and Gordon) 105–9
criticisms
  disinflation, failure to explain 108–9
  loss function 108
  reputational considerations 109
  policy under a rule 106–7
  policy under discretion 106
  time inconsistency problem 107
open economy policies 78–103
  backward-looking Phillips Curve 290–96
  discretion 253–4
  forward-looking Phillips Curve 241–72
  imperfect capital mobility 80–81, 87
  information sets 85–6
  loss function 85
  Mundell-Fleming model see extended Mundell-Fleming model; Mundell-Fleming model
  optimal policy settings 86–92
  policymakers’ goals and information sets 85–6
  see also closed-economy models
Open Market Desk, Federal Reserve Bank (New York) 43, 217
optimal instrument, choice 11–14
deterministic setting 12–13
stochastic terms 13–14
optimal monetary policy
  backward-looking Phillips Curve 276–80
  commitment, under 166–75, 243–53
timeless perspective 193–204
cost-push shock see cost-push shock and information variables 46–50
and IS-LM model (basic model) 30
New Keynesian approach 51
objective function and optimal policy rule 194–8
optimal instrument, choice 11–14
robustness of optimal policy rules 26–7
serially correlated disturbances 250–53
policy setting, informed 48–9
information variables 46
and uninformed policy setting 38, 47
policy setting, informed and
uninformed 46
policymaker’s preferences 9–11, 137–43
heuristic argument 10
Poole, William 3, 5
combination policies 45–6, 50
and foreign interest rate shocks 91
IS-LM model, stochastic version 3,
7, 11, 22, 28
and Mundell-Fleming model 79
extended 81
and uncertainty 17
Posen, Adam S. 129
precommitment, policy with 117–18
predetermined expectations
lagged feedback rules 64–5
Prescott, Edward C. 4, 5, 104, 108
price levels, vs inflation targets 204–17
conservative central banker, role
214–17
flexible targets
inflation targets 208–9
price levels 205–8
tradeoff between inflation and real
output variability 209–14
policymaker’s objective function,
and optimal policy under
discretion 205–9
price setting, forward-looking 147–8
price stability goal 106
price stickiness
flexible inflation rates 164
and stochastic price adjustment
model (Calvo) 145, 146, 147
see also sticky information model
(Mankiw and Reis)
principal-agent model 124
pure policies 12
and combination policies 18
and Mundell-Fleming model,
extended 81
quadratic price adjustment cost model
(Rotemberg) 145, 150–51
and staggered nominal wage model
154
and sticky information model 154

Richard T. Froyen and Alfred V. Guender - 9781847208644
Downloaded from Elgar Online at 01/28/2019 12:15:39PM
via free access
Index

rational expectations concept 4
Reis, Ricardo 5, 145, 154–6
reputational equilibria 111–14
problems 114–15
reserves, as monetary policy instrument 34–5
risk-management paradigm 3
Rogoff, Kenneth 5, 118, 119, 205
Romer, David H. 129
Rotemberg, Julio 5, 137, 145, 150–51, 154

Sargent, Thomas J. 27, 65
separation principle 51
short-run operating target 11, 30
simple commitment 166
optimal policy under 197–8
variances of inflation rate and output gap 170
SIT (strict inflation targeting regime) 281
see also inflation: strict targets
slippage, in monetary control 35, 36
Söderström, Ulf 26, 232
speed limit policy 217–22
backward-looking Phillips Curve 274
stabilization bias
and conservative central banker
closed economy 179–80
open economy 254–6
discretion 118, 177, 179
staggered nominal wage contracts 145, 152–4
staggered nominal wage model 145
state contingent rule 118, 120
sterilization parameters 83, 84
sticky information model (Mankiw and Reis) 154–6
Natural Rate Hypothesis 159–60
sticky prices see price stickiness
Stiglitz, Joseph 150
stochastic price adjustment model (Calvo) 145–9
aggregate price level 146
forward-looking price setting 147–8
and quadratic price adjustment cost model 151
real marginal cost and output gap 148–9
and staggered nominal wage contracts 154
and sticky information model 154
stochastic terms
choice of optimal instrument 13–14
Summers, Lawrence S. 108, 129
supply shocks 53, 61, 91–2
multi-period model (Barro and Gordon) 109–10
surprise inflation 106
Svensson, Lars 46, 165, 243, 275
target rule framework 137, 287–90
Tabellini, Guido 107, 123
target vs instrument rules
closed economy 181–9
extending instrument rule 185–7
inflation targeting with instrument rule 182–5, 258–62
information sets 187–9
New Keynesian economics 190
open economy 258–65
operationalizing 188
optimal explicit instrument rule, in open economy 262–5
targets and instruments framework 31–2
Taylor, John 5, 27, 109
staggered nominal wage contracts 145, 152–4
Taylor Rule 136
backward-looking Phillips Curve 277, 286–7, 301
temptation
best supportable rule 113
reputational equilibria 111
zero inflation 112
time inconsistency problem 104, 107
conservative central banker, appointment as solution to 118–19
degree of “conservatism” 121
with escape clause 119–23
overriding 121
modified Barro and Gordon model 117
timeless perspective 6
discretionary policymaking and 212
Index

optimal monetary policy 193–204
  discretion and simple commitment compared 198–201
  open economy 265–8
  and stabilizing of inflation rate 213
  Woodford on 194
Tinbergen, Jan 31
  tit for tat (trigger) strategy 111–12
Tobin, James/Tobin tax 99
  trial solutions 56, 57, 64
  trigger strategy 111–12
Turnovsky, Steven J. 9, 96
  two-period labor contracts
    lagged feedback rules 73–4
UIP condition 80, 94, 95, 97
  optimal monetary policy 244
UIP disturbance 79
  unconditional expectations yields 158
  undetermined coefficients method
    lagged feedback rules 64, 65
    timeless perspective 198
    variable price level, instrument problem with 56, 57
variable price model 53–5
  instrument problem 55–61
minimum state variable approach 56
  Vestin, David 209
wage contracts see labor contracts,
  lagged feedback rules; staggered
  nominal wage model
wage indexation 81, 96
  Wallace, Neil 65
  Waller, Christopher J. 5, 115, 124, 126
  Wallich, Henry 3, 28
  Walsh, Carl E. 5, 123, 124, 126, 128,
    235, 243
  speed limit policy 217
  Waud, Roger N. 43, 46, 48, 63
  Webb, Steven 129
  Weiss, Laurence 9
white noise process
  all shocks 245–50
  cost-push shock as 168–72, 196, 200,
    207
  Woglom, Geoffrey 65
  Woodford, Michael 46, 71, 137, 165
    on timeless perspective 6, 194, 204
Yates, Anthony 128
  yf shock 89
zero inflation 106, 110, 112, 117