

Embrace the Shifting Stars

Advocating Powell's Approach on Understanding Monetary Policy in Changing Economy

Yiming Zhang

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To MSCF Students

Conventional Views of Monetary Policy

Are Policymakers Navigated by the Stars?

2%

—
Inflation

5%

—
Unemployment

3%

—
Growth

Conventional Views of Monetary Policy

Are Policymakers Navigated by the Stars?

2%

—
Inflation

Desired Inflation rate π^*

5%

—
Unemployment

Natural rate of unemployment u^*

3%

—
Growth

Potential output growth r^*

Conventional Views of Monetary Policy

Are Policymakers Navigated by the Stars?

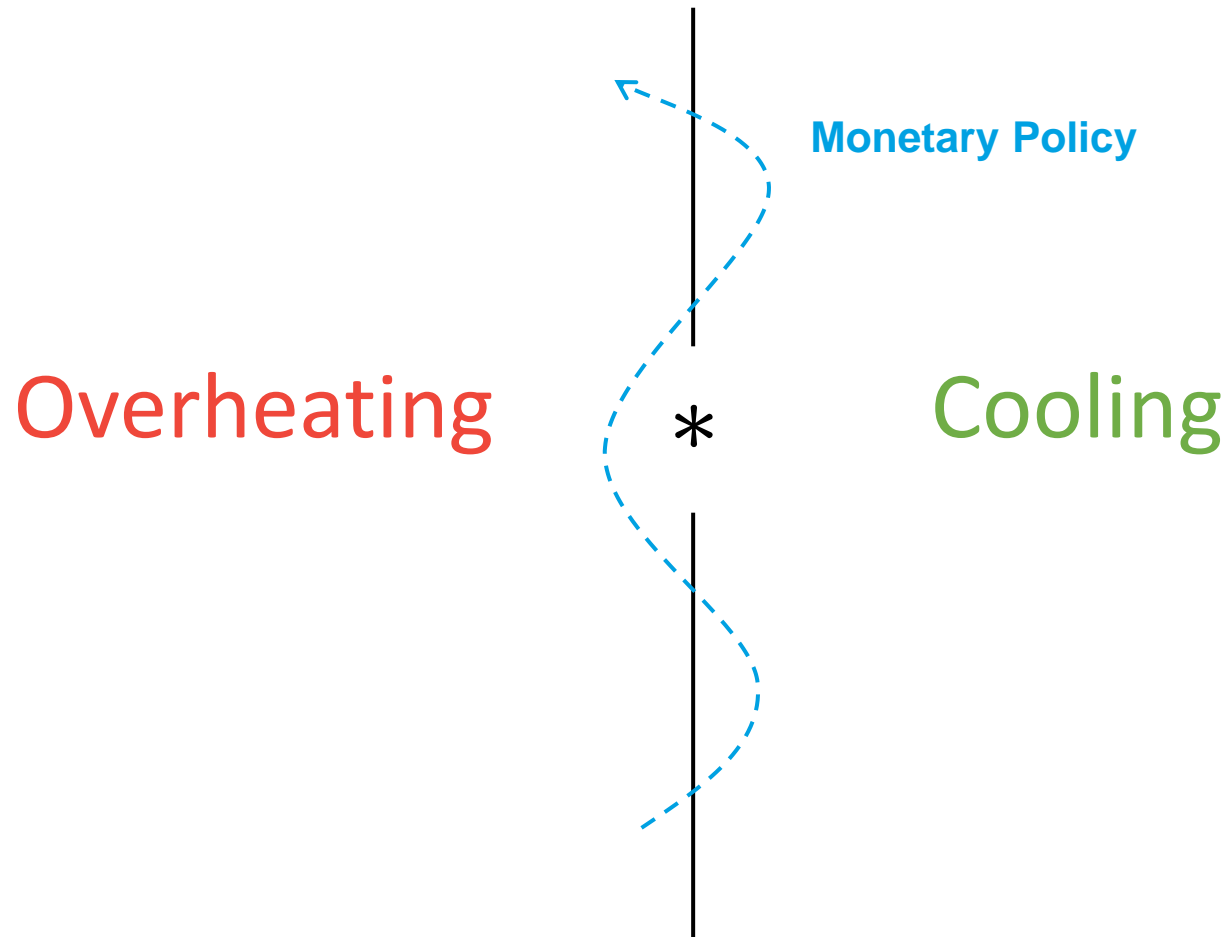
Overheating

*

Cooling

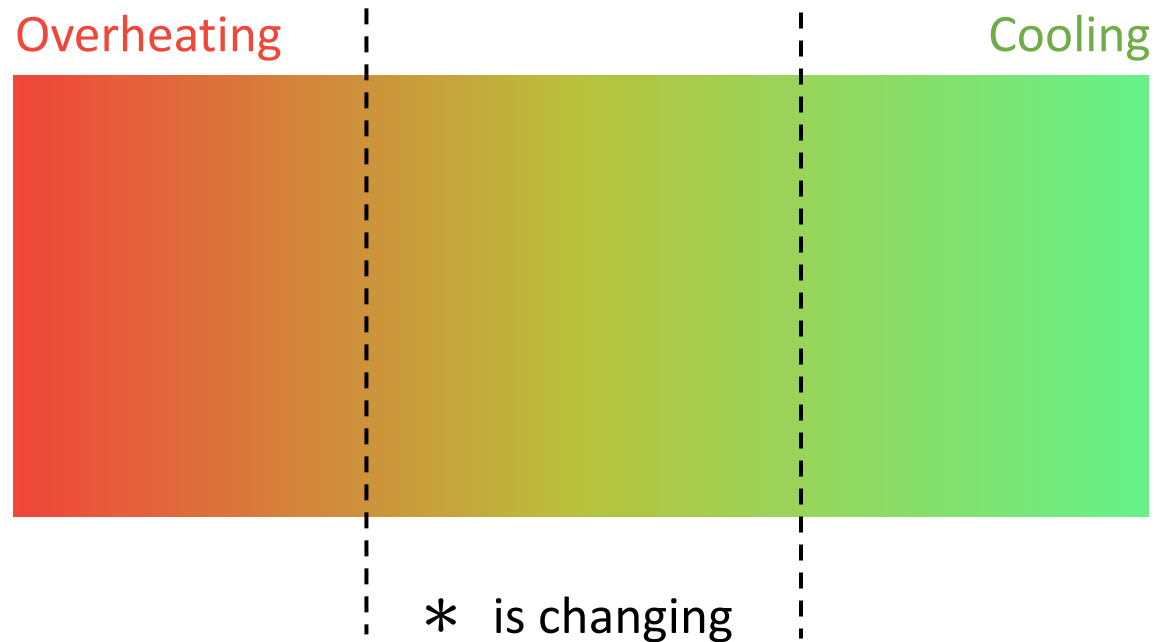
Conventional Views of Monetary Policy

Are Policymakers Navigated by the Stars?



Current View of Monetary Policy

Stars Are Shifting and Cannot Be Estimated Accurately

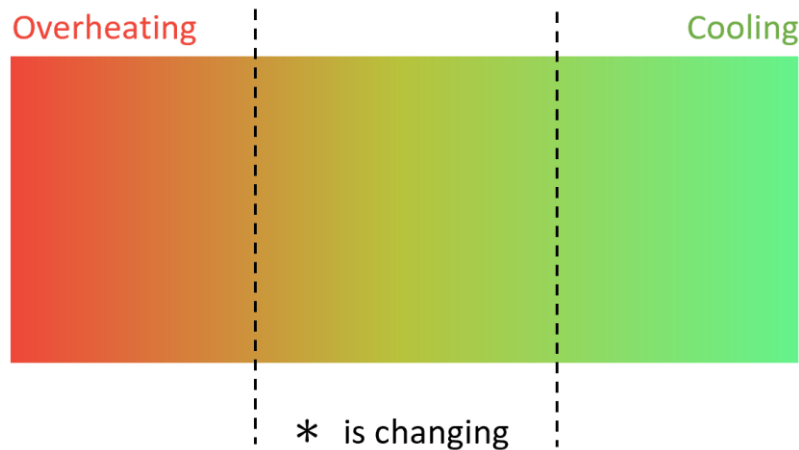


Current View of Monetary Policy

Stars Are Shifting and Cannot Be Estimated Accurately

“ ... the FOMC has been navigating **between the shoals** of overheating and premature tightening with **only a hazy view** of what seem to be shifting navigational guides.

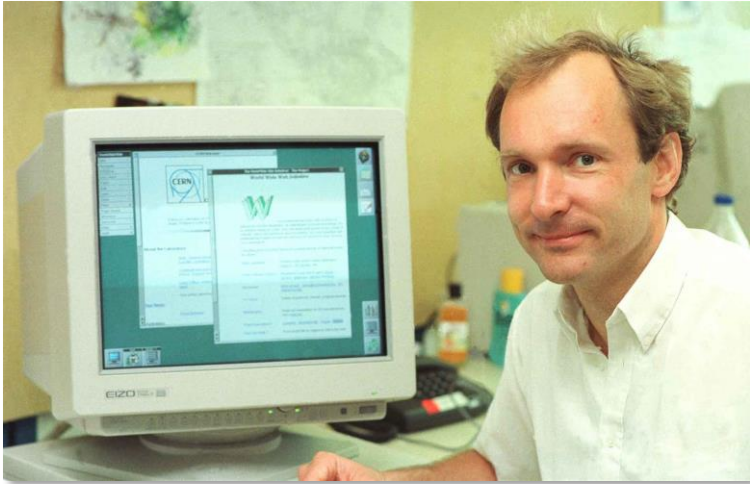
”



Case Study: “New Economy” of the Late 1990s

Contradicting Views Between Conventional and Shifting Stars

Figure: Internets and Online Services



Conventional

- Low unemployment
- High growth
- Overheating risk



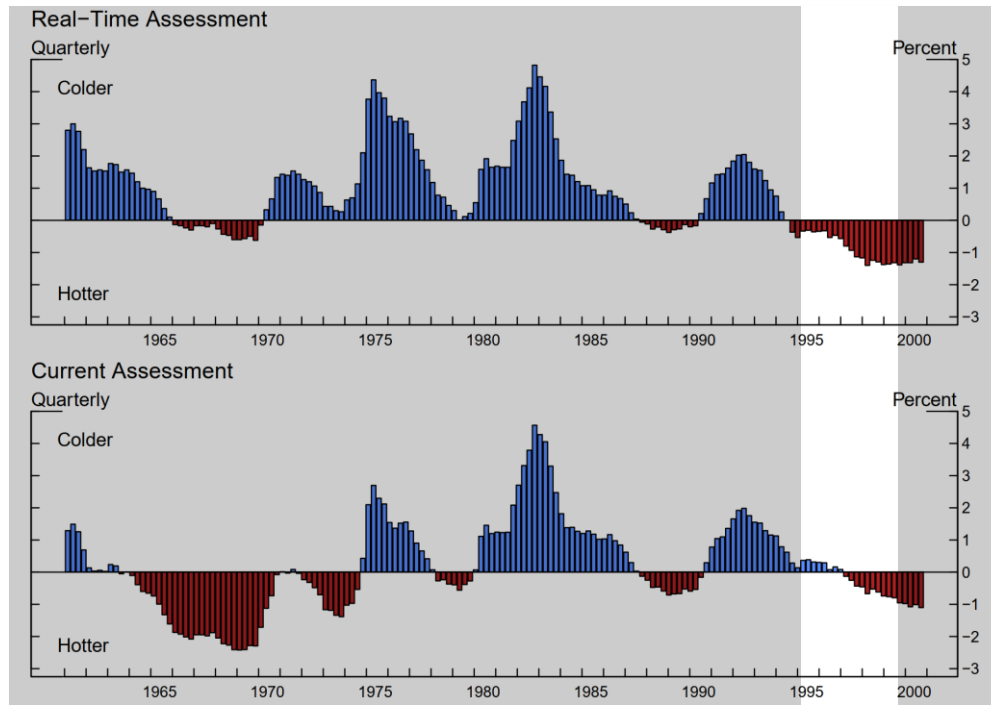
Shifting Stars

- Real-time estimates can be imprecise
- Stars are shifting as productivity changes
- Wait and see the acceleration

Case Study: “New Economy” of the Late 1990s

Real-time Assessment of stars can be imprecise

Figure: Real-Time and Current Assessment of Unemployment rates



Source: Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis, FRED)

- Real-time assessment overestimated the employment rate
- Current estimate shows adequate rate due to “New Economy”

Conclusion: Decision Matrix

Reasons for Finance Practitioners to Use Shifting Stars

Decision Criteria	Shifting Stars	Conventional View
Method Assumptions	Dynamic targets	Fixed targets
Cost	Post-estimate (cheap)	Real-time estimate (expensive)
Data Required	Same Metrics	Same Metrics
Robustness	High	Low (volatile)
Reactiveness	Slow	Quick
Quality of Output	Precise	Imprecise
Fit the current market	Yes	No

References

Blinder, Alan S., and Ricardo Reis (2005). "Understanding the Greenspan Standard," paper presented at "The Greenspan Era: Lessons for the Future," a symposium sponsored by the Federal Reserve Bank of Kansas City, held in Jackson Hole, Wyo., August 25-27,

Monetary Policy in a Changing Economy, Chairman Jerome H. Powell. At "Changing Market Structure and Implications for Monetary Policy," a symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 24, 2018

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