

# Goals and Conduct of Monetary Policy

## FIN 204 Lecture 11.2.

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## 1 What are the Goals of Monetary Policy in the US?

# The General Goals of Monetary Policy

The main goals of the FED are:

- ① encourage high employment
- ② promote economic growth
- ③ maintain price stability
- ④ stabilize interest rates and foreign exchange rates
- ⑤ prevent financial market and banking system crashes

# How Are these Goals Achieved?

## Intermediate and operating targets of the FED

The goals of the monetary policy (MP) cannot be directly achieved.

### Intermediate targets of MP

**Intermediate targets of MP:** Those factors that affect economic growth, price stability and the other main goals of MP. Examples:

- Monetary aggregates: M1, M2, M3
- Short-term interest rates

But even these are not directly controlled by the Central bank.

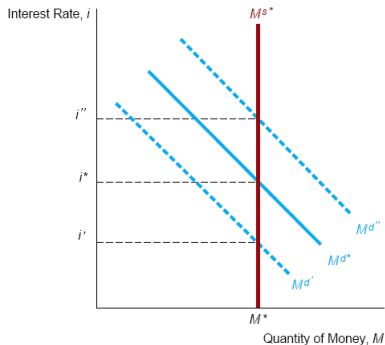
### Operating (Instrument) targets of MP

**Operating targets of MP:** Those factors that affect monetary aggregates and are directly influenced by the decisions taken at the FED. Examples:

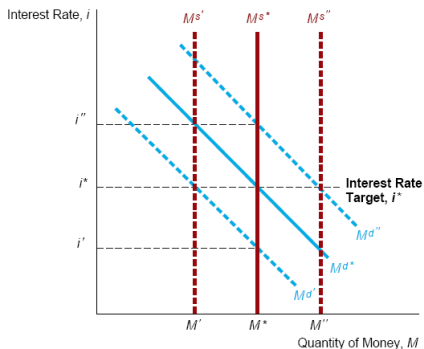
- Interbank interest rate (FED Funds Rate)
- Monetary base: currency held by individuals + bank reserves

# Conflicts Between Intermediate Targets

Choosing a monetary aggregate target

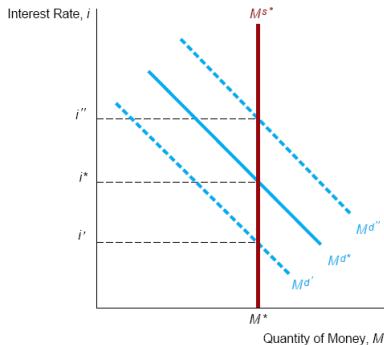


Choosing an interest rate target

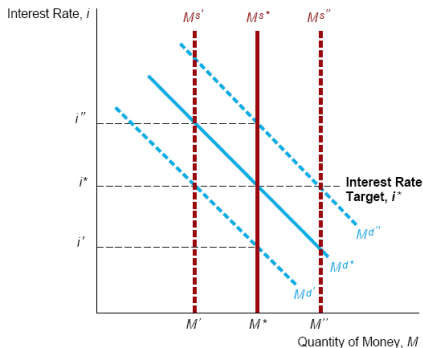


# Conflicts Between Intermediate Targets

Choosing a monetary aggregate target



Choosing an interest rate target



If the intermediate targets are in conflict, how to choose between them?

# How to Choose Between MP Targets

What defines MP *control*?

## ① Measurability

- Monetary Aggregates: subject to revisions, adjustments
- Interest rates: Nominal or real?

## ② Direct controllability

- Monetary Aggregates: discount ratio; reserve requirement
- Interest rates: open market operations. However: expected inflation is very hard to control.

## ③ Effect on the MP goals

# A Bit of US Monetary Policy History

How were the policy instruments developing over time:

- 1 1913 - 1921: Discount rate was the primary tool
- 2 Early 1920s: Open market operations accidentally discovered
- 3 By late 1920s: OMO main instrument
- 4 1933: Reserve requirement introduced
- 5 1942-1952: Interest rate pegs to finance the Government
- 6 1950s-1960s: Interest rate targeting
- 7 1970s: Targeting monetary aggregates
- 8 Since 1980s: Smoothing interbank interest (FED Funds) rates