Discussion of “Lessons for the FOMC’s Monetary Policy Strategy” by Carl Walsh

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A remarkably broad and sweeping survey of the modern literature on monetary policy

- Master class in central banking
- Drills down on models of average inflation targeting versus asymmetric average inflation targeting (embedded in the 2020 Monetary Policy Framework), as alternative policies for dealing with the lower bound on interest rates.
    - Incredibly comprehensive and concise review of literature
- Looks at practical questions involved in interpreting the Fed's dual mandate, especially when the "natural" rate of unemployment is difficult to estimate.
- Compares the 2020s with 1970s, unpacking especially the errors of the 1970s where inflation expectations were allowed to keep drifting up.

A robust critique of Fed's slow response to rising inflation in 2021-22.

- Essentially argues that most reasonable models would have called for raising interest rates much sooner than the Fed actually did.
  - Taylor rule, however, quite sensitive to choice of equilibrium rate interest rate, which is in fact an extremely volatile variable.
- Looks at the rationales for the slow response and finds them wanting
- Considers whether the Fed's forward guidance policy unnecessarily tied its hands.
- Analyzes the literature on the consequences of the delay
- Asks whether the Fed made a wise gamble when it decided to assume the inflation surge was transitory
- Eviscerating about expanding the objective to incorporate inclusive expansions

Highlighting some of the conclusions

- When policy gets behind the curve, it needs to move faster
- Forward guidance is not useful if the Fed is the only one that listens to it.
- Avoid mission creep
- Policy framework must be robust, conditions can change very quickly.
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- (Are we really so sure that making the needed institutional and tax changes to allow for effective – and potentially deep -- negative rate policy would not be preferable to all the cartwheels that have been made to deal with the perceived zero interest lower bound?)

Central bank independence is elephant in the room

- Walsh’s paper reminds us that political pressures on central banks may have been in remission but it is a big mistake to think they have gone away.
  - Monetary policy not akin to setting a thermostat: an irreducible political economy element
  - And political economy pressures have come back big time the past decade
  - Policies such as average inflation targeting fail because they neglect political economy
- Optimal monetary framework must be robust to political pressures.
- Deglobalization leads to pressures on central bank independence
  - (Rogoff, 2003 and Afrouzi, et. al., 2024)
- Rogoff (1985) suggests that instituting an independent central bank is most reliable and effective long-run solution to achieving low and stable inflation.
  - Introduces inflation targeting based on incentives
  - Most robust institutional design is to have “conservative” central bankers who have a strong commitment to stable inflation