

Discussion of 'The Federal Reserve In a Globalized World Economy'

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Some Big questions in international monetary economics

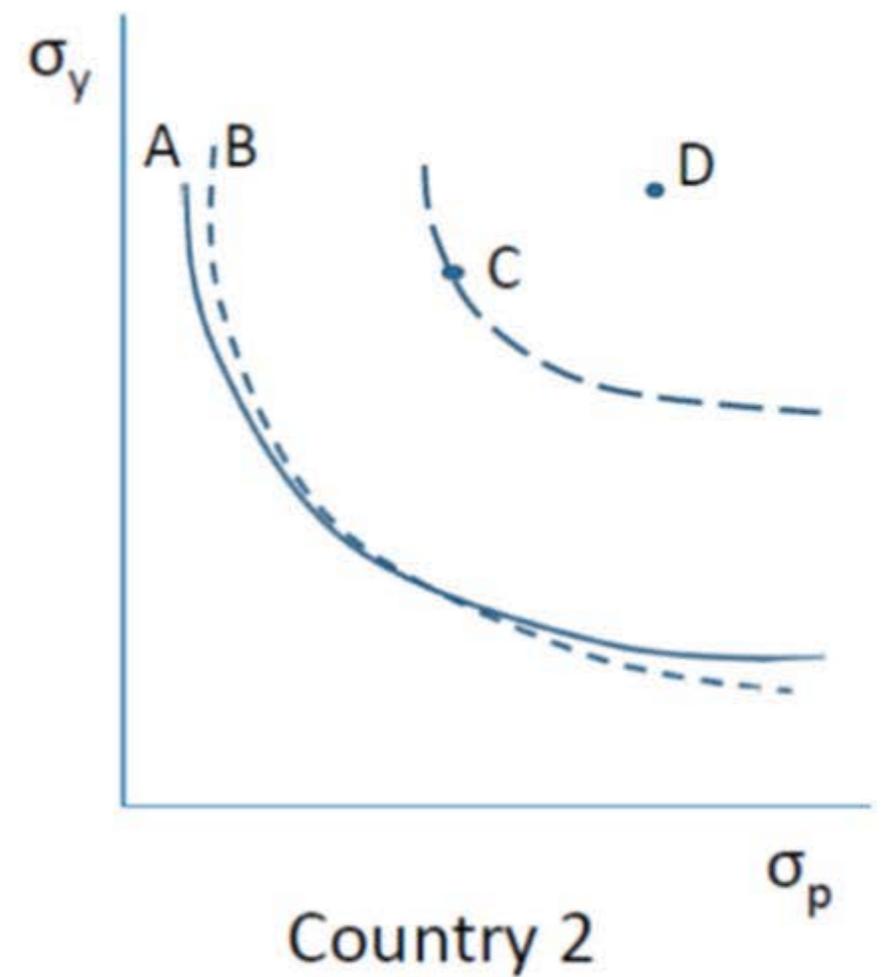
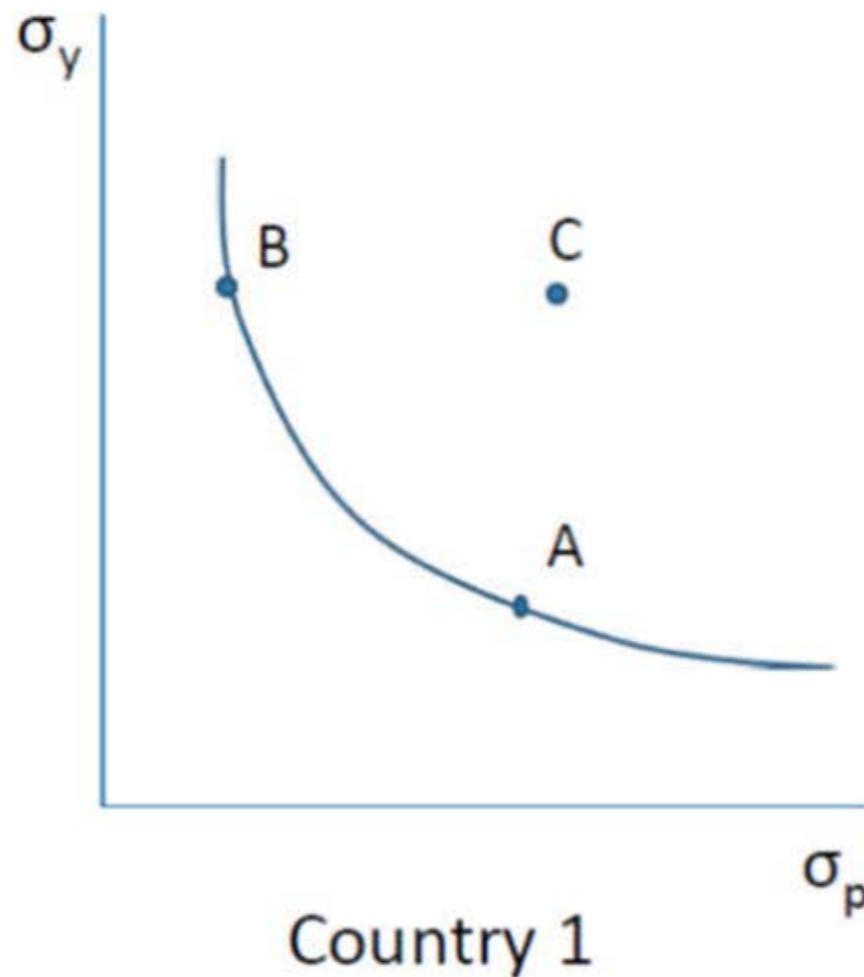
- Are gains to monetary policy coordination important?
- Should we worry about 'beggar thy neighbor' bad outcomes in absence of coordination?
- Are exchange rates 'different' from other asset prices and worthy of targeting?

Optimal Non Cooperative Monetary Policy in Open Economy Dsge Models with Inflation Targeting

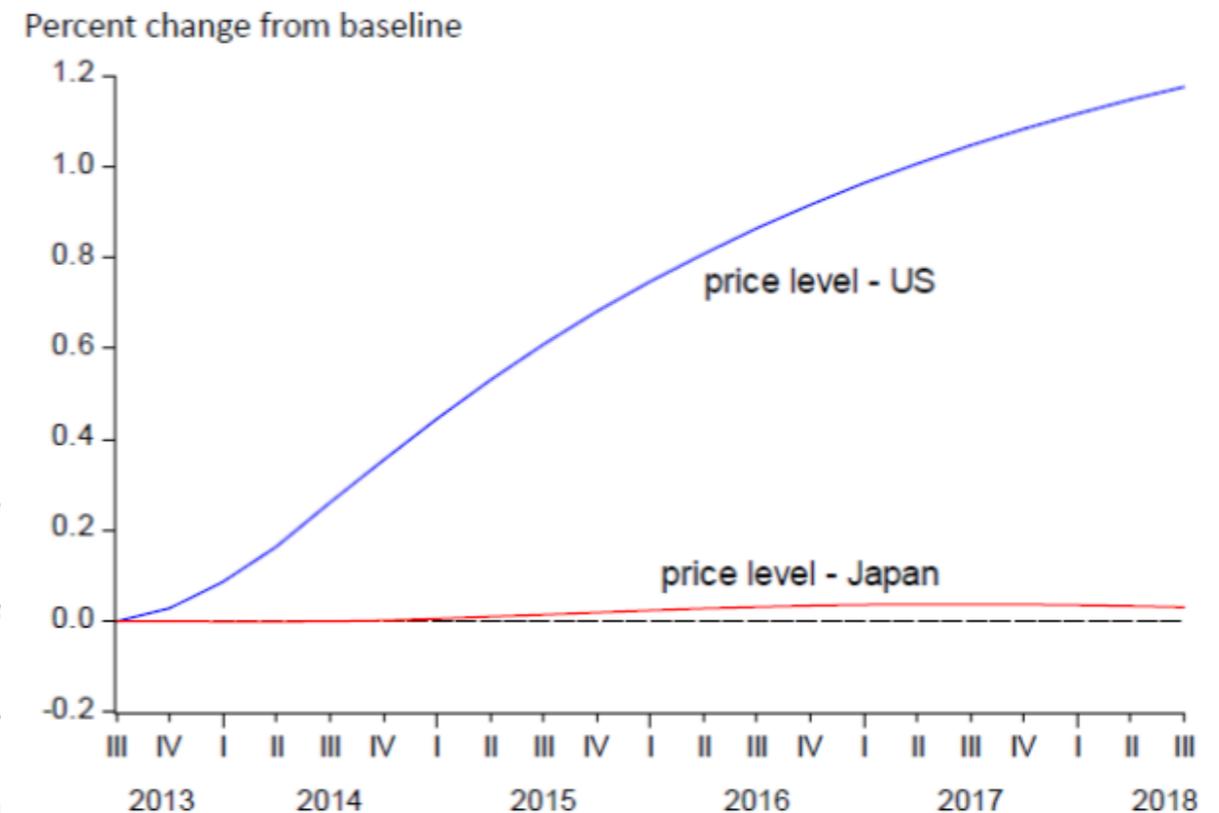
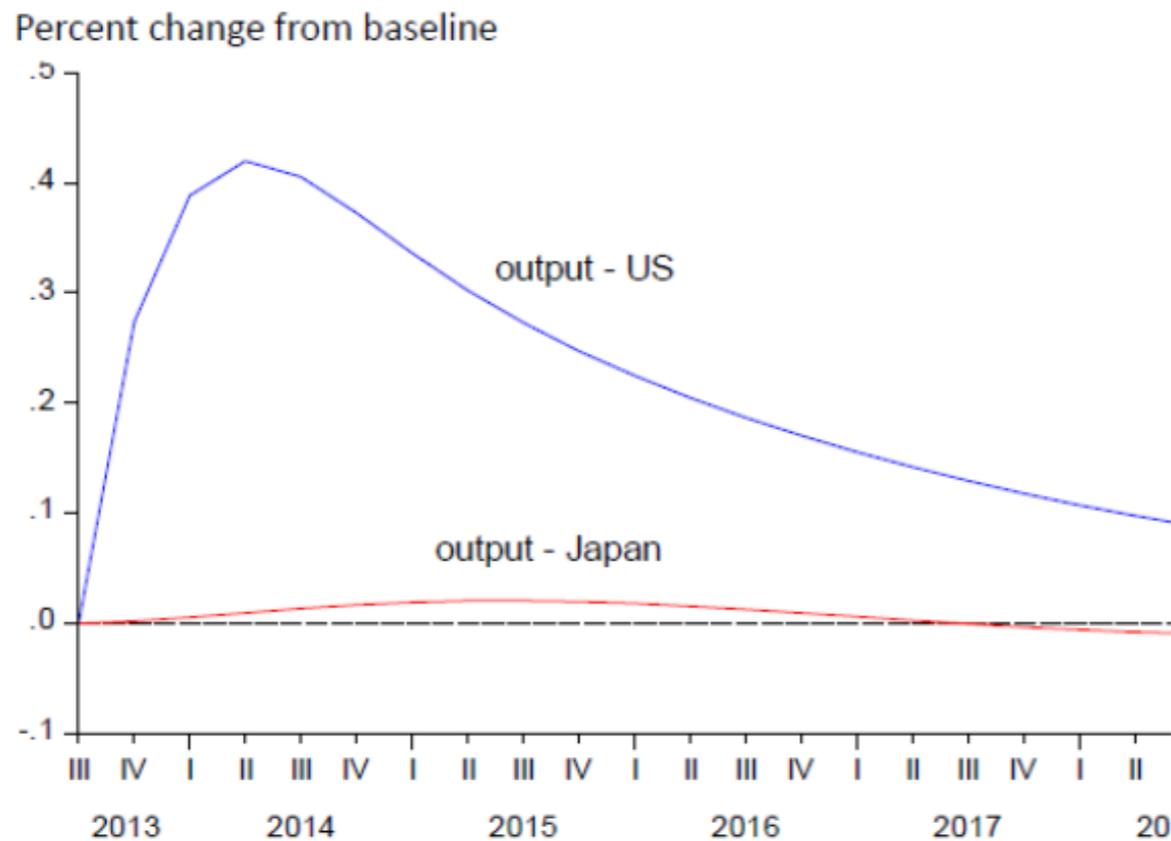
- Flexible Exchange Rate
- An 'asset price' with a Unit Root
- Co integrated with National Price Levels
- Implemented with a Taylor Type Rule
- Bad news Good exchange rate news to inflation shocks

Naughty or 'Nice'?

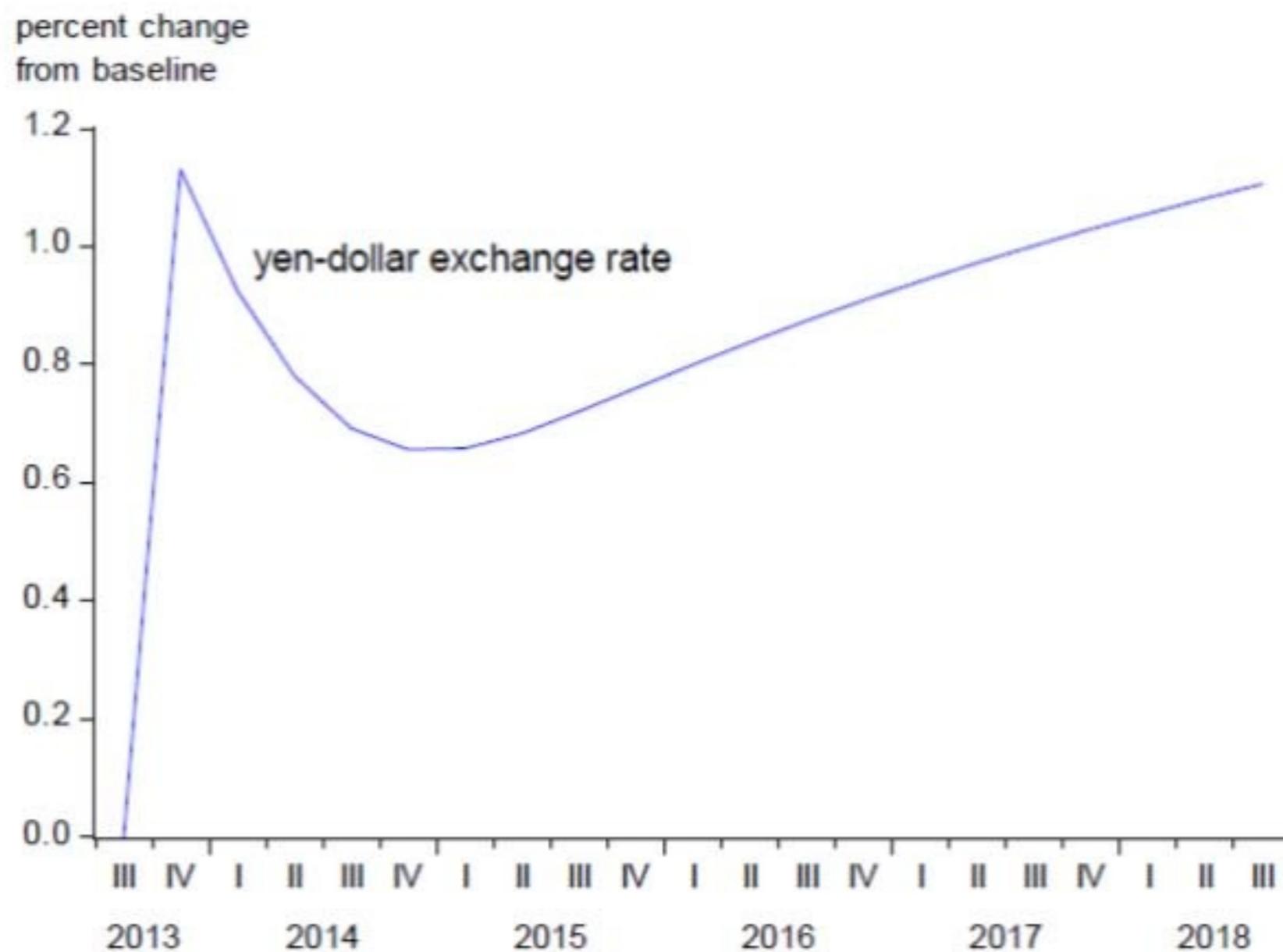
- Simulations find modest gains to policy coordination
- But this is because they are usually simulated with good policies
- If country 1 runs a bad policy C it worsens the policy frontier for country 2 a lot
- Creates huge gains to cooperateto run non cooperative optimal policy!



Policy Mistake in US: Funds Rate too low for too long has very modest effect on foreign output



But Big effect on Nominal and Real Exchange Rate. Dornbusch overshooting from Taylor rule mistakes!



Beggar's Banquet? Negative EM output spillovers from US Taylor rule mistakes: funds rate too on for too long reduces EM output!

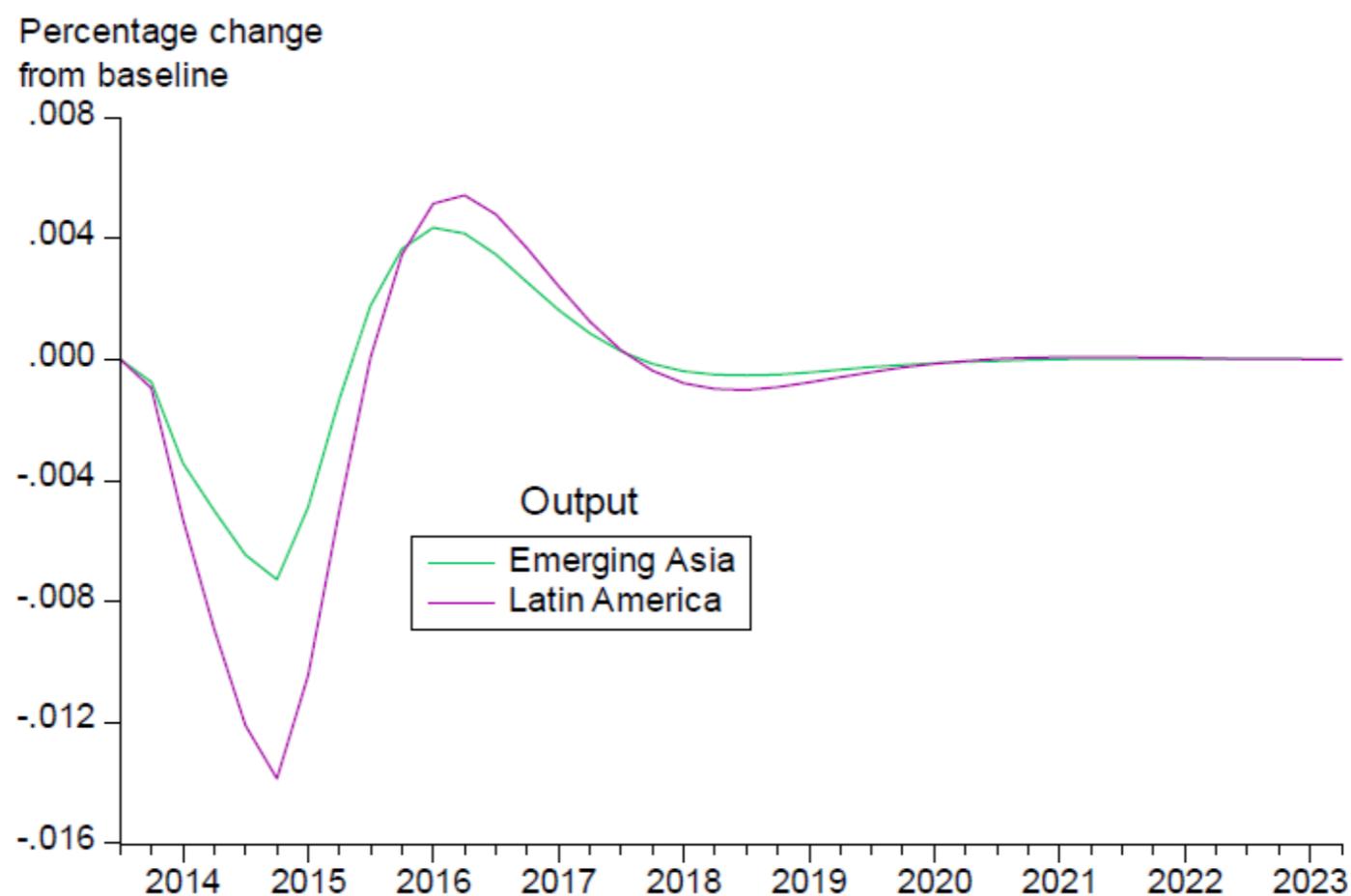


Figure 4: Exchange Rate and Output-Price Effect of a US Policy Rule Deviation Impact on the exchange rate and output and prices, according to GPM6, of a temporary negative shock to US interest rate rule of 0.2 percentage points.

Race to the Bottom: Policy mistake at home begets policy mistake abroad

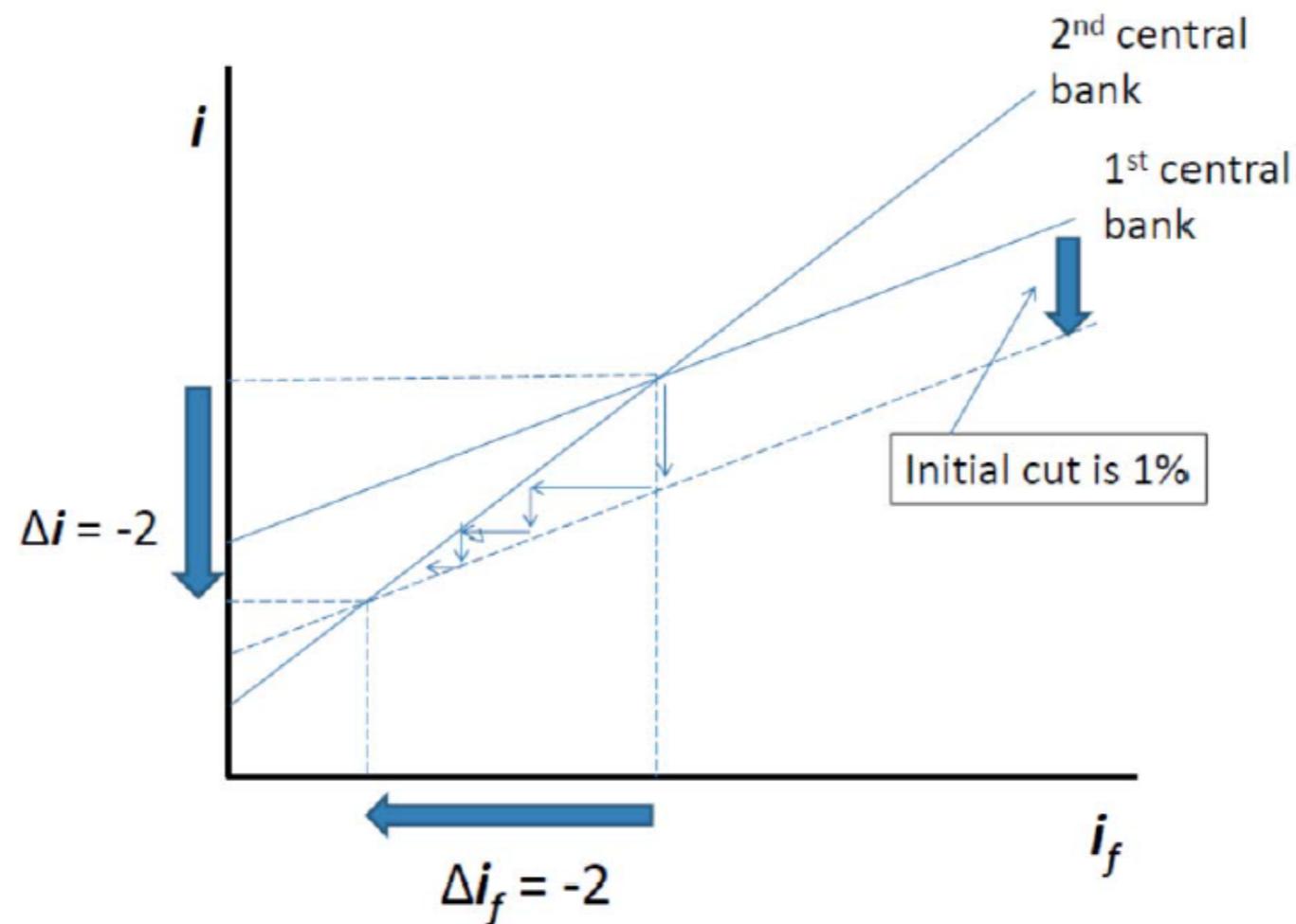


Figure 5: The Policy Deviations Multiplier: Each central bank matches, at least in part, the interest rate change at the other central bank. This creates a multiplier effect in which final interest rate change is much larger than the initial change.

Plausible? Yes and fully consistent with Cgg (1998)

$$R_{\text{ger}} = \text{constant} + 1.25(\pi - \pi^*) + .25(\text{gap}) + .07(\text{fed funds})$$

$$R_{\text{jap}} = \text{constant} + 1.80(\pi - \pi^*) + .10(\text{gap}) + .09(\text{fed funds})$$

What to make of the Taylor Critique?

- Logic impeccable - in a global economy, if a big country makes a big policy mistake there will be big gains to cooperation
- And cooperation is easy to implement - just don't make the policy mistake and revert to non cooperative optimal !
- But what if big country doesn't revert - think Eurozone and Switzerland in 2011
- Surge in EurCHF from flight to safety pushed inflation below target to zero. With policy rate constrained by zero bound Snb announced and has defended ever since a Svensson full proof floor at 1.20. Size of Snb balance sheet endogenous - whatever it takes to defend the floor.
- Other post crisis examples less clear cut at least to me. But on two points we all can agree.....
- This is a great paper ...and.....

QE begets QE!