Revisiting Monetary Policy in a Low Inflation *and Low Utilization* Environment

Alan S. Blinder
Princeton University

FRB Boston Conference
October 16, 2010

Bagehot and recent history

- "Lend freely, at a penalty rate, against good collateral."

↓ ↓ ↓

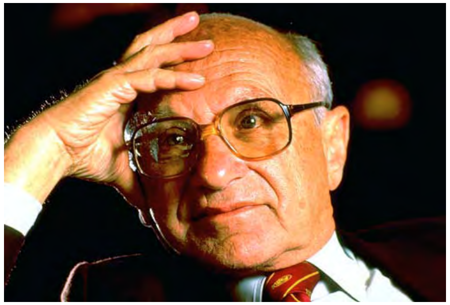
Most CBs did ↓ ↓

Well, not much. ↓

Well, it varied.

- For the ECB, Bagehot+ was just about enough (until Greece).
- But the Fed, BoE, and now BoJ felt compelled to do more.
- Why? In Fed's case, the ZLB led to a perceived need for unconventional monetary policy.
  - ECB never hit the ZLB; neither did the BoE, but it came close.

Friedman and recent history



- "Don't peg the nominal interest rate."
- Why not? $r = i - \pi$
- Friedman was thinking mainly about *upward* instability when π is rising and r is falling.
- But the argument is symmetric: When i is stuck at zero, and π is *falling*, r is *rising*.
- The ZLB is what leads to unconventional monetary policy.

Four conclusions

1. (obvious) In an environment of *low inflation*, we need to worry much more about the ZLB.
2. (less obvious, but should be obvious) If that environment also has *low utilization*, we may need a large dose of expansionary monetary policy.
   - Especially if fiscal policy is paralyzed, e.g., by large budget deficits.
3. (deduction) Given our starting point, unconventional monetary policy will be more important than in the past.
   - So the recent episode may be less aberrant than it appears.
4. Maybe we should devise more safeguards against bumping up against the ZLB.

Types of unconventional monetary policy

- Commitment via words
- A higher π^*
- Lower the interest rate on reserves (no ZLB here)
- Quantitative easing

a) Treasuries (work on term premia)

b) Private-sector assets (work on risk premia)

- Supervisory forbearance (*if* CB is a supervisor)

Question for research/thinking

Which of these is best,
under what circumstances?