

Realities of Making Policy

I. Lags

Often ignored but of *great* practical importance

A. “Inside” lags

1. Information lag
2. Recognition lag
3. Decision lag
4. Action lag

B. “Outside” lag

1. The transmission mechanism
2. The state of the economy

II. Three important questions

- A. Where are we now?
- B. Where do we want to go?
- C. What should we do to get from here to there?

III. Where are we now?

When do economic data become available?

- A. Financial data
- B. Labor market data
- C. Output data
 1. GDP

2. Other indicators

- a. Inventories
- b. New orders
- c. Housing starts
- d. Stock market

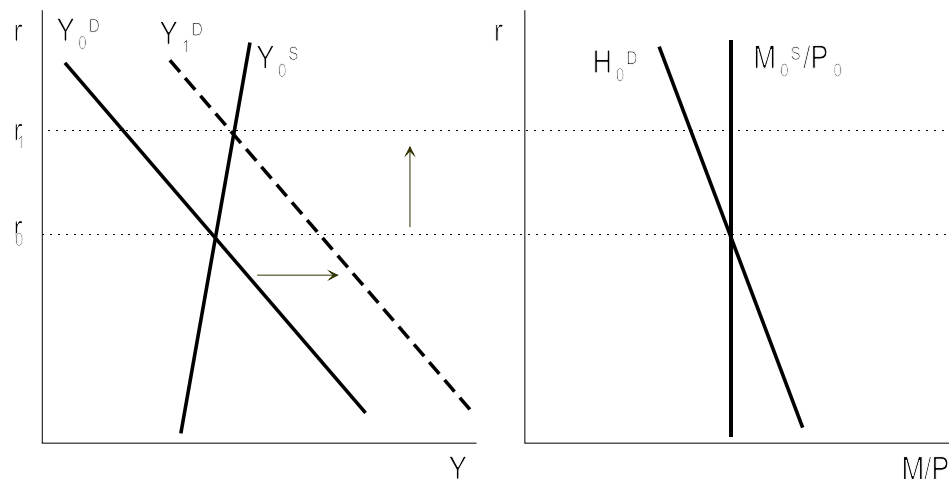
IV. Where do we want to go?

A. What is the “right” place for the economy to be?

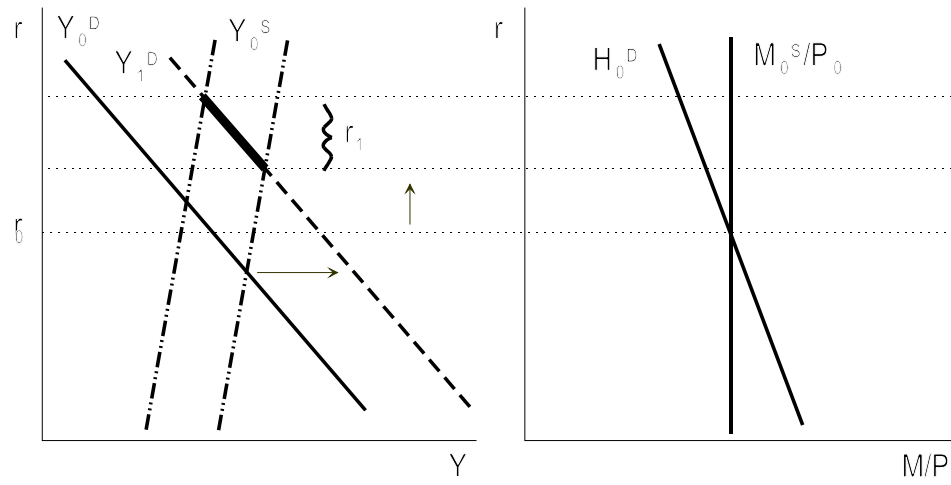
B. Uncertainties

1. Intercepts

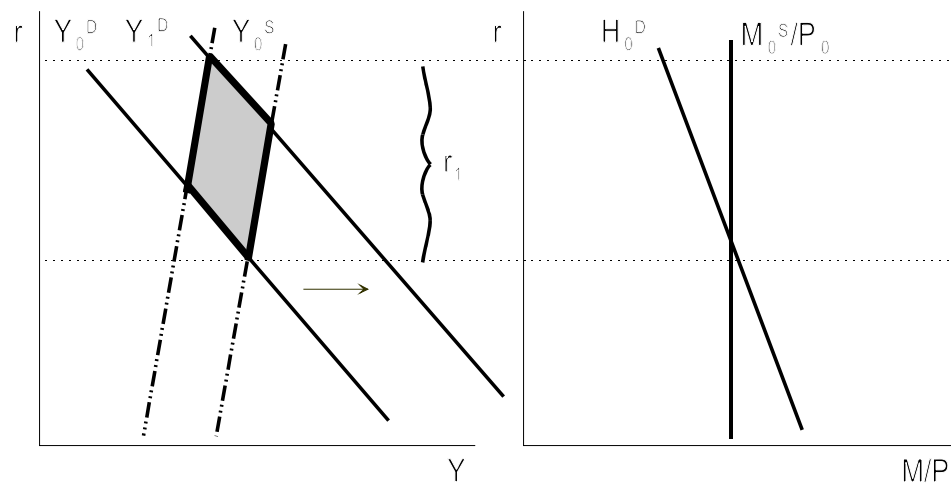
a. With no uncertainty



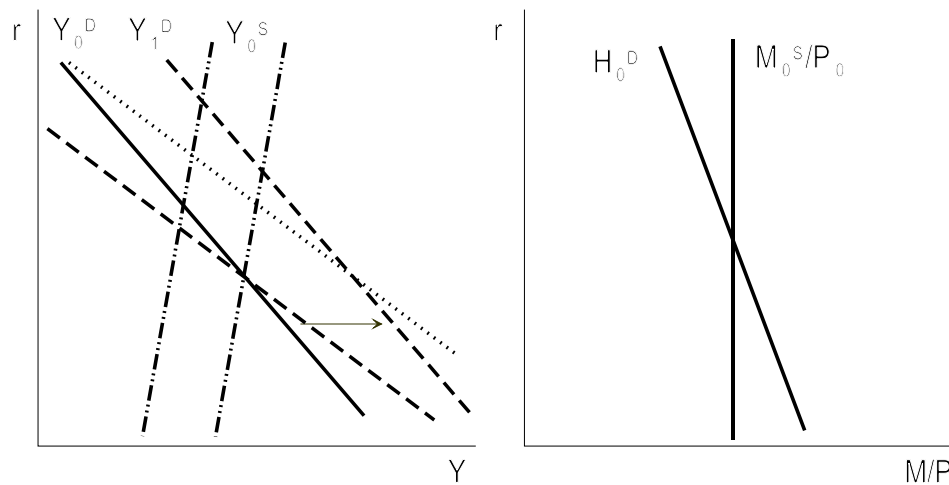
b. Uncertainty about position of Y^S



c. Uncertainty about positions of both Y^S and Y^D



2. Slopes: Y^D curve



V. What should we do to get from here to there?

A. Can monetary policy do what we want it to do?

1. Long run

2. Short run

B. Can policy work in a timely way?

1. Inside lag - very short for monetary policy

2. Outside lag - very long for monetary policy

VI. Reasonable goals for making policy

A. Counter-cyclical policy

Limited but possible

B. Long-run behavior of the economy

1. Real activity

2. Inflation