International Monetary Policy Coordination: Past, Present and Future

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Overview

• **Present**: Many complaints about cross-border monetary policy spillovers
  – calls for international monetary policy coordination
• **Past**: Contrasts sharply with 1980s, 1990s and until recently, which was...
  – Near an Internationally Cooperative Equilibrium (NICE)
    • Much as theory predicted
  – Non-Inflationary Consistently Expansionary (NICE)
    • a NICE system for a NICE time
• **Future?**
Monetary policy deviations at some central banks led to policy deviations abroad

• Examples

• Global Great Deviation
  – Hoffmann & Bogdanova (2012)
Housing Investment versus Deviations from Policy Rule in Europe During 2001-6

Source: OECD
Two projections based on the meaning of "substantial labor market improvement"
Explanation #2

No policy deviations; policies are good.

– Not beggar-thy-neighbor
– Complaints are part of a move to easier policies
– Don’t worry so much about interest rate differentials or capital flows and controls.
Simple Monetary Theory of NICE

• perfect capital mobility
• a flexible exchange rate
• staggered wage setting
• domestic prices affected by
  • domestic wages
  • price of foreign goods
• output influenced by
  • the real interest rate
  • the real exchange rate
  • foreign demand for exports
• demand for real money balances determined by
  • real income
  • nominal interest rate
• Simple rule for monetary policy in each country:
  • policy rate responds to aggregate prices
Country 1

\[ \sigma_y \]

Country 2

\[ \sigma_y \]
Percent change from baseline
Empirical Support from Estimated Models...
Percent change from baseline

price level - US

price level - Japan

TMCM
The Breakdown of the NICE System...
Initial cut is 1%
Alternative View: The Tradeoff Curve Shifted

Source: Mervyn King’s Stamp Lecture (2012)
Key Points Behind Alternative View

• Rules-based policy is good in normal times,
  – But “times are by no means normal”
  – So we have to deviate
• Global deviation is good (at least for G7)
• “these policies are not ‘beggar-thy-neighbor’ but rather are positive-sum, ‘enrich-thy-neighbor’ actions”
Going forward

• Goal should be an expanded rules-based system similar to the 1980s, 1990s and until recently which would operate near an international cooperative equilibrium.

• International monetary policy coordination—at least formal discussions of rules-based policies and the issues reviewed here—would help the world get to this desirable situation