Discussion of "Monetary Policy Inertia or Persistent Shocks?" by Julio Carrillo, Patrick Fève and Julien Matheron

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May 2006

Background

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- Generalized Taylor (1993) rule:

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- Econometric problem: Difficult identify ρ_1, ρ_2

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  - Match i response: ρ_1, ρ_2 not identified
  - Match i, y, π, π^w, ξ responses: ρ_1 small, ρ_2 large
  - Benchmark estimates: $\rho_1 = 0.298$, $\rho_2 = 0.874$, $\sigma_\nu = 0.169$

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- Identification problem ("multiple local optima") highlighted

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- Taylor rule omits important elements

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  Compare with VAR equation!

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- Compare with other shock in VAR?

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  Report ρ_1, ρ_2 also in sensitivity analysis.
- How does model match interest rate response to other shocks?

  Independent check.

The Taylor (1993) rule

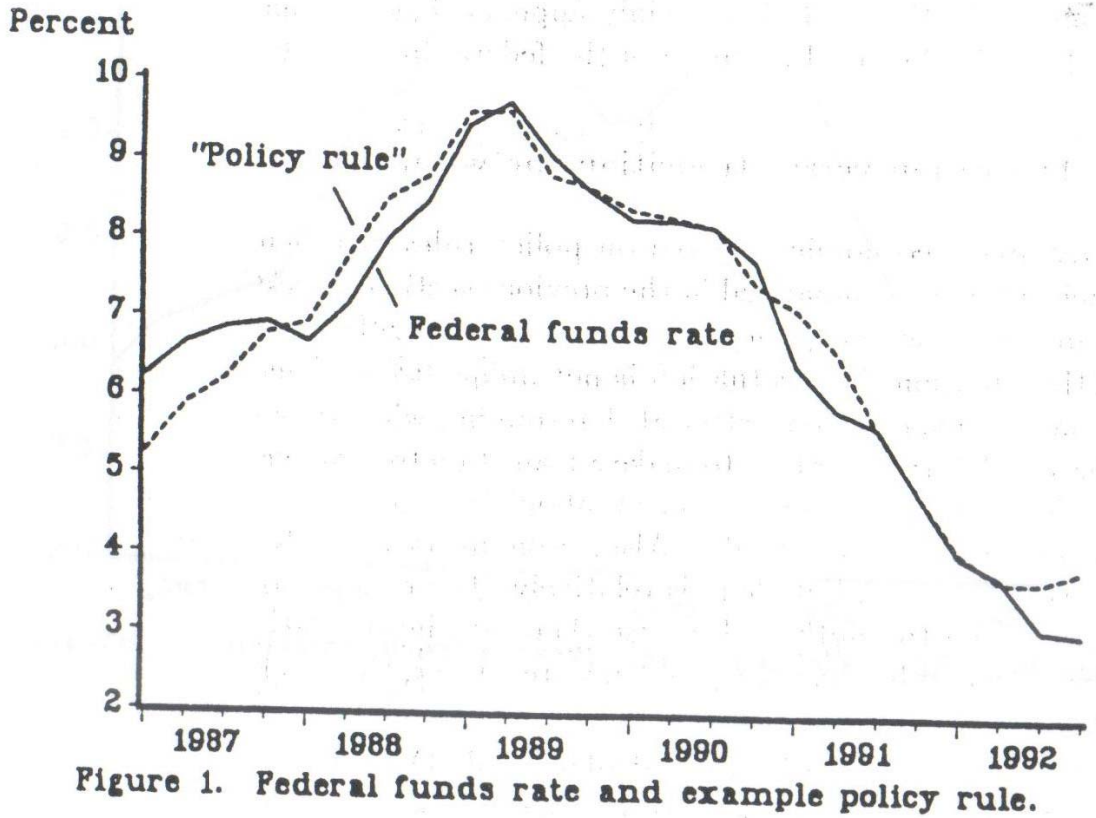

Figure 1. Federal funds rate and example policy rule.

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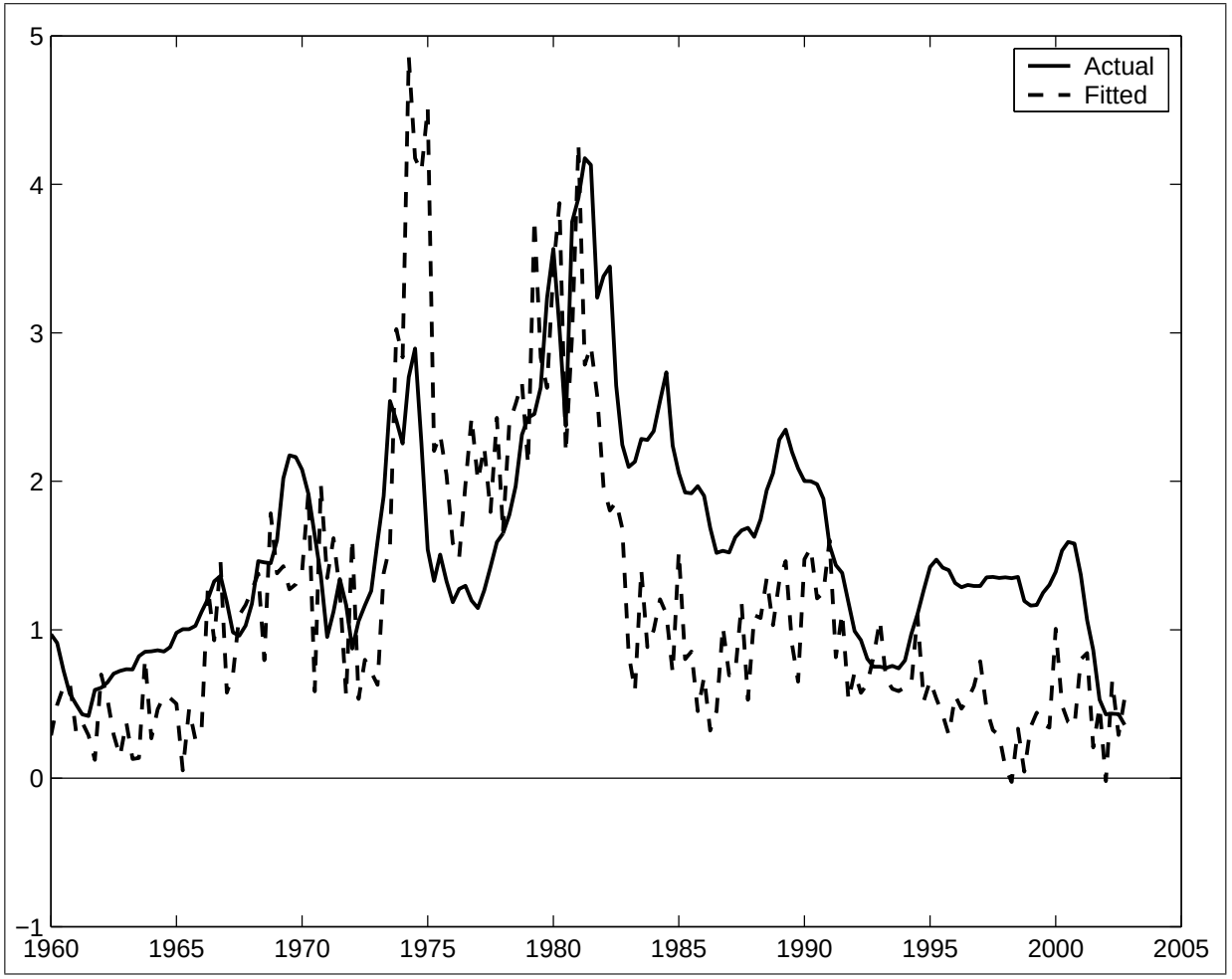
Estimated Taylor rule without smoothing



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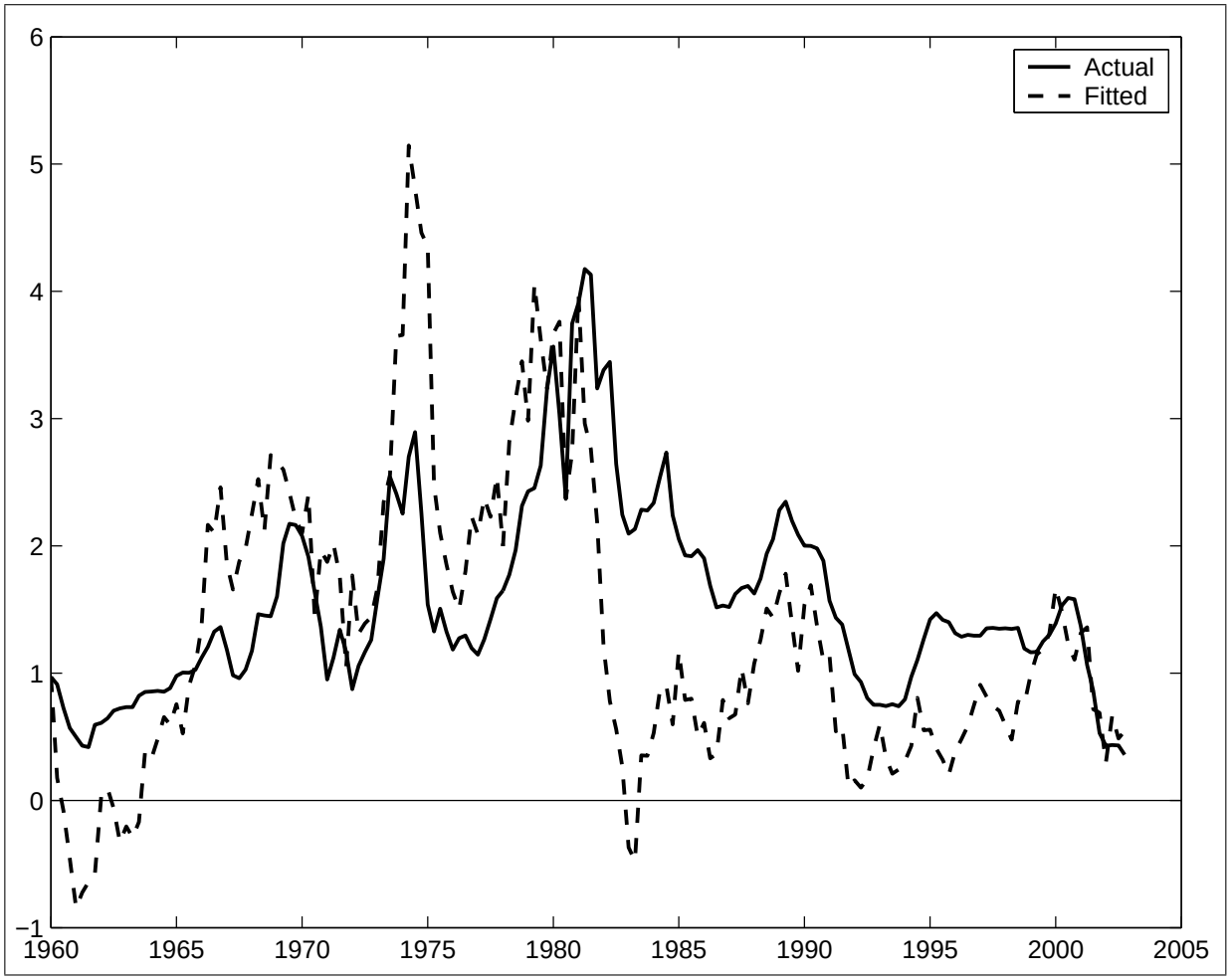
Actual and fitted interest rate using CFM estimates



Fitted: $i_t = 0.702\,[1.5\pi_t + 0.125y_t] + 0.298i_{t-1}$

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