Goals of Monetary Policy

**Goals**
1. High Employment
2. Economic Growth
3. Price Stability
4. Interest Rate Stability
5. Financial Market Stability
6. Foreign Exchange Market Stability

*Goals often in conflict*

### Money Supply Target

1. $M^d$ fluctuates between $M^{d'}$ and $M^{d''}$
2. With $M$-target at $M^*$, $i$ fluctuates between $i'$ and $i''$
Interest Rate Target

![Diagram of interest rate target]

1. $M^d$ fluctuates between $M'^d$ and $M'^d''$
2. To set $i$-target at $i^*$ $M^s$ fluctuates between $M'$ and $M''$

Criteria for Choosing Targets

Criteria for Intermediate Targets
1. Measurability
2. Controllability
3. Ability to Predictably Affect Goals

Interest rates aren’t clearly better than $M^s$ on criteria 1 and 2 because hard to measure and control real interest rates

Criteria for Operating Targets
Same criteria as above
Reserve aggregates and interest rates about equal on criteria 1 and 2. For 3, if intermediate target is $M^s$, then reserve aggregate is better

Taylor Rule, NAIRU and the Phillips Curve

Taylor Rule
Fed funds rate = inflation + equilibrium real fed funds rate + 1/2 (inflation gap) + 1/2 (output gap)

Phillips Curve Theory
Change in inflation influenced by output relative to potential, and other factors
When unemployment rate < NAIRU, inflation rises
NAIRU thought to be 6%, but inflation falls with unemployment rate below 5%
Phillips curve theory highly controversial