Panel on
“Welfare Considerations Beyond Price Stability”

Banco de Portugal

April 1st, 2022

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Principles of Monetary Policy Design

- *Long run*: Anchoring of long term inflation
- *Short run:*
  - If *nominal rigidities* are the only friction

    → natural output = efficient output

    → strict inflation targeting ("Divine Coincidence")

    * What inflation measure?
  - With *real frictions*:

    → optimal output between natural and efficient

    → "controlled" deviations from long run inflation target

  - With *heterogeneous households*: at the margin, equalization of marginal utilities of consumption

Monetary Policy and Endogenous Financial Crises

Boissay, Collard, Galí and Manea (2022)

- Nominal rigidities ⇒ non-neutrality of monetary policy
- Endogenous capital accumulation ⇒ protracted investment booms
- Idiosyncratic productivity shocks ⇒ capital reallocation through credit markets
- Private information and limited enforcement ⇒ "financial fragility“
- If $r^k < \phi$ → “financial crisis”

  investment boom → increase in financial fragility

  → greater focus on *output stability* is desirable

  → deviations from inflation target

Boissay, Collard, Galí and Manea (2022)

		Frictionless	Frictional credit market				
Rule	ϕ_y	Welfare Loss CEV (%)	Welfare Loss CEV (%)	Crisis time (%)	Length (quarter)	Output loss (%)	$\mathbb{E}(\pi_t^2)$
SIT	–	0	0.1114	9.85	5.91	-5.78	0.0000
Taylor rules ($\phi_\pi = 1.5$)	0.025	0.0000	0.1198	10.47	5.94	-5.75	0.0004
	0.050	0.0001	0.1137	9.87	5.80	-5.53	0.0012
	0.125	0.0009	0.0964	[8.00]	5.31	-4.94	0.0064
	0.250	0.0037	0.0706	5.00	4.58	-4.24	0.0200
	0.500	0.0116	0.0466	1.39	3.64	-3.16	0.0516
	0.750	0.0197	0.0467	0.45	4.49	-2.45	0.0817