

Implementing Monetary Policy in the 1980s

Introductory Remarks

Donald D. Hester

This morning we are very fortunate to have three interesting and distinctive papers that treat different aspects of the problem of implementing monetary policy. The first is by Carl Walsh, who has been a visitor at the Kansas City Federal Reserve Bank. His paper is one of two recent highly innovative studies that he has prepared. They use the rational expectations apparatus to suggest why model structure should not be viewed as being invariant to the Federal Reserve's operating procedures.

The second paper is by Ed Kane. Professor Kane's paper contains original artwork and indeed is a very imaginative contribution that considers how monetary policy will be implemented in a changing financial environment.

The third paper is by Ben Friedman, who argues that net debt may be a better target for monetary authorities than a monetary aggregate. In this audience he can surely expect some dissent.

Before turning the meeting over to these gentlemen, I would like briefly to mention two topics that I feel are important for implementing monetary policy in the coming years. They are not considered in this morning's papers. First, with growing automation in funds management by banks and other traders, it has become increasingly possible to exploit rigidities in the intraday schedules according to which money market transactions and reserve positions are settled. Through repurchase agreements, Eurodollar transactions, and "daylight overdrafts" banks and their customers have been able to increase the transactions settling capacity of a given volume of bank reserves. This slippage could and should be arrested by moving to real-time reserve accounting wherein a bank would be expected to have an adequate volume of

reserves relative to deposits continuously or at least at several different randomly chosen points of time within a day. This reform would considerably weaken the appeal of repurchase agreements and Euro-dollar accounts.

Second, financial instrument futures markets have probably had an important effect on the transmission of monetary policy. However, there is an important omission in the set of contracts that is offered; there is no consumer price index contract. If there were such a contract, the public and monetary authorities could measure the expected rate of inflation over time intervals of different length and could determine real interest rates accurately. With long-term contracts pension funds and long-duration investment projects could be hedged. Real interest rates are appealing intermediate monetary policy indicators, as Wick-sell long ago suggested. I hope that these topics can be addressed in the following discussion or on a future occasion.