influences suggests the FOMC median projection may be more nearly correct," he said. Meanwhile, "U.S. evidence from recent readings on GDP growth and market-based inflation expectations suggests the market view of the path of the policy rate may be more nearly correct."

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Presentation (pdf) (bullard-hoover-5-may-2016pdf) | Press Release.

International Monetary Stability: A Multiple Equilibria Problem?

May 5, 2016

St. Louis Fed President James Bullard addresses two ways of approaching the classic question of whether monetary policy should be better coordinated across countries. The traditional approach assumes all central banks follow "good" policy, defined as obeying the Taylor principle. In the alternative view, some countries do not follow the Taylor principle and, therefore, have "bad" policy. The first approach leads, in theory, to a unique worldwide equilibrium; the second approach leads to multiple equilibria with potentially more volatility in global financial markets. The choice of which way to look at this question these days, in a post-crisis world, may come down to a judgment of whether U.S. and foreign policymakers are still following "good" policy rules as they were, in theory, before the financial crisis. Bullard's remarks were prepared as part of a panel discussion at a conference at the Hoover Institution at Stanford University in California.

St. Louis Fed's Bullard Discusses International Monetary Stability Debate

STANFORD, Calif. – Federal Reserve Bank of St. Louis President James Bullard discussed ["International Monetary Stability: A Multiple Equilibria Problem?"](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-hoover-5-may-2016.pdf)on Thursday during a conference hosted by the Hoover Institution at Stanford University.

During his remarks, he addressed whether monetary policy should be better coordinated across countries, noting that the debate over this classic question in international macroeconomics has once again moved to center stage in recent years.

To help answer this question, he compared the conventional wisdom concerning international monetary stability with an alternative interpretation, both based on similar New Keynesian models. All policymakers follow "good" monetary policy under the traditional view, while some policymakers follow "bad" monetary policy under the alternative view.

In this context, he explained that "good" policy obeys the Taylor principle, meaning that nominal interest rates are adjusted more than one-for-one with deviations of inflation from an inflation target, whereas "bad" policy means the Taylor principle is not being met.

"The conventional wisdom suggests that under 'good' monetary policy in each country, worldwide equilibrium is unique and international policy coordination is unnecessary," Bullard said. Under the alternative view where some countries follow "bad" policy, "the result is multiple equilibria and, potentially, a lot of excess volatility in the worldwide equilibrium."

Bullard noted that the difference between the two views on international monetary stability is essentially a judgment on whether U.S. and foreign monetary policymakers have been able to replicate "good" monetary policy rules in the aftermath of the financial crisis.

"A reasonable conclusion may be that not all central banks have been able to replicate pre-crisis 'good' policy with post-crisis unconventional monetary policy tools. This would make the multiple worldwide equilibria view more nearly correct," he said, adding that there is plenty of room for debate on this issue.

Conventional Wisdom

In a traditional view, Bullard noted that each country follows the Taylor principle. "Should the world's central banks coordinate policy in this environment? No," he said. He explained that when all policymakers worldwide follow "good" policy focused only on domestic variables, worldwide equilibrium is unique and the payoff from international policy coordination is small, according to this view.

The payoff is small because gains from policy cooperation stem from taking into account the effect of foreign economic activity on the domestic marginal cost of production, Bullard said. Under policy cooperation, a central bank should respond to both foreign inflation and domestic inflation. "But policymakers do almost as well with respect to their goals by simply ignoring this effect," he added.

"Many have concluded from this pre-crisis line of thinking that it does not pay to worry about international monetary policy cooperation," he said. "The thinking is that the possible gains are small and, practically speaking, it would be hard to get the world's policymakers to play the cooperative equilibrium."

An Alternative View

Bullard then set forth the parameters of an alternative view in which all features of the international economy are the same as in the traditional view, except that monetary policymakers in one or more countries do not follow the Taylor principle.

He said it may be reasonable to assume that some countries are following "bad" policy as described here because these are not normal times for monetary policy in the U.S. or the world economy.

"In particular, in many countries, it is difficult for monetary policy to respond to declines in inflation when the policy rate is subject to the zero lower bound," he said, adding that quantitative easing and forward guidance may or may not substitute effectively for more normal policies.

"Whether the U.S. or other countries are following the Taylor principle today hinges on what one thinks about unconventional monetary policy. If unconventional monetary policy is ineffective, then the global equilibrium may be overly volatile," he said.

He added, "The alternative view may be one way to represent recent events in global financial markets in response to monetary policy decisions." As possible examples, he cited the "taper tantrum" in 2013, the global reaction to prospective quantitative easing by the European Central Bank during the fall of 2014, and the surprise devaluation of China's currency in August 2015.

Thus, while the conventional wisdom provides a good framework for thinking about the situation in international monetary policy before the financial crisis, Bullard said that the more radical, but less established, multiple equilibria view may be a way to describe the post-crisis global financial market reaction to central bank decisions.

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