UNIVERSITY OF THE PEOPLE

BUS 2203-01 Principles of Finance 1 – AY2024-T2

Learning Journal Unit 6

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Chapter 17 of the textbook discusses the history of policy blunders and successes at the Federal Reserve, as well as the trade-offs and policy targets that central banks like the Fed must consider when conducting monetary policy. The chapter also introduces the Taylor Rule, an equation that suggests what the Fed's target interest rate should be based on economic conditions.

Over its history, the Fed has shifted from engaging in pro-cyclical policies that exacerbated the boom and bust of the business cycle, to implementing countercyclical policies starting in the late 1980s that aim to smooth out the cycle. This shift to “leaning into the wind” rather than running with it played an important role in the increased macroeconomic stability of the last few decades (Wright & Quadrini, 2009). However, the Fed still faces trade-offs between priorities like inflation versus unemployment and sets specific targets like interest rates or money supply growth to meet its policy goals. One target that likely guides Fed policy is the Taylor Rule, which recommends interest rate changes based on inflation, GDP growth, and other economic factors (Wright & Quadrini, 2009).

The Fed has improved its performance over time by switching from destabilizing pro-cyclical policies to stabilizing countercyclical ones. However, it continues to confront trade-offs and must choose targets carefully to meet its dual mandate of promoting full employment while maintaining price stability. The Taylor Rule provides useful policy guidance by connecting interest rates to economic conditions.

Reference:

Wright, R.E. & Quadrini, V. (2009). Money and Banking. Saylor Foundation.

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