

# MONETARY POLICY RULES AND MACROECONOMIC STABILITY: EVIDENCE AND SOME THEORY

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## Abstract

We estimate a forward-looking monetary policy reaction function for the postwar United States economy, before and after Volcker's appointment as Fed Chairman in 1979. Our results point to substantial differences in the estimated rule across periods. In particular, interest rate policy in the Volcker-Greenspan period appears to have been much more sensitive to changes in expected inflation than in the pre-Volcker period. We then compare some of the implications of the estimated rules for the equilibrium properties of inflation and output, using a simple macroeconomic model. The pre-Volcker rule is shown to be consistent with the possibility of persistent, self-fulfilling fluctuations in inflation and output. In contrast, the Volcker-Greenspan rule is stabilizing.

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