COMMENTS ON ‘OPTIMAL INFLATION TARGETS: INSIGHTS FROM AN AGENT-BASED MODEL’

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A subjective bird's eye view on policy pros and cons of the ABM approach vs standard DSGE frameworks

A rich, very stimulating paper, which illustrates the potential of ABMs for monetary policy analysis.

- Pros:
  - Allows imperfect rationality (more realistic)
  - Gives greater flexibility in the modelling of behaviour and choice of assumptions
- Cons:
  - Can miss stabilising general-equilibrium effects
  - Gives greater flexibility in the modelling of behaviour and choice of assumptions

Questions about model choices

- Why compare debt levels, rather than debt service, to payroll?
- Why doesn’t the real interest rate adjust upwards when inflation is higher?
- The ratio of the hiring to the firing propensity is key: how can it be measured?

Suggestion 1: Unemployment in the Taylor rule

The last wave of Taylor rules incorporate the output gap or unemployment:

- omitting this term likely penalises low inflation targets
- it would be interesting to see results for a Taylor rule including the output gap:
  - Do higher inflation targets remain as attractive?
  - What is the optimal balance between the weights on inflation and the output gap?

Suggestion 2: Productivity effects

"Productivity isn't everything, but, in the long run, it is almost everything."
Paul Krugman

- The model assumes that productivity does not respond to economic developments.
- Productivity feedbacks (though capital accumulation) could be added from:
  - *Lower savings*
  - *Greater inflation uncertainty (which typically follows higher inflation)*

  and then to:
  - *Wages*
- Such feedbacks would shed light on the conclusions from the model that discouraging savings and higher inflation increase output.

Concluding remarks

- A rich, thought-provoking illustration of what ABMs can bring to the table when analysing monetary policy
- A stimulating starting point for future monetary research
- Operational use calls for better understanding why key outcomes are so contrasted (*e.g.* 0% unemployment for 4% inflation vs 39% inflation for 0% inflation)
- Enriching the specification of the Taylor rule would bring the simulations closer to current monetary policy making
- Introducing productivity feedbacks would appear to promise very interesting discussion of policy effects