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The Effects of Monetary Policy: Theory with Measured Expectations

Abstract:

We study the effects of monetary policy on aggregate consumption with a general equilibrium model but without making assumptions about expectation formation. The key idea is to express consumption of non-hand-to-mouth households as a function of expectations only and to elicit all expectations appearing in the consumption functions for alternative policy scenarios with a tailored survey. We illustrate this approach by computing aggregate consumption for alternative policies before the March 2021 and March 2022 FOMC meetings. We find that a modest forward guidance statement in the March 2021 FOMC meeting would have reduced aggregate consumption by 0.17% on impact and an interest rate hike of 50 basis points in the March 2022 FOMC meeting would have reduced aggregate consumption by 0.1% on impact.