Bennett McCallum: On Monetary Policy Instruments

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The McCallum Rule

The McCallum rule adjusts the growth rate of the monetary base, allowing for gradual shifts in velocity, to stabilize nominal spending.

Is the monetary base (sometimes called "currency plus noise") still related to nominal GDP? Was it ever?

Bank Reserves and Nominal Spending

Belongia and Ireland, "The Transmission of Monetary Policy Shocks Through the Markets for Reserves and Money," use a structural VAR to model the supplies of and demands for bank reserves and Divisia M2.

Across four sample periods spanning 1967 and 2020, expansionary shocks to monetary policy – identified as shifts to the supply curve for reserves – generate faster growth in M2 followed by faster growth in nominal spending.

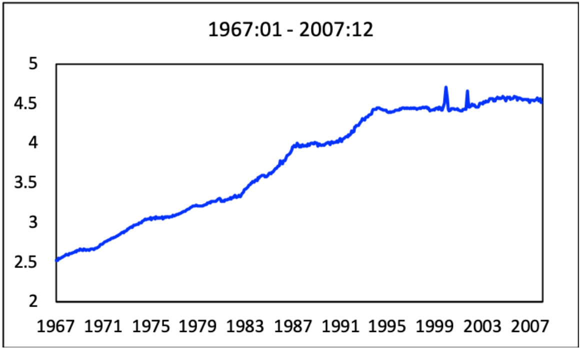
The Data

For 1967-2007, data on reserves are from the Federal Reserve Bank of St. Louis and adjust for changes in reserve requirements and for the effects of deposit sweep programs.

The St. Louis Fed discontinued its adjusted reserves series in November 2019.

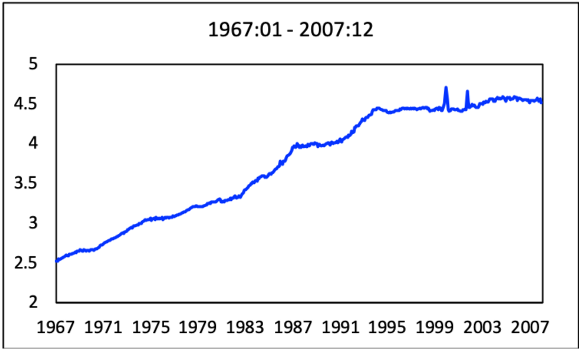
For the post-2008 period, a series on reserves is constructed using the Federal Reserve Board's series for the monetary base and currency.

The Data



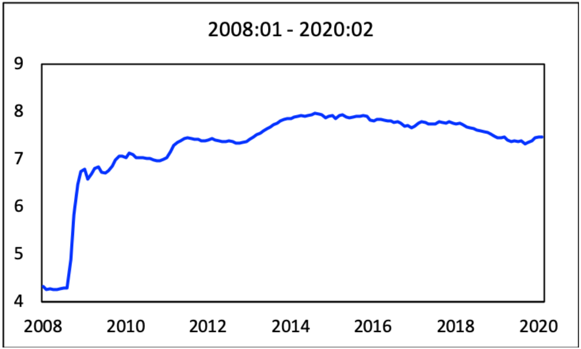
Reserves grew by 5.5 percent per year from 1967 through 1979 and by 8 percent per year from 1983 through 1994.

The Data



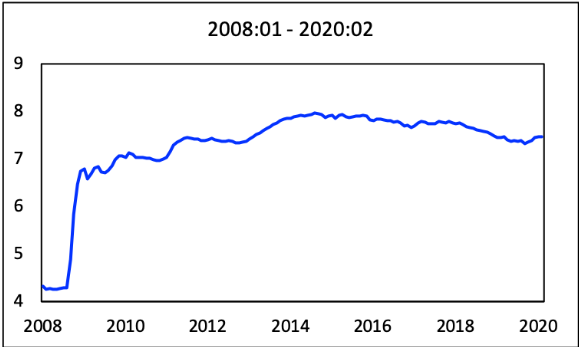
Reserves grew by less than 1 percent per year from 1995 through 2007, even after accounting for sweep programs, and spiked temporarily higher in 2000 and 2001.

The Data



Reserves grew dramatically in 2008 (from \$75 to \$886 billion), as the Fed initiated the payment of interest on reserves.

The Data



Reserves growth from 2009:01 through 2020:02 (from $886 to $1736 billion) was 6.3 percent per year – much faster than in 1995-2007 but slower than 1983-1994.

The McCallum Rule

The McCallum rule could be a useful reference today, to aggregate the effects of traditional interest rate policy and quantitative easing/tightening.

It would also allow the FOMC to describe its policies in a consistent way, at or away from the zero lower interest rate bound.

And it can be used to target either the level or the growth rate of nominal GDP.