

Central Bank Exit Policies

Posted by [Alfonso Esparza](#) at 10:23 am EDT, 10/01/2009

Very interesting to read Donald L. Kohn's thoughts on the conditions, tools and how to communicate when a Central Bank is ready for an exit strategy. This will come in handy to measure what the Fed is doing and how they are sticking to Kohn's recommendations.

Conditions for Exit

In its most important aspects, the decision about when to begin exiting from the unusual policies is not materially different from any decision to start tightening monetary policy. We will need to begin to remove the extraordinary degree of accommodation in its various dimensions when we judge that exiting from the current stance of policy will be necessary to preserve price stability as the economy returns to higher levels of resource utilization. Because it takes people time to adjust their spending and pricing decisions in response to a change in interest rates or other aspects of financial conditions, like other monetary policy decisions, that judgment will need to be based on a forecast of economic developments, not on current conditions. So we must begin to withdraw accommodation well before aggregate spending threatens to press against potential supply, and well before inflation as well as inflation expectations rise above levels consistent with price stability.

I cannot give you a small list of variables that will trigger an exit; as always, our forecasts will use all available sources of information. And I can't predict how rapidly we will have to raise short-term interest rates from around zero or remove other forms of accommodation; that too depends on how the economy seems to be recovering and the outlook for inflation. Clearly, the present degree of accommodation—as gauged by nominal and real short-term interest rates and the size of our balance sheet—is extraordinary, and we will have to take account of how that is influencing spending and inflation expectations when deciding when and how fast to tighten.

The full text of Donald L. Kohn at the Cato Institute is available at the [Fed's website](#)

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