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Targeting Nominal GDP Futures Contracts
2 comments

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September 17, 2009

Scott Sumner's column at Cato Unbound is a compelling read. I still get the feeling that Sumner and I may be thinking past one another. Sumner maintains that monetary policy was too tight in the Summer of 2008 and this lead directly to what I forecast as the "recession within a recession"."

I agree with this line of thinking. In early 2008 I argued that the "there is no tightrope." That is, that the Fed was unnecessarily concerning itself with inflation. This crisis was the first time I found myself *less* hawkish than the Fed. However, this dovishness was inspired by a feeling that a collapse in the financial sector would create an enormous increase in the demand for money.

I don't see how thinking that the Fed was too tight is at odds with thinking that the popping of the credit bubble was behind the crash.

Looking back, I think I did fall prey to the notion that the Funds rate should be dropped in targeted bursts. Going straight to zero might have been a better plan. Yes, there is the fear of "spooking the market," but sometimes we have much more to fear than fear itself.

What I found particularly intriguing, however, was Sumner's proposal for a targeting Nominal GDP futures contracts. I am a bit of an institutional conservative, so a change this radical would make me very, very nervous but at first blush it seems to make a lot of sense.

One is essentially, "targeting expectations." This seems like exactly what we want to do. I haven't thought through exactly how this works with productivity shocks, however.

Suppose that in 2015 there are major nanotech breakthroughs and the economy begins to expand rapidly. This type of target would have the Fed step on the brakes pretty heavily. If technological growth were large enough it seems that the Fed would be required to generate unemployment, deflation or more likely a combination of both. So, I am not sure how we respond to that it Sumner's framework.

Lastly, I think Jim Hamilton misread Sumner's recommendation. Hamilton writes

> Perhaps there are some more details of what Sumner has in mind that I am missing, but I don't really understand how it could work. The essence of any Fed operation is an exchange of assets of equivalent value. Traditionally, the Fed uses the money it creates to purchase a T-bill, thereby increasing the quantity of money in circulation. However, a futures contract is not an asset, but instead is an agreement between two parties for which neither party initially compensates the other.

I don't think Sumner is suggesting the Fed use future contracts as a tool of monetary policy. Presumably standard open market operations with t-bills would still work. Simply, that the Fed expand or contract the money supply such that future contract trades at the Fed's target value.