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Nominal GDP Stabilization: Chasing a Mirage

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Abstract

This paper argues that NGDP targeting is unlikely to produce macroeconomic stability. Contrary to the policy objective, NGDP targeting can increase macroeconomic turbulence. DSGE models that prove the effectiveness of NGDP stabilization policy rest on two assumptions. The first assumption is that macroeconomic volatility is a consequence of exogenous shocks to an otherwise stable system. The second assumption is that central banks can act upon aggregate variables. Neither of these assumptions is accurate. An economy is an ecology of interacting agents, some of whom have rivalrous plans. Macroeconomic volatility is an endogenous and intrinsic feature of such an economic system. Furthermore, central banks act upon some agents in the economic system, not on aggregate variables. The percolation of central bank actions through production networks can impede coordination efforts of economic agents during recessions, thereby increasing macroeconomic volatility.

Key Words: NGDP, Recession, Monetary Policy, Ecology of Plans.

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