Discussion of Evans and Honkapohja, “Robust Learning Stability.”

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1Views expressed are those of the author and do not necessarily reflect official positions of the FOMC or the Federal Reserve System.
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- That condition is known as *expectational stability*. 
What the literature has shown

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- Comforting.
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  - Agents are trying to robustly track the changing environment in which they operate.
- Concentrate on operational rules in the sense of McCallum.
  - Keep policymaker information in line with reality.
- In particular, contemporaneous values of output and inflation are not known when policy decisions are made.
Main findings

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- Policymakers following these recommended approaches in this environment would be surprised to find that the economy does not coordinate on the intended equilibrium.
Main findings

- There are many recommended good or “optimal” policies for this model ... 
  - ... but most produce expectational instability in this setting.
- Policymakers following these recommended approaches in this environment would be surprised to find that the economy does not coordinate on the intended equilibrium.
- To obtain expectational stability, use the expectations-based rules of Evans-Honkapohja (2003, 2006).
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- Another analogy: default punishment in models with endogenous debt constraints.
Expectational instability

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- Does it happen?
  - Consider the breakdown of Bretton Woods.
  - And maybe we should worry about Sweden, as we will see below.
Taylor-type rules

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- Instability requires the combination of operational rules with constant gain learning.
Duffy and Xiao

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- The expectations-based approach of Evans and Honkapohja solves this problem and provides robust expectational stability.
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- There is nothing optimal about instability.
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- Avoids committing to a particular recursive algorithm to describe learning.
- But, expectational stability still plays a role in that analysis.
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- Stability still an issue.
Responding to expectations

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- Potential games.
Final thoughts

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- Thanks to the Bank of Japan for inviting me to participate.
- I appreciate the attention to stability issues, which I think are insufficiently analyzed in macroeconomics.
- Instability can produce the “big ticket losses” that policymakers really worry about.