

News Release

THE FEDERAL RESERVE BANK *of* KANSAS CITY

1 Memorial Drive • Kansas City, MO 64198 • Phone: 816.881.2683

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CONTACT: Tim Todd
816/881-2308
timothy.todd@kc.frb.org

TAYLOR RULE DEVIATIONS AND FINANCIAL IMBALANCES

Over the last 25 years, the U.S. economy has faced several financial shocks. While the nature of the crises varied, each was preceded to some extent by a buildup of financial imbalances. A key question for policymakers to consider is whether policy actions taken before a crisis contributed to the growing imbalances.

In the article “Taylor Rule Deviations and Financial Imbalances,” George Kahn, a vice president and economist at the Federal Reserve Bank of Kansas City, examines whether monetary policies targeting stable inflation and sustainable long-term economic growth inadvertently resulted in feeding financial imbalances by keeping interest rates too low for too long. The article appears in the second quarter edition of the Bank’s *Economic Review*.

To answer this question, Kahn uses deviations from Taylor rules, which prescribe a policy rate setting based on inflation and economic output, as an indicator of whether monetary policy was too tight or too accommodative. Such deviations may be an appropriate response to unusual economic or financial conditions, Kahn writes, but larger and more persistent deviations may contribute to a buildup of financial imbalances. The article concludes that while there does appear to be a statistically significant relationship between Taylor rule deviations and a number of financial indicators, their economic significance is mixed.

The article is available on the Bank’s website at www.KansasCityFed.org.

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