Natural Yield Curve Targeting
During Unconventional Times

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Abstract

While the short-term natural rate of interest is commonly assessed in the context of monetary policy decisions, its usefulness as a target is diminished when nominal rates are constrained by the lower bound. Policy makers reacted to such an environment during the global financial crisis with a range of new instruments, including quantitative easing and forward guidance, which proved to be effective in influencing the yield curve beyond the short-term rate. I study the potential of these instruments in a rule-bound environment during both regular business cycles and when the policy rate is constrained by a lower bound. I construct the long-term counterpart of the natural rate and employ variants of it as targets for the yield curve. I find that output and inflation are stabilized when switching to a long-term natural rate target. I uncover the natural yield curve for the US from 1961 – 2017 and discuss effects of the rule bound behavior in a counterfactual analysis.

Keywords: Natural Rate, Monetary Policy, Yield Curves, Interest Rate Rules, Term Premium, Quantitative Easing, Forward Guidance

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