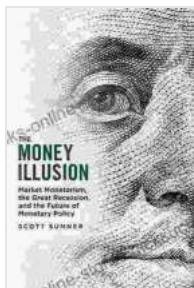
Market Monetarism, The Great Recession, and the Future of Monetary Policy



The Money Illusion: Market Monetarism, the Great Recession, and the Future of Monetary Policy

by Scott Sumner

4.5 out of 5

Language	: English
File size	: 3827 KB
Text-to-Speech	: Enabled
Screen Reader	: Supported
Enhanced typesetting	: Enabled
Word Wise	: Enabled
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Lending	: Enabled

Market monetarism is a monetary policy framework that emphasizes the use of market-based indicators to guide monetary policy decisions. This approach differs from traditional monetary policy frameworks, which typically rely on economic models to forecast inflation and output. Market monetarists argue that market-based indicators, such as the price of gold or the yield on the 10-year Treasury bond, provide a more accurate and timely measure of economic conditions than economic models.

History of Market Monetarism

The roots of market monetarism can be traced back to the early 20th century, when economists such as Ludwig von Mises and Friedrich Hayek argued that the free market was the best way to allocate resources and that

government intervention in the economy was generally harmful. In the 1970s, economists such as Milton Friedman and Anna Schwartz developed a monetarist theory of inflation, which argued that inflation was caused by an excessive supply of money. This theory led to the adoption of monetarist policies in many countries, including the United States.

In the early 2000s, a new generation of economists, including Scott Sumner and David Beckworth, developed market monetarism as a response to the shortcomings of traditional monetarism. Market monetarists argued that traditional monetarism was too narrow in its focus on the money supply and that it did not take into account the role of other market-based indicators.

Market Monetarism and the Great Recession

The Great Recession was the worst economic downturn since the Great Depression. It began in December 2007 and ended in June 2009. The recession was caused by a number of factors, including the subprime mortgage crisis, the collapse of the housing bubble, and the failure of Lehman Brothers.

Market monetarists argued that the Great Recession could have been avoided if the Federal Reserve had adopted a more aggressive monetary policy. They argued that the Fed should have increased the money supply more quickly and that it should have kept interest rates lower for longer.

The Fed did eventually adopt a more aggressive monetary policy, but it did so too late to prevent the recession. The Fed's slow response to the crisis was due in part to its reliance on economic models, which failed to predict the severity of the recession.

The Future of Monetary Policy

The Great Recession has led to a reassessment of monetary policy. Market monetarism is one of the leading alternatives to traditional monetarism. Market monetarists argue that the Fed should focus on market-based indicators, such as the price of gold or the yield on the 10-year Treasury bond, to guide monetary policy decisions.

The future of monetary policy is uncertain. However, market monetarism is a promising alternative to traditional monetarism. Market monetarism provides a more accurate and timely measure of economic conditions than economic models. This approach could help the Fed to avoid future recessions.

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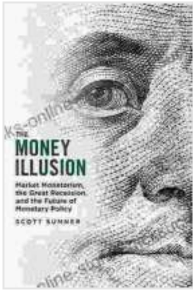

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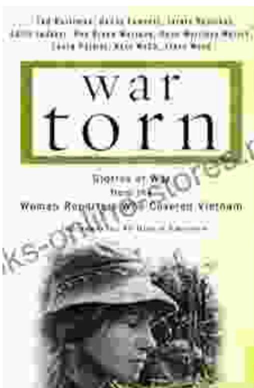

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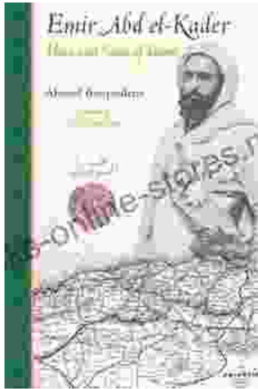

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