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Some issues concerning interest rate pegging, price level determinacy, and the real bills doctrine

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Abstract

In a recent paper, Canzoneri, Henderson and Rogoff have shown that it is possible for the monetary authority to peg the nominal interest rate without creating price level indeterminacy in a simplified version of the 1975 Sargent-Wallace model. The present paper begins by reviewing that result, which involves a limiting case of a money supply rule that depicts the authority as responding to current values of the interest rate. Then it shows that there exists an alternative rule that will peg the nominal rate without creating indeterminacy, but that this rule induces a different pattern of price level fluctuations. Next the paper considers whether indeterminacy will prevail if the authority tries to effect a peg in a third way: by simply standing ready to buy and sell securities at the desired rate. Finally, the implications of the foregoing results are drawn for arguments concerning the real bills doctrine and some critical comments are directed at the recent attempted rehabilitation of that doctrine by Sargent and Wallace

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