**The tradeoff between being ahead of the curve and accurate forecasting**[1]

I would like to better highlight a basic tradeoff of monetary policy decision making that is partially implicit in remarks made by some of the previous speakers. On one hand, due to lags in the impact of monetary policy efficient policy has to be geared to the state of the economy in the future. As a consequence inflation targeting is really inflation forecast targeting.[2] During committee meetings Stan occasionally referred to this as "making decisions ahead of the curve".

On the other hand, since the future state of the economy is uncertain and even data about the current state of the economy arrives with a lag, monetary policy committees have to make decisions on the basis of current forecasts about the future. Inevitably those forecasts rely on data availability at decision time. Broadly speaking this data consists of the past history and of recent indicators. To minimize future forecast errors policymakers need to determine how much weight to give to recent indicators in comparison to past history. This is an important inference problem in which they have to decide (paraphrasing an old Hebrew proverb) whether one swallow signals the arrival of spring or not. More generally they have to decide how much of recent changes will persist into the future. But learning about the persistence of economic variables is more accurate the more one waits in order to observe how long a given change persists into the future.[3]

The upshot is that policymakers face a tradeoff between making decisions "ahead of the curve" and between waiting in order to obtain a better evaluation of changing economic conditions. The more a monetary policy committee waits before making a decision the better are its forecasts of the economy for a given time period in the future. But waiting also raises the likelihood that policy will be "behind the curve". Thus, monetary policy committees face the difficult task of finding the optimal balance between those two factors.

[1] Comment made by Alex Cukierman at a panel discussion at the June 18 2013 Farewell Conference Honoring Governor Stanley Fischer.

[2] See Svensson, L.E.O., 1997, "Inflation forecast targeting: implementing and monitoring inflation targets". **European Economic Review** 41, 1111–1146.

[3] See Muth J.F., 1960, "Optimal properties of exponentially weighted forecasts**", Journal of the American Statistical Association**, 55, June, 299-306 and Brunner K., Cukierman A. and Meltzer A., 1980, "Stagflation Persistent Unemployment and the Permanence of Economic Shocks", **Journal of Monetary Economics**, 6: 467-492.