Discussion of

"The Effects of Foreign Shocks when U.S. Interest Rates are at Zero"

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What are the "true" spillover effects of foreign shocks?

- Most models fail to account for the zero lower bound (ZLB) on nominal interest rates:
  - *Overstate* the effectiveness of monetary policy;
  - *Understate* the effects of adverse shocks.
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How can we simulate models with the ZLB?

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2. Stochastic simulations but imposing perfect foresight:
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Benefits and limitations of stochastic simulations.

1. Deterministic simulations:
   - Least difficult to implement.
2. Stochastic simulations but imposing perfect foresight:
   - Provide estimates of *probabilities*: confidence bands, standard deviations, likelihood of deflation, etc.
3. Stochastic simulations:
   - Allow the study of *policy design* when there is uncertainty about the future state of the economy—Svensson (2003) estimates the "optimal long-run mean inflation rate".
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Stochastic simulations (imposing perfect foresight) of FRB/US model with ZLB.

TABLE 1

MACROECONOMIC PERFORMANCE UNDER THE TAYLOR RULE

	Inflation Rate				
	0	1	2	3	4
Percent of time funds rate bounded at zero[1]	14	9	5	1	<1
Mean duration of periods funds rate bounded[2]	6	5	4	3	2
Constant bias adjustment to target inflation	.7	.3	.1	.0	.0
Standard deviation of:					
Output gap	3.6	3.2	3.0	2.9	2.9
Inflation	2.0	1.9	1.9	1.9	1.9
Federal funds rate	2.3	2.4	2.5	2.5	2.5

1. Percent of quarters funds rate ≤ 5 basis points.
2. Mean number of consecutive quarters funds rate ≤ 5 basis points.

Source: Reifschneider and Williams (2000)

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