

A New Approach to Model the Forward-Looking Monetary Policy Function

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I develop a new approach to model the forward-looking monetary policy function. Unlike existing studies, I recognize that the forward-looking components - future inflation and future output growth - are intrinsically unobserved. I use the short-term and long-term Greenbook forecasts, both individually and jointly, to extract the latent variables and jointly estimate the policy parameters. Evidence suggests that the Federal Reserve weighs future inflation higher than future output growth and the long-term state of economy gains precedence over the short-term. The policy rate from our approach also provides an alternative measure of monetary policy stance in a zero lower bound environment.