

Jan Willem van den End, Maria Demertzis, Yakov Ben-Haim, 2018, Evaluating monetary policy rules under fundamental uncertainty: an info-gap approach, *Economic Modelling*, to appear.

**Abstract** Monetary transmission mechanisms after the financial crisis are poorly understood. This implies that monetary policy decisions are made under very high and immeasurable uncertainty. We evaluate alternative Taylor rules that reflect different views, assuming fundamental uncertainty on the parameters and shocks. Rather than selecting rules based on their econometric fit, we apply info-gap theory to rank the rules according to a different criterion: the trade-off between robustness to uncertainty and performance. We find that in the euro area a standard Taylor rule, based on a traditional and well understood macroeconomic model, outperforms more complicated rules that include a credit spread or a debt-to-GDP ratio. It implies that monetary policy that refrains from aiming at financial stability is most robust to uncertainty.

**Keywords** Monetary Policy, Monetary Strategy, Knightian uncertainty, info-gaps, satisficing

### Highlights

- We use info-gap theory to identify monetary policy rules that are robust to fundamental uncertainty.
- The standard Taylor rule shows the most favourable trade-off between robustness and performance.
- Taylor rules that include a credit spread or a debt-to-GDP ratio lead to less robust policy decisions.
- Monetary policy should refrain from aiming at financial stability given the uncertain effects.