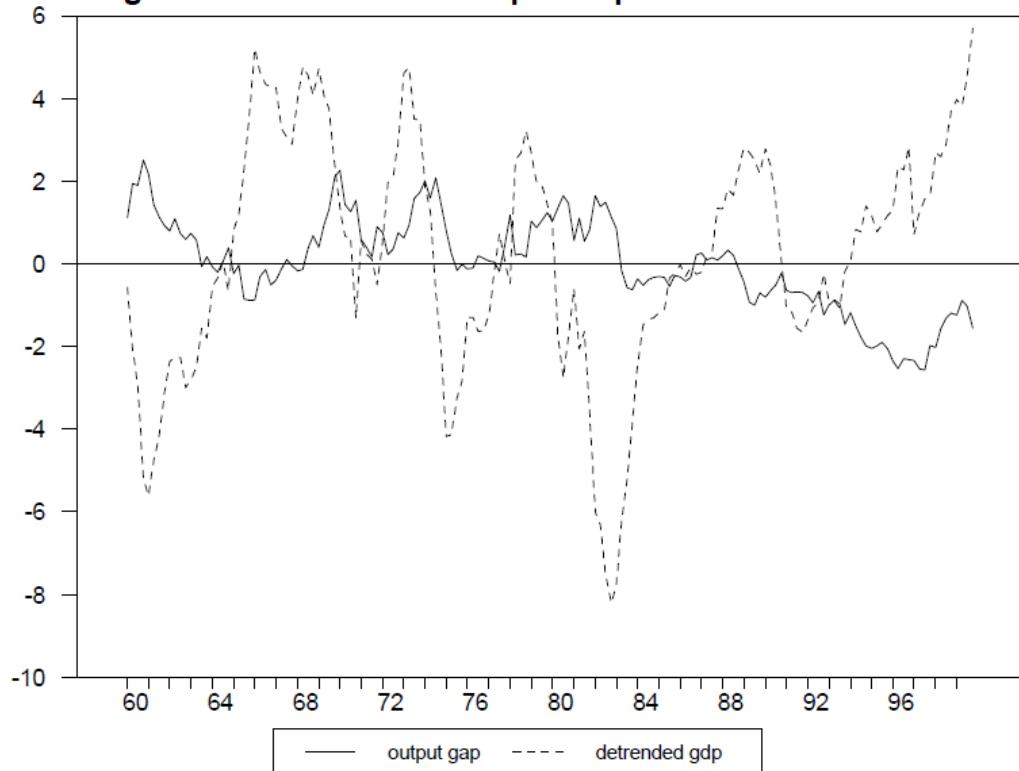


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Figure 2. Model-Based Output Gap vs. Detrended GDP



the Federal funds rate. The solid line represents the "Policy rule," which is a hypothetical rule that would have been followed had the Federal Reserve chosen to follow a constant interest rate target. The dashed line represents the actual Federal funds rate. The policy rule line rises sharply from 1987 to 1989, peaks at 9.5 percent in early 1989, and then falls sharply to 3.5 percent by 1992. The actual Federal funds rate follows the policy rule line closely until 1989, then begins to fall more rapidly than the policy rule line, reaching 2.5 percent by 1992.

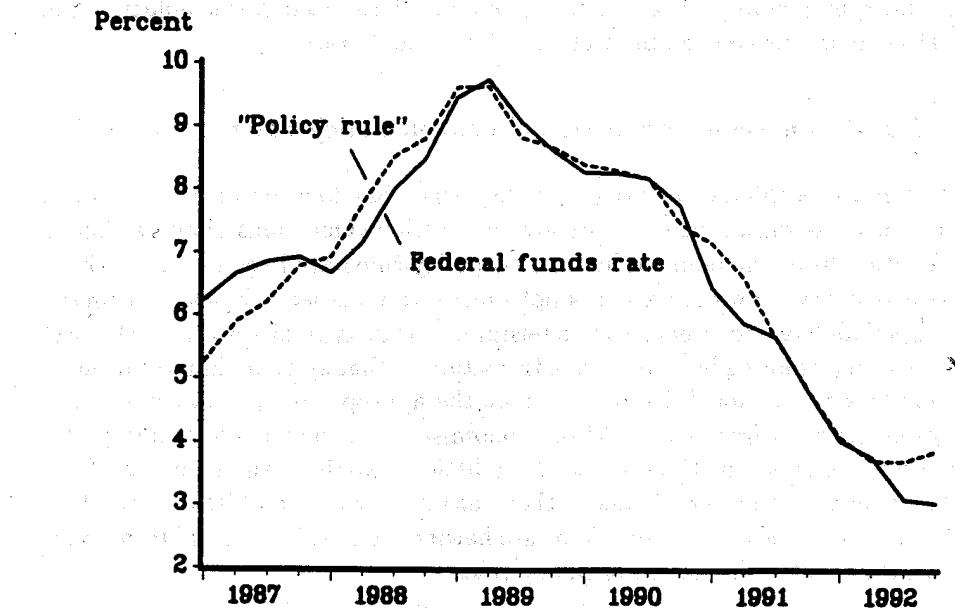


Figure 1. Federal funds rate and example policy rule.

the Federal funds rate. The solid line represents the "Policy rule," which is a hypothetical rule that would have been followed had the Federal Reserve chosen to follow a constant interest rate target. The dashed line represents the actual Federal funds rate. The policy rule line rises sharply from 1987 to 1989, peaks at 9.5 percent in early 1989, and then falls sharply to 3.5 percent by 1992. The actual Federal funds rate follows the policy rule line closely until 1989, then begins to fall more rapidly than the policy rule line, reaching 2.5 percent by 1992.

Efficient frontier based on Model 1.a

