The views expressed here are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.
Why Review Our Framework?

• **Good practice** to reassess our strategies, tools and communications (Bank of Canada does this regularly)

• More likely to hit effective lower bound in the future

• Frequently will be fighting inflation from below target

• Inflation expectations matter
More Limited Space for Funds Rate Cuts

R-star estimates (median of SEP)

Source: Haver
Inflation Consistently Short of 2% Target

Core & Headline PCE Inflation, 12-month change

- PCE
- PCE excluding energy goods & services

FOMC Inflation Target
Inflation Expectations Matter More Now

Coefficient on Lagged Inflation and Inflation Expectations

Source: BLS, BEA, CBO, SPF

Note: Specification uses headline CPI inflation. One-year ahead inflation expectations from the Survey of Professional Forecasters.
Source: Jordà, Martí, Nechio, and Tallman (FRBSF Economic Letter, 2019).
Achieving Target Inflation in the Future

Three viable alternative strategies at the ELB

- Nominal income targeting
- Price-level targeting
- Average-inflation targeting
All Designed to “Make Up” For Misses

Symmetric Inflation Targeting

Average Inflation targeting
All Designed to “Make Up” For Misses

Symmetric Inflation Targeting

Average Inflation Targeting
Focus on Average Inflation Targeting

• Good make-up properties
• Easier to communicate than NIT or PLT

• But important questions remain:
  • Is the required averaging window of “reasonable” length?
  • Is AIT effective if expectations are backward looking?
  • Does AIT work well if some households do not participate in financial markets?
  • Would AIT be credible?
  • Should it be a temporary policy at the ELB?
A Framework to Assess AIT

- New Keynesian economy (Amano, Gnocchi, Leduc)
  - 20% of households with no access to financial markets
  - 75% of firms with backward-looking expectations
  - ELB binds 20% of the time

- CB minimizes inflation and output gaps using rule:

\[ i_t = r_t + \phi \frac{1}{n} \sum_{k=0}^{n} (\pi_{t-k} - \bar{\pi}) \]

- With \( \phi = 1.5 \), \( n = 6 \) quarters
Evaluating Monetary Frameworks

Amano, Gnocchi, and Leduc (2019)
Evaluating Monetary Frameworks

Amano, Gnocchi, and Leduc (2019)
Evaluating Monetary Frameworks

Amano, Gnocchi, and Leduc (2019)
Credibility is critical
Need to adopt regime before ELB episodes
Implies a willingness to disinflates if necessary
Credibility of IT Regime Achieved Over Time

Inflation and long-term inflation expectations

- CPI inflation (12-month percent change)
- Inflation expectations (10-year annual average)

Source: Haver
Summary

• With Fed objectives met, good time to review framework
• AIT is an attractive option, but credibility would be key
• Still, bar for change is high
• A lot of analysis, discussion, and debate is still needed