Discussion of *Average Inflation Targeting: Time Inconsistency and Intentional Ambiguity* by C. Jia and C. Wu

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FOMC announcement about AIT

"Our longer-run goal continues to be an inflation rate of 2 percent. Our statement emphasizes that our actions to achieve both sides of our dual mandate will be most effective if longer-term inflation expectations remain well anchored at 2 percent. ... Our new statement indicates that we will seek to achieve inflation that averages 2 percent **over time**. Therefore, following periods when inflation has been running below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for **some time.**"

Motivation for being vague about horizon

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3. Potential reluctance to tame future inflation

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2. Uncertainty about how the public will react
3. Potential reluctance to tame future inflation
4. **Optimal from a social welfare perspective**

This paper

Authors demonstrate how to design AIT to maximize the well-being of households.

In the presence of a temporary cost-push shock, the central bank faces a trade-off between stabilizing inflation and the output gap.

- Tell the public you are going to take a long time to bring average inflation to target to create more pessimistic expectations

- Once the shock is over, go back to IT or as short of a horizon AIT as possible

Makes an important distinction between the CB's objective function and the social welfare function

Lays out an exit strategy from AIT

Rational expectations assumption

Model relies heavily on the expectations channel of monetary policy

Limited survey and experimental evidence for forward-looking expectations, even when the CB is credible

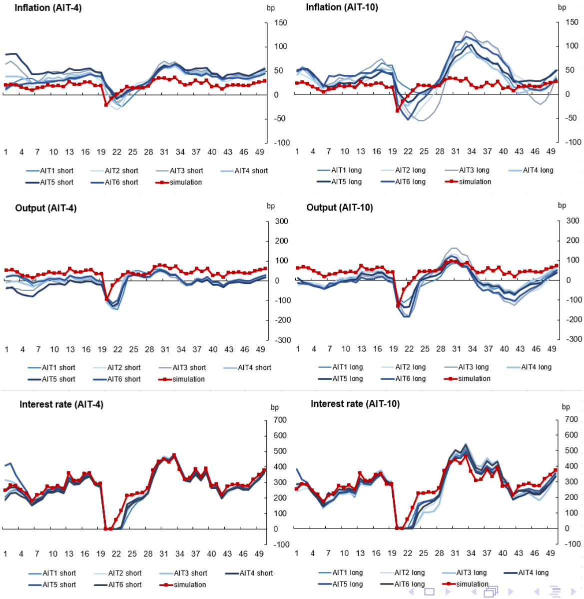
- Coibion-Gorodnichenko-Kamdar (2018), Adams (2007)
- Weak expectations channel of monetary policy (Kryvtsov-Petersen, 2015, 2021, Pfajfar and Žakelj, 2014, 2018)
- History-dependent policies less effective at coordinating expectations away from and at ELB (Arifovic-Petersen, 2017; Kostyshyna-Petersen-Yang, 2021; Hommes-Makarewicz, 2021)

Kostyshyna-Petersen-Yang, 2021

Experimental horse race comparing AIT with 4- and 10-period horizons to IT, DM, PLT, NGDPLT

- sequence of persistent demand shocks
- credible CB
- included brief episodes at the ZLB

Kostyshyna-Petersen-Yang, 2021



Kostyshyna-Petersen-Yang, 2021

Long horizons don't work

- Monetary policy is out of sync with the economy
- Most people extrapolate trends
- Insufficient understanding of the necessary 'make-up'
- Unmanaged inflation leads to unanchored expectations

Better to have a short window when agents are backward-looking
Amano-Gnocchi-Leduc-Wagner (2020), Nessen and Vestin (2005)

Social evolutionary learning

Bounded rationality about the targeting horizon L

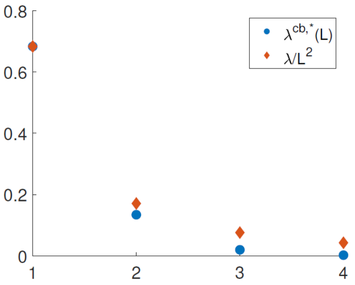
- Relevant to the FOMC announcement
- Would it be optimal to be ambiguous about L when there is evolutionary learning about inflation?
- Arifovic-Salle-Trong (2022) show that more guidance/communication is needed to learn how to forecast under history-dependent mandates
- Confusion about the Fed's AIT announcement suggests need for better communication (Coibion-Gorodnichenko-Knotek-Schoenle, 2020)

How much weight to place on inflation stabilization

Paper shows that the optimal λ^{CB} is a decreasing function of L.

- Long horizon means "it'll take longer to bring inflation back to target"
- To compensate for that greater inflation instability, need to react more to inflation and less to the output gap

Figure 4: $\lambda^{cb}(L)$ for multi-period AIT



Notes: $\lambda^{cb}(L)$ (y-axis) as a function of L (x-axis). Blue dots: $\lambda^{cb}(L) = \lambda^{cb,*}(L)$; red diamonds: $\lambda^{cb}(L) = \lambda/L^2$.

Also makes sense under backward-looking expectations

Conclusion

Excellent read

Rationalizes the Fed's ambiguous policy mandate announcement

Makes valuable distinctions between the social welfare function and the stated objectives of the CB - useful to study other unconventional mandates

Demonstrates how credibility can be maintained for longer (valuable in a situation when the cost-push shocks have been quite persistent)