# Slides for SOMC

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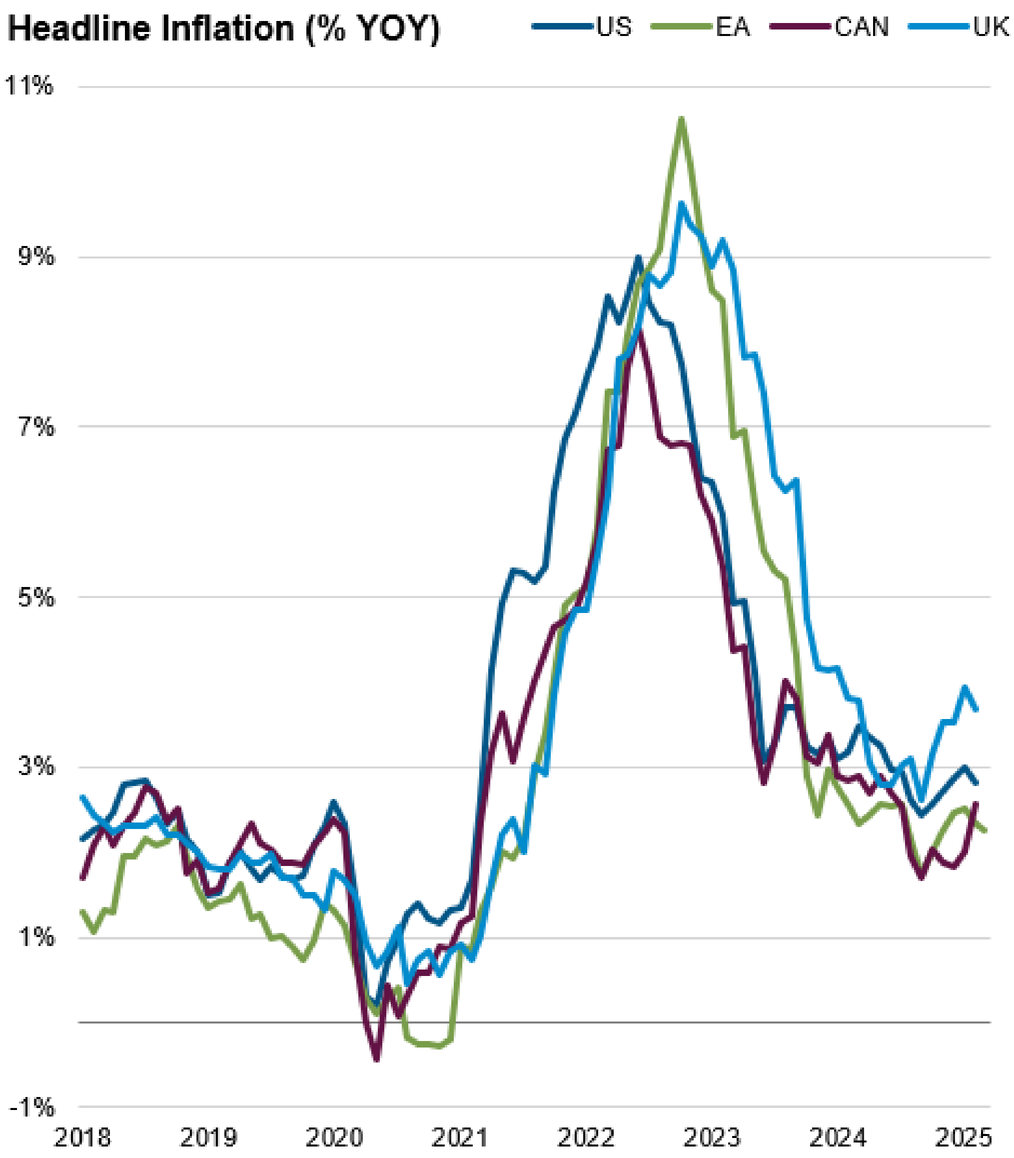
# Global Inflation Surge and Retreat

*Common Factors Behind Inflation Surge*

Adverse Aggregate Supply Shock

All in Fiscal – Monetary Demand Support

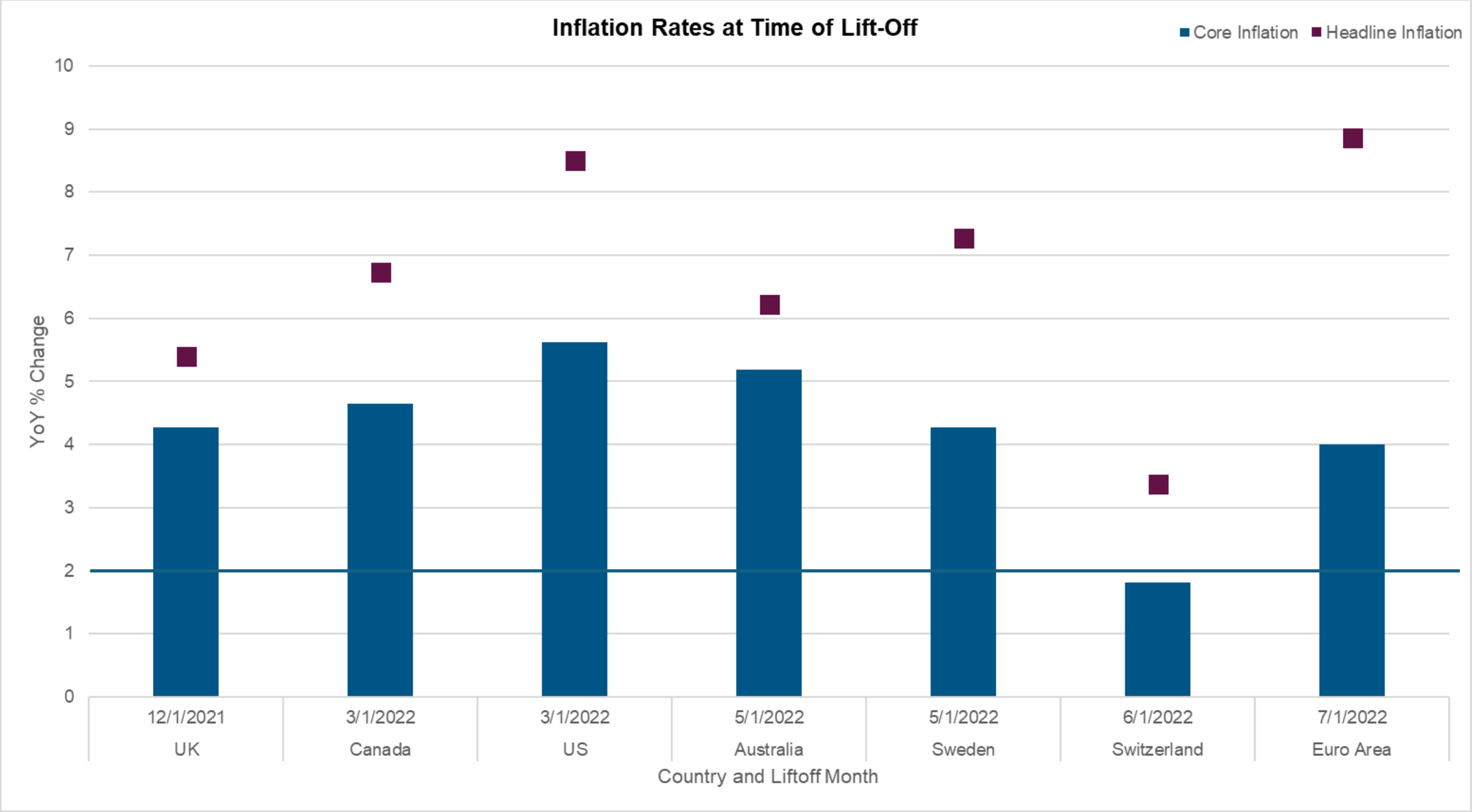
Huge Change in Relative Prices



# No Advanced Economy I.T. Central Bank Hiked Rates Before Inflation Well Exceeded Target

*And No AE* I.T. *Central bank (save Switzerland) Hiked Rates before CORE Inflation Exceeded Target*

If "falling behind the inflation curve" post pandemic is an indictment of a monetary policy framework, it is an indictment of inflation targeting in the UK, Canada, Australia, Sweden, and EMU as well as FAIT in US




Source: English, Forbes, Ubide (2024); Clarida (2024)

# Projecting an Ex-Ante Overshoot of the Inflation Target under Appropriate Policy was not New to FAIT

## *It was a Feature of Inflation Targeting Under the Bernanke Fed in 2012*

"The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate *at least as long as ……. inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."*

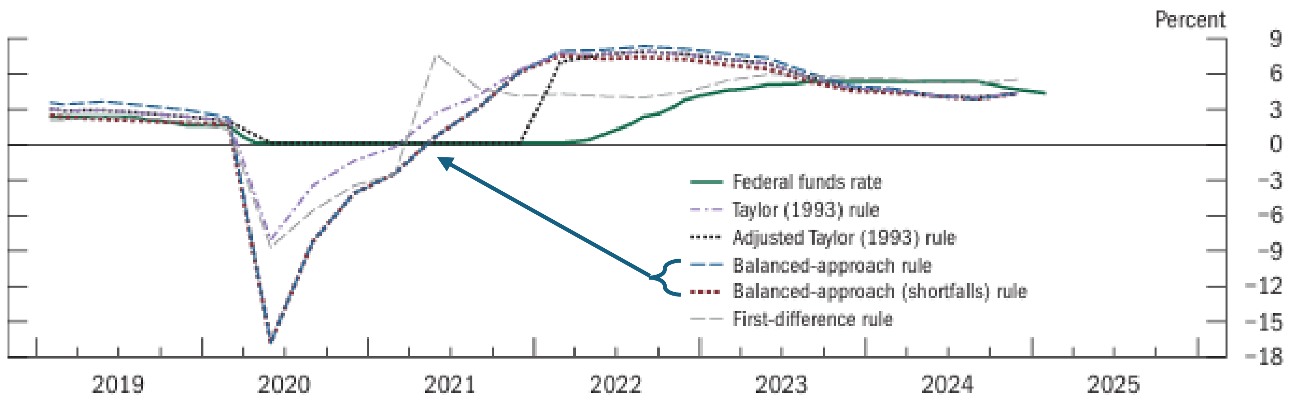
FOMC Statement, December 12, 2012

# The Focus on “Employment Shortfalls” Did not in Itself Delay Lift – Off

*Standard Taylor Type Policy Rules – including the ‘Shortfalls Rule’ Monitored by the Fed - Signaled Lift Off in September 2021*

…and by August 2021 I myself had concluded and said publicly that “if…core PCE inflation this year does come in at, or certainly above, 3 percent, I will consider that much more than a “moderate” overshoot of our 2 percent longer run objective.”

**Historical federal funds rate prescriptions from simple policy rules**




Note: The rules use historical values of core personal consumption expenditures inflation, the unemployment rate, and, where applicable, historical values of the midpoint of the target range for the federal funds rate. Quarterly projections of longer-run values for the federal funds rate, the unemployment rate, and inflation used in the computation of the rules' prescriptions are interpolations to quarterly values of projections from the Survey of Primary Dealers. The rules' prescriptions are quarterly, and the federal funds rate data are the monthly average of the daily midpoint of the target range for the federal funds rate and extend through January 2025.

Source: Federal Reserve Monetary Report to Congress (March 2023 and February 2025) and Clarida , “Outlooks, Outcomes, and Prospects for US Monetary Policy’’, Peterson Institute Remarks, August 4, 2021.

# Lift Off *Was* Constrained by the Threshold Forward Guidance Provided in September 2020 FOMC Statement

*This Guidance was Consistent with , but was not Mandated by, the New Framework*

....The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range *until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment* and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time......

.....Voting against the action were Robert S. Kaplan, who expects that it will be appropriate to maintain the current target range *until the Committee is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals as articulated in its new policy strategy statement*, but prefers that the Committee retain greater policy rate flexibility beyond that point; and Neel Kashkari, who prefers that the Committee indicate that it expects to maintain the current target range *until core inflation has reached 2 percent on a sustained basis*.

FOMC Statement, September X, 2020

# Lift Off Was Also Constrained by the Forward Guidance on QE Provided in the December 2020 FOMC Statement

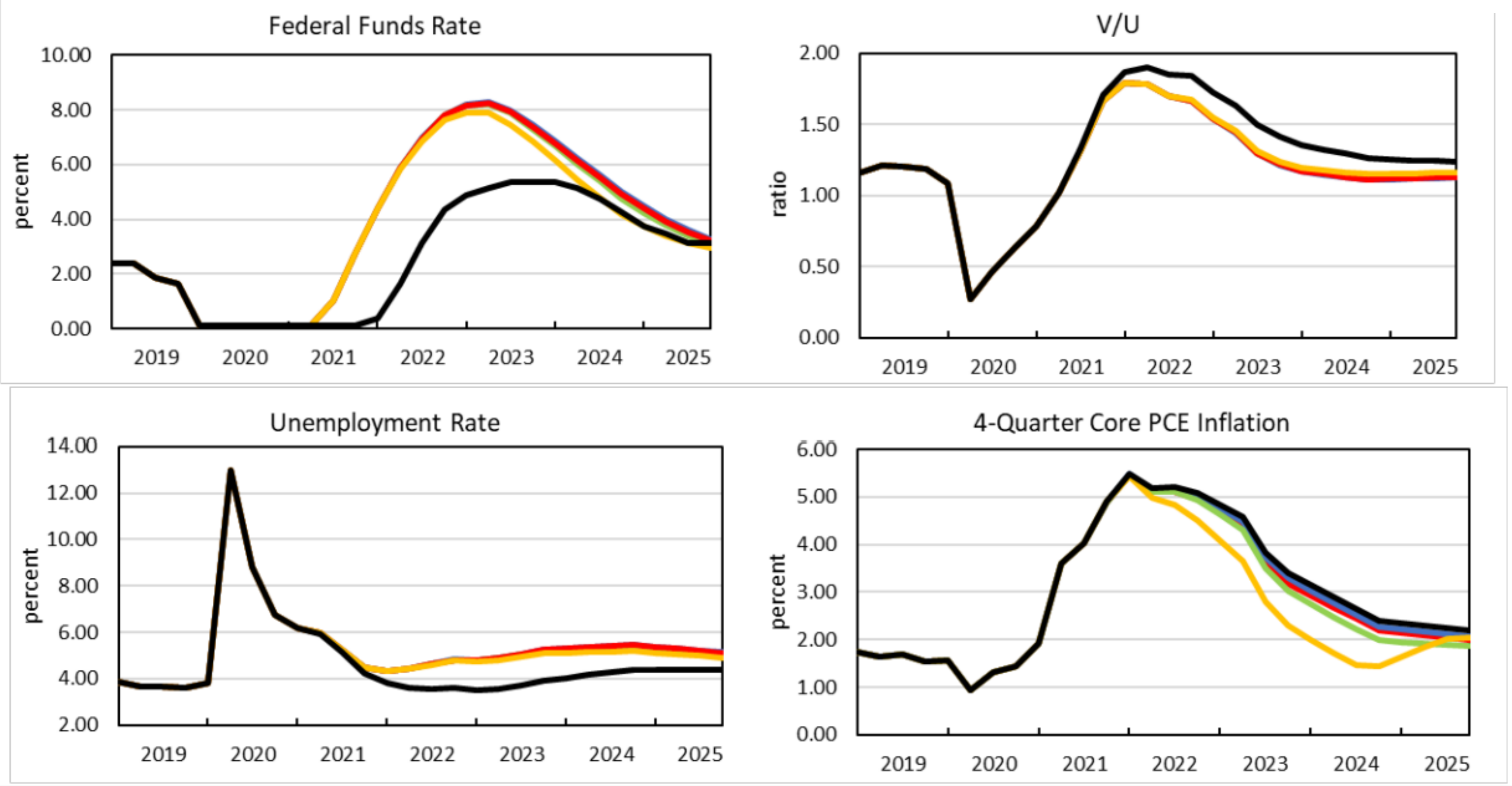
*As Well as by the Goal to Avoid another Taper Tantrum by Communicating that Rate Hikes Would be Delayed Until Taper Had Concluded*

....The Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month *until substantial further progress has been made toward the Committee's maximum employment and price stability goals*.

FOMC Statement, December 16, 2020

# Serious Counterfactual Thanks to Dave Reifschneider

Economic Effects of the Counterfactual Monetary Policy: FRB/US Simulations Assuming Well-Informed Financial Market Participants Using Different Specifications of the Phillips Curve




Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Federal Reserve Bank of New York, Federal Reserve Board, and author's calculations.

The black lines are actual and SPD projected results. The other lines are simulation results derived using wage and price equations based on the standard FRB/US model (red), the Bernanke and Blanchard specification (blue), the Cecchetti and others hot/cold model (green), and the Gagnon and Collins low inflation bend model (yellow). Under the counterfactual policy, in early 2021 the FOMC announces that it will follow the prescriptions of the V/U version of the BA rule and will begin normalizing the size of the SOMA portfolio. In response, financial markets revise their expectations as predicted by the model but do not have perfect foresight about future shocks to real activity and inflation. Other agents are less informed and revise their expectations in line with the predictions of a small VAR model.

# Summing Up

I think that future scholars will look back on this period and will conclude that it didn't reveal very much about inflation targeting versus flexible average inflation targeting frameworks or single mandate versus dual mandate central bank charters.

The spike in inflation in 2021-22 will be interpreted as a one-time price level shock that central banks should have better foreseen but that was largely inevitable given the magnitude of the covid - shock to aggregate and sectoral supply, the land war in Europe, and the "all in" response from fiscal and monetary authorities that these shocks triggered which certainly ex post boosted aggregate demand well north of available aggregate supply.

The rapid and through 2024 relatively painless disinflation will, if it continues, be seen as reflecting in part the unwinding and reversal of the adverse supply shocks that contributed to the initial inflation spike in the first place as well as the belated pivot to aggressive rate hikes once the threat was recognized.

The lessons learned over time will be derived I think from an informed and rigorous assessment of the costs and benefits of the tools of forward guidance and QE as they were deployed this decade in their various and sundry permutations.

# Lessons Learned with Specific Relevance for the Fed

Recognize there are costs as well as benefits to forward guidance , especially threshold forward guidance, on policy rates.

> In my judgement, the FOMC in September 2020 would have been well served then to adopt President Kashkari's preferred language "…The Committee ….expects to maintain the current target range *until core inflation has reached 2 percent on a sustained basis."*
>
> This in essence Bernanke – Evans TPLT at the ZLB which as I argued in a number of speeches as Vice Chair would be (and is) my preferred way to operationalize the August 2020 Framework Statement in ZLB episodes

If FOMC does plan to tolerate or aim for an inflation overshoot in a future ZLB episode (as it communicated in 2012 and 2020) it should quantify the amount of the overshoot it will tolerate up front as in the December 2012 "Evans Rule" FOMC guidance.

Recognize that there are costs as well as benefits to QE, especially "open-ended" programs such as QE3 and QE4, and as well to forward guidance on QE that would constrain lift off

> QE is not a "free lunch" to the fiscal authority in a world of IORB – it does not extinguish debt or eliminate coupon payments – it merely changes the maturity structure of an existing quantum of government debt from fixed to floating . It should be subject to cost benefit analysis by the FOMC especially given the 2019 formal adoption of the "ample reserves" framework - and the expansive definition of ample reserves.
>
> At minimum, the hurdle for open ended QE - and its attendant off-ramp challenges - should be set very (very) high.

An elegant way to incorporate much of the above is for the FOMC to embrace formal scenario analysis as part of the SEP as has been recommended by Bernanke for the BOE.

> Note this will require the FOMC to agree on one or a set of Taylor type reaction function (Papell and Prodhan)
>
> QE /QT and balance sheet path should be included in the scenarios