A Case for Monetary Policy Accommodation

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Long-Run Strategy for Monetary Policy (January 2012)

- **π^* = 2% PCE inflation**

- **U_t^* ~ 5.25% - 6% time-varying**

  SEP long-run central tendency

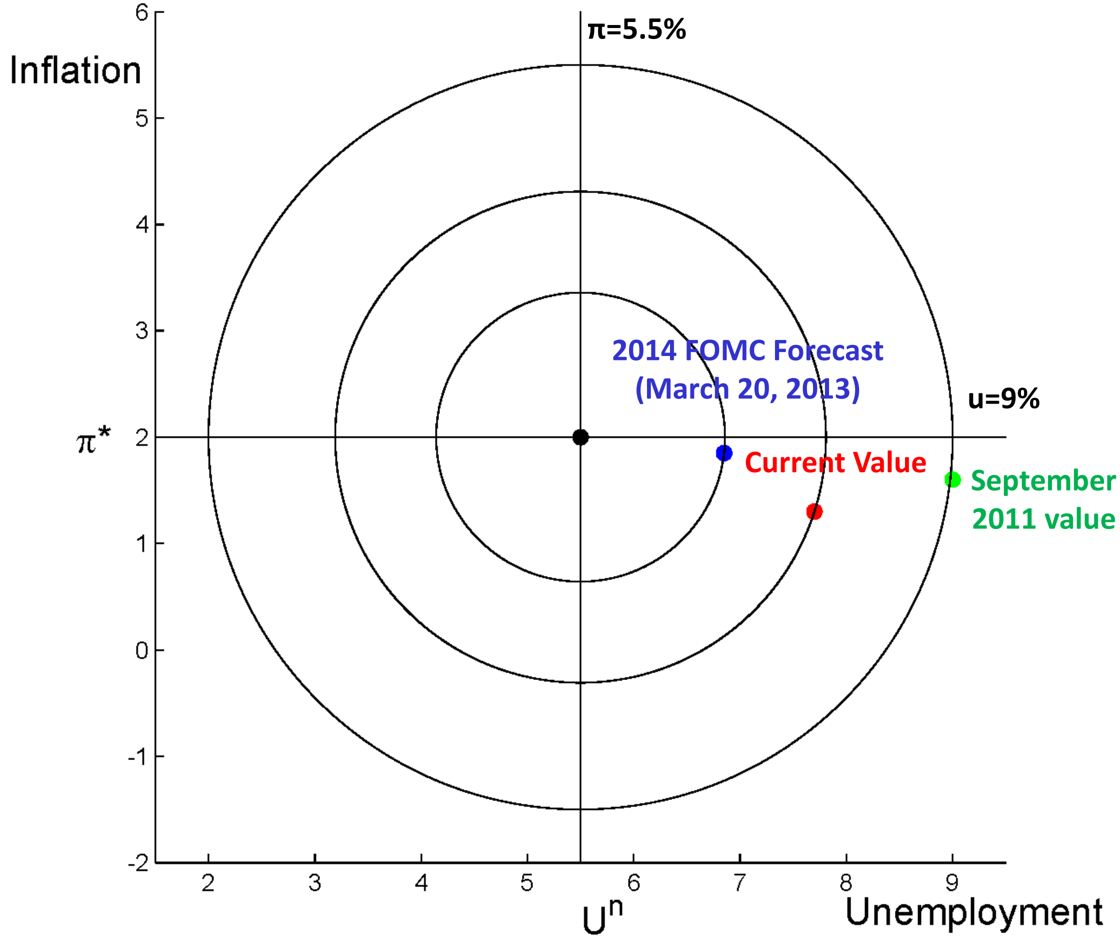
- **Balanced approach to reducing deviations of inflation and employment from long-run objectives**

Current and Expected Policy Losses

Loss Function
(percent)

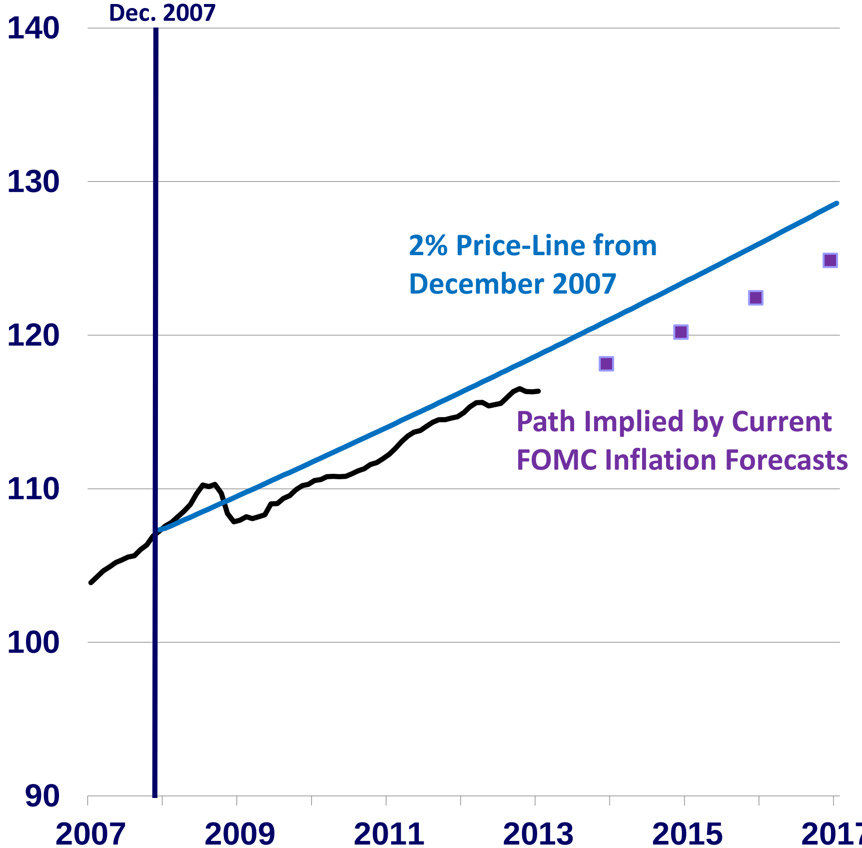
$$L = (\pi - \pi^*)^2 + 0.25\,(y - y^*)^2$$

$$L = (\pi - 2)^2 + (u - u^n)^2$$



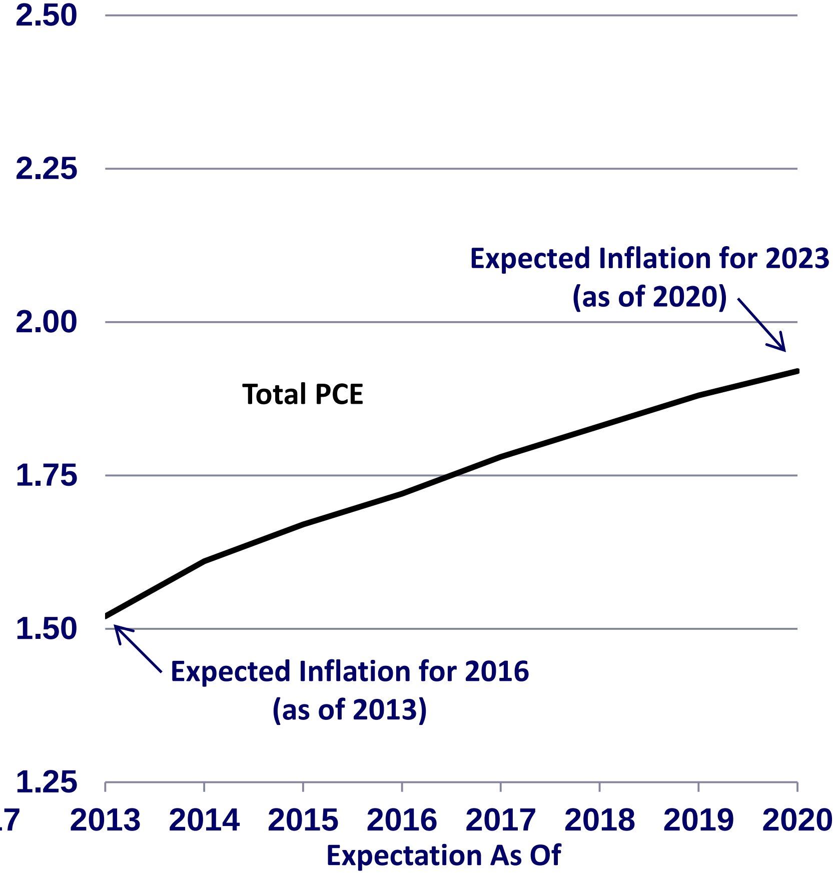
Subdued Actual and Expected Inflation

Total PCE Price Index
(level)



Source: Inflation forecasts are from the March 20, 2013 FOMC Summary of Economic Projections

Expected Future Three-Year Ahead Inflation
(percent)

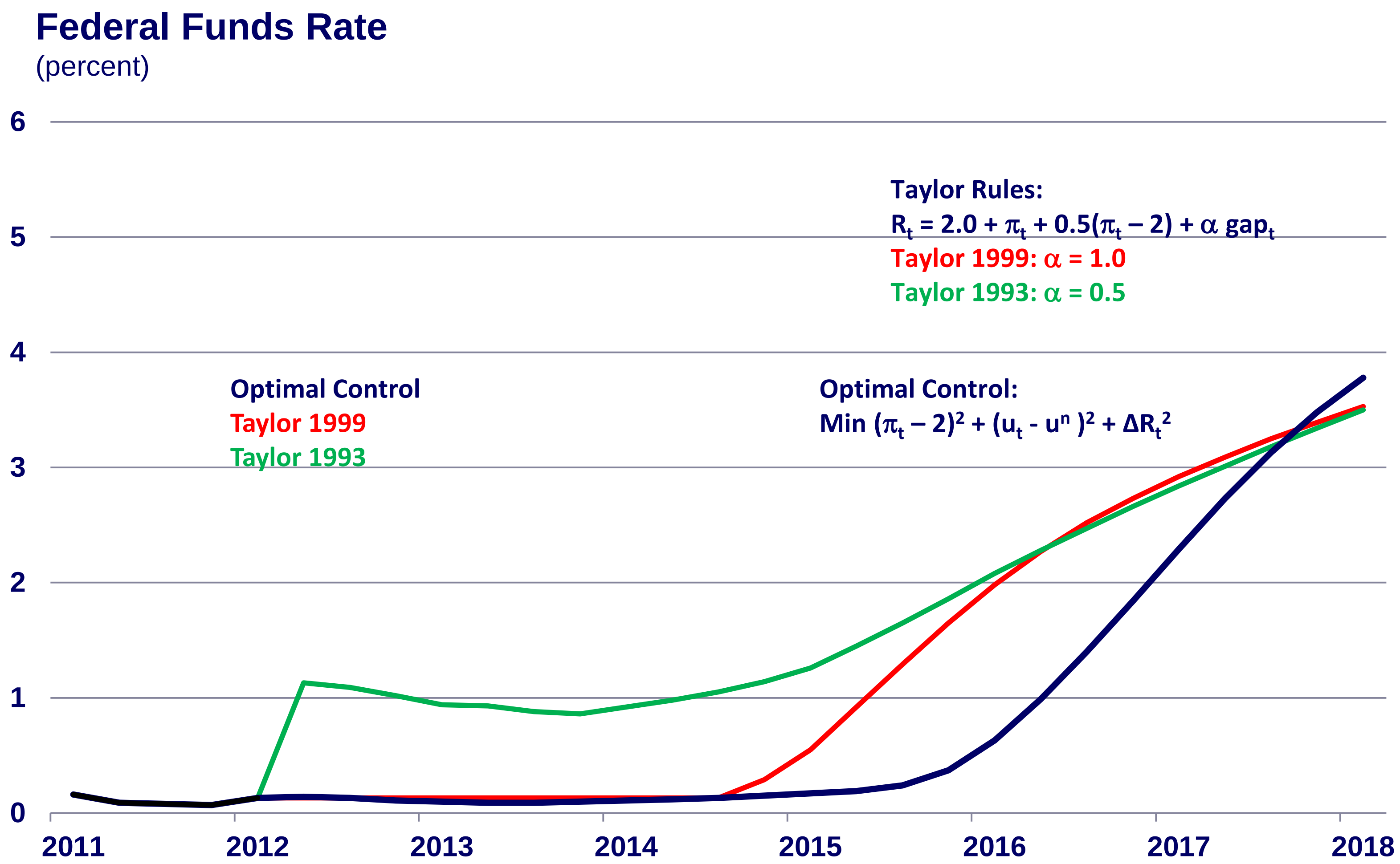


Source: FRB-Chicago Staff Calculations

Recent Policy Actions

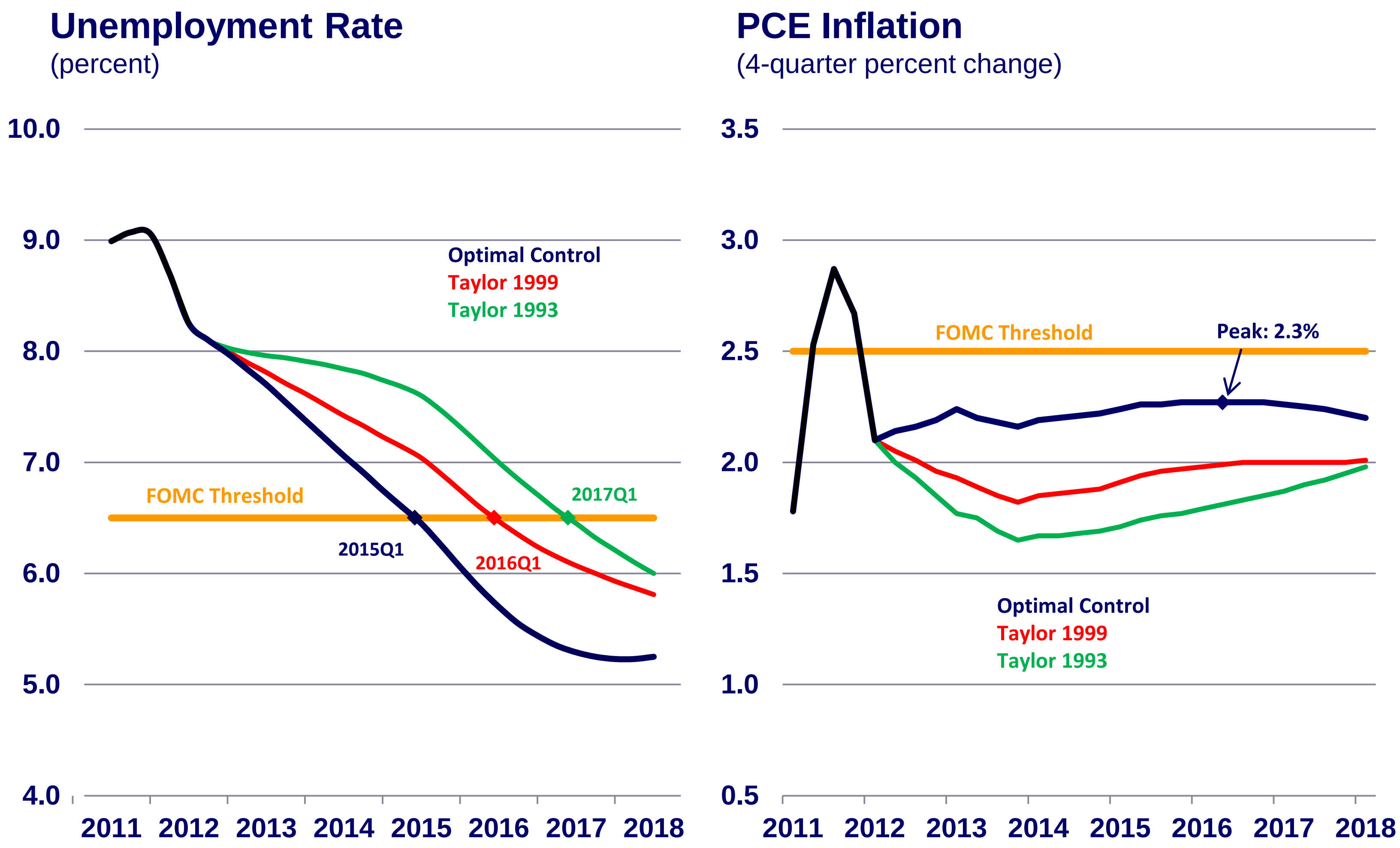
- **Open-ended Treasury and MBS purchases**
  - $85 billion per month
  - Until there is substantial improvement in labor markets
- **Low fed funds rate at least until:**
  - Unemployment < 6.5% or
  - Inflation forecast > 2.5%
- **Highly accommodative policy even after the recovery strengthens**

Alternative Policy Prescriptions



Source: Janet L. Yellen, "Perspectives on Monetary Policy," Boston, June 6, 2012

Progress toward the Dual Mandate Goals with Alternative Policies



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