Research Working Papers

Did the Federal Reserve Break the Phillips Curve? Theory and Evidence of Anchoring Inflation Expectations

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Communicating a longer-run inflation objective better anchored inflation expectations in the United States, which may explain the weaker relationship between inflation and unemployment in recent years.

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In a macroeconomic model with drifting long-run inflation expectations, the anchoring of inflation expectations manifests in two testable predictions. First, expectations about inflation far in the future should no longer respond to news about current inflation. Second, better anchored inflation expectations weaken the relationship between unemployment and inflation, flattening the reduced-form Phillips curve. We evaluate both predictions and find that the Federal Reserve's communication of a numerical inflation objective, first through its Summary of Economic Projections and later through the announcement of a 2 percent target in 2012, better anchored inflation expectations. Moreover, inflation expectations in the United States have remained anchored amid the volatility of the COVID-19 pandemic. In contrast, similar analysis reveals no evidence of anchoring in Japan despite the adoption of a numerical inflation target.

JEL Classification: E31, E52, E58

Additional Files

Appendix

Code and Replication Files

Article Citations

- Bundick, Brent, and A. Lee Smith. "Did the Federal Reserve Break the Phillips Curve? Theory and Evidence of Anchoring Inflation Expectations." Federal Reserve Bank of Kansas City, Research Working Paper no. 20-11, September. Available at https://doi.org/10.18651/RWP2020-11

Related Research

- Coibion, Olivier, and Yuriy Gorodnichenko. 2015. "Is the Phillips Curve Alive and Well After All? Inflation Expectations and the Missing Disinflation." *American Economic Journal: Macroeconomics*, vol. 7, no. 1, pp. 197–232. Available at https://doi.org/10.1257/mac.20130306
- Gürkaynak, R. S., A. Levin, and E. Swanson. 2010. "Does Inflation Targeting Anchor Long-Run Inflation Expectations? Evidence from the U.S., UK, and Sweden." *Journal of the European Economic Association*, vol. 8, no. 6, pp. 1208–1242.

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