Research Working Papers

From Deviations to Shortfalls: The Effects of the FOMC's New Employment Objective

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A monetary policy that stabilizes employment shortfalls, rather than deviations in employment from its maximum level, leads to higher inflation and higher employment on average.

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We analyze the effects of a monetary policy that stabilizes "shortfalls" rather than "deviations" of employment from its maximum level. A shortfalls-stabilization rule leads to expectations of more accommodative policy in expansions, raising average inflation and nominal rates. These effects are significantly amplified by incorporating history dependence in labor markets, a feature in labor-search frameworks. In a calibrated model of labor-search frictions and nominal rigidities, the adoption of a shortfalls rule raises average inflation and nominal policy rates by 90 basis points, reduces the likelihood of a binding zero lower bound, and implies a steeper and nonlinear Phillips curve.

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