



Research Working Papers

Maintaining the Anchor: An Evaluation of Inflation Targeting in the Face of COVID-19

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Globally, central banks prevented high inflation post-pandemic from becoming embedded in inflation expectations.

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This paper provides evidence that inflation targeting delivered well-anchored inflation expectations during the post-2020 inflation surge. Using a macroeconomic model, we first illustrate how long-term nominal interest rates respond to an unexpected burst of inflation under both anchored and unanchored inflation expectations. Then, we evaluate these predictions using high-frequency financial market data from nine advanced economies. Specifically, we examine whether inflation expectations embedded in asset prices remained anchored as inflation climbed in the aftermath of the pandemic. Our results suggest that inflation expectations were just as well, or in some countries better anchored, after the pandemic. We show that this favorable outcome was broadly accompanied by perceptions of an aggressive monetary policy response to above-target inflation.

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Related Research

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