Research Working Papers

Does Communicating a Numerical Inflation Target Anchor Inflation Expectations? Evidence & Bond Market Implications

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Communicating a longer-run inflation objective helped anchor inflation expectations in the United States but not in Japan.

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High-frequency empirical evidence suggests that inflation expectations in the United States became better anchored after the Federal Reserve began communicating a numerical inflation target. Using an event-study approach, we find that forward measures of inflation compensation became unresponsive to news about current inflation after the adoption of an explicit inflation target. In contrast, we find that forward measures of nominal compensation in Japan continued to drift with news about current inflation, even after the Bank of Japan adopted a numerical inflation target. These empirical findings have implications for the term structure of interest rates in the United States. In a calibrated macro-finance model, we show that the apparent anchoring of inflation expectations implies lower term premiums in longer-term bond yields and decreases the slope of the yield curve.

JEL Classification: E31, E52, E58

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Related Research

- Gürkaynak, Refet S., Andrew Levin, and Eric Swanson. "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. Available at https://doi.org/10.1111/j.1542-4774.2010.tb00553.x
- De Michelis, Andrew, and Matteo Iacoviello. "Raising an Inflation Target: The Japanese Experience with Abenomics." European Economic Review, vol. 88, September, pp. 67-87. Available at https://doi.org/10.1016/j.euroecorev.2016.02.021

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