

# News Release

THE FEDERAL RESERVE BANK of KANSAS CITY

925 Grand Boulevard • Kansas City, MO 64198 • Phone: 816.881.2683

[www.KansasCityFed.org](http://www.KansasCityFed.org)

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**CONTACT: Tim Todd**  
**816/881-2308**  
[timothy.todd@kc.frb.org](mailto:timothy.todd@kc.frb.org)

## WHAT IS THE OPTIMAL INFLATION RATE?

In the late 1970s and early 1980s, many countries, including the United States, experienced high inflation. A broad consensus emerged that this performance was unacceptable, and monetary policymakers around the world adopted policies to bring inflation down. With inflation undesirably high, policymakers knew the direction to push inflation even if they were uncertain of its ultimate destination. Today, with inflation much lower in the United States and elsewhere, the question of what inflation rate to aim for has moved front and center.

In their article, “What is the Optimal Inflation Rate?” Roberto M. Billi, economist, and George A. Kahn, vice president and economist, both of the Federal Reserve Bank of Kansas City, use a standard, modern macroeconomic model to estimate the “optimal” inflation rate for the United States. The optimal inflation rate is defined as the inflation rate that maximizes the economic well-being of the public. The article appears in the second quarter edition of the Bank’s *Economic Review*.

Policymakers generally agree that the optimal inflation rate should be above zero to ensure nominal interest rates do not fall to their zero lower bound. Once nominal rates have fallen to zero, policymakers cannot lower them further. At that point, the conventional tool of monetary policy for stabilizing the economy becomes ineffective in addressing an economic downturn. As a result, output and inflation may become more volatile.

The model used by Billi and Kahn, when calibrated to U.S. data, shows an optimal U.S. inflation rate of 0.7 percent to 1.4 percent per year as measured by the PCE price index. The authors’ estimate is the first to be based on a model in which policymakers are assumed to directly maximize the public’s economic well-being.

The article is available on the Bank’s website at [www.KansasCityFed.org](http://www.KansasCityFed.org).

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