



# TD Economics

## Special Report

July 27, 2007

### INFLATION TARGETING BY THE FED: WILL IT EVER HAPPEN, AND WOULD IT MATTER?

There has been much talk in the press lately about the adoption of an inflation target (IT) by the Fed. Despite pursuing a de facto inflation targeting policy regime, the Fed is yet to formally adopt IT as its official policy. In fact, the discussion on the formal adoption of an inflation target in the U.S. has been ongoing for some time now. Lately, though, the debate received a shot in the arm with the confirmation of Ben Bernanke – an open advocate of inflation targeting – as the Chairman of the Board of Governors of the Federal Reserve System<sup>1</sup>. Indeed, with an ardent supporter of IT at the helm, the recent posture of the Fed’s monetary policy has unambiguously shifted to one that suggests a strong preference for “price stability” over “full-employment” – that is, an anti-inflation bias.

However, in spite of the Chairman’s open advocacy, the adoption of IT is not a done deal. Standing in its way is a number of important factors that would appear to work against its implementation. In this piece, we present an analysis on the virtues (and pitfalls) of explicit inflation targeting by central banks, and offer an assessment of the implications of its implementation by the Fed for the financial markets.

#### Why target inflation?

Since the introduction of an explicit inflation target by the Reserve Bank of New Zealand in 1990<sup>2</sup>, the use of inflation targeting has become increasingly common among central banks around the world. To date, the number of IT central banks has swollen to 31 – of which there are 8 industrialised countries<sup>3</sup>. This approach to the implementation of monetary policy has become increasingly common, due in large part to the pronounced success of IT central banks in achieving and sustaining low inflation, and

#### HIGHLIGHTS

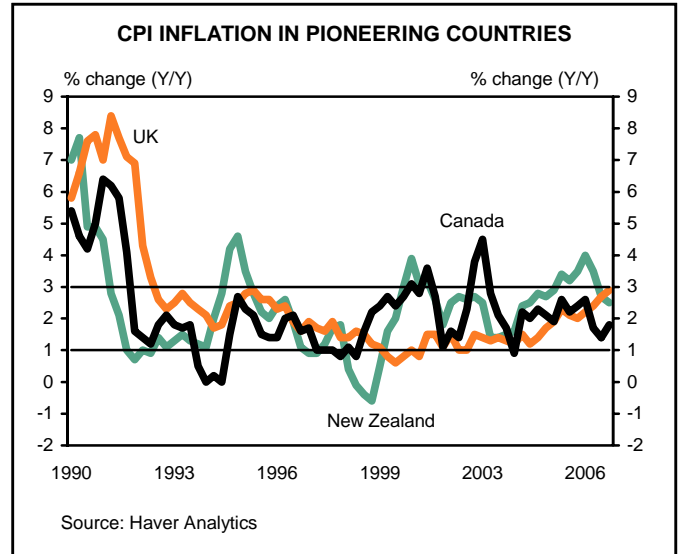
- **Inflation targeting increases the predictability of monetary policy, and provides a basis on which inflation expectations can be formed.**
- **The inflation compensation on bonds tends to be lower in inflation targeting economies, compared to their non-inflation targeting counterparts.**
- **Inflation targeting central banks, such as the Bank of Canada, have been successful in achieving and sustaining low inflation.**
- **The adoption of inflation targeting in the U.S. would be a formalisation of what many see as the de facto monetary policy framework of the Fed.**
- **Despite its success in combating inflation, there are still important benefits to be accrued to the U.S. economy if the Fed adopts an inflation target.**

effectively managing inflation expectations in their respective economies. The profound shift to IT – away from the once pervasive “discretionary policy framework<sup>4</sup>” – was in part due to the inherent time inconsistency problems that generally arise in an environment where monetary policy is used to engineer short-run reductions in unemployment – at the expense of higher inflation. That is, in the absence of any credible commitment to low inflation, central banks are capable of generating short-term gains in output (or lowering unemployment) by surprising the markets (and the general public) with the pursuance of accommodating monetary policy – after expectations have

been formed, and prices set. The general outcome of this approach to monetary policy implementation, however, has usually been higher and more volatile inflation rates, resulting from greater inflation uncertainty, as the public – in anticipation of this action by the monetary authority – revises its inflation expectations upward. In addition to this hide-and-seek game between the public and the monetary authority in a discretionary policy framework, inflation expectations are generally more sensitive to temporary shocks, thereby generating greater volatility in the inflation rate.

This is a natural consequence of the fact that without a clear notion of the central bank's acceptable level of inflation – and a demonstrated commitment to price stability by the monetary authority – the inflation expectations of the public will respond to temporary shocks to the economy. To get a better understanding of this outcome, let us assume for a moment that the economy is being hit by a shock to fuel prices. Without the ability to correctly anticipate the policy response of the monetary authority to this event, the public will rationally expect consumer prices (and therefore consumer price inflation) to increase in the future. As a consequence of the higher inflation expectations, agents will immediately demand higher wages, and consequently, increasing prices beyond the level supported by the initial shock – even if the shock turns out to be short-lived. This sensitivity of inflation expectations to shocks hitting the economy (resulting from uncertainty about the monetary policy response) will therefore lead to higher and more volatile inflation – an unwelcome consequence of non-commitment.

The reason for inflation targeting, therefore, is quite simple. In an environment where the policy target is precisely defined, and the framework for achieving it clearly articulated, there tends to be better performance in achieving the policy objective, as the public – particularly, the financial markets – adjusts its expectations in line with the prescribed target set by its respective central bank. In spite of its appealing features, however, IT was introduced in the three pioneering countries as a means of combating the once pervasive inflationary spiral that existed at the time – with resounding success. In Canada, for example, the introduction of IT was met with immediate results – with the headline rate of inflation falling from an average of 4.5 percent in the five years preceding the implementation of IT to 2.3 percent in the following five years. Along



with Canada, the other two pioneering countries also experienced amazing successes in lowering the level and variability of their inflation rates, immediately following the adoption of IT. Not surprisingly, in all cases the introduction of IT resulted in the inflation rate falling precipitously, and stabilising at (or close to) the levels set by the monetary authorities, and remaining within that range for most of the period under review. This success in taming inflation has also been a hallmark of other IT central banks around the world – including those in developing countries. As a result of their achievements, IT central banks have been able to garner immense credibility from the public.

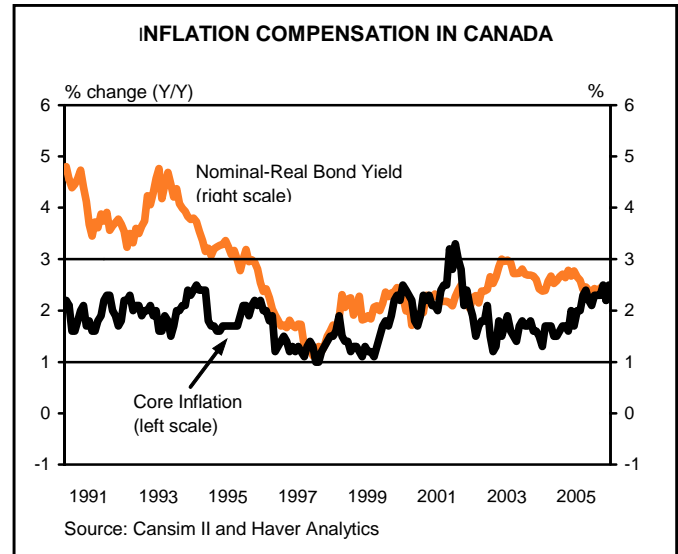
### It's all about anchoring inflation expectations

The key benefit of an inflation targeting policy regime is the clarity it provides on the objective(s) of monetary policy, and more importantly, the precision it offers on the target of the central bank. To get a flavour of this advantage that IT provides, it would be useful to compare the mandate for the Federal Reserve System with that of the Bank of Canada (BoC), as it relates to the conduct of monetary policy. In the US, the dual mandate for the Fed is the "...pursuit of maximum employment, stable prices, and moderate long-term interest rates". Indeed, while these broad objectives reflected in the mandate for the Fed are almost identical in spirit to that of the BoC, the refinement of what is meant by "stable prices" is essentially done by the BoC, by delineating an exact numerical value. To do this, the BoC provides a range, and an operational target which it considers to be consistent with the achieve-

ment of price stability in Canada. That is, the mandate of the BoC was further refined to allow it to "... conduct monetary policy aimed at keeping total CPI inflation at 2 per cent, with a control range of 1 to 3 per cent around the target."

The duality of objectives for the Fed presents a key inherent complication to monetary policymaking in the US. That is, with only one instrument available at its disposal (the fed funds rate), the Fed can conceivably have only one target at a time. As a result of this, without further clarity given on the respective weights (or priorities) assigned to these two policy objectives, the public will be unable to correctly anticipate the policy response of the monetary authority to shocks hitting the economy. This outcome becomes more pronounced when the two policy objectives conflict. For example, imagine a situation where the economy is experiencing a recession, while at the same time the inflation rate is rising – as occurred in the U.S. during the 1970s stagflation. In this scenario, the monetary authority can either pursue an accommodating monetary policy (lower the fed funds rate) to stimulate output – at the expense of a higher inflation rate – or pursue a restrictive monetary policy to lower inflation (increase the fed funds rate) – at the cost of further depressing economic output. It cannot do both. To this end, by identifying price stability as the main objective, and the inflation rate as the target, IT central banks such as the Bank of Canada, for example, will clearly follow the latter policy prescription as they attempt to bring consumer price inflation under control.

Another major benefit of IT, as exemplified above, is the fact that it reduces monetary policy uncertainty. That is, in an environment where the objective of monetary policy has been clearly set out, the monetary policy response becomes predictable. This predictability of monetary policy ensures that the excessive volatility in inflation that is usually the hallmark of a discretionary policy environment is reduced significantly. This feature of IT is a distinct advantage of this framework, in that it ensures that the public can fully anticipate the policy response of the monetary authority to deviations in inflation from the prescribed target. For example, when it emerges that there are sustained upward pressures on consumer prices – meaning that inflation may be heading above the prescribed range – the public would be in no doubt that the central bank will respond by increasing the policy interest rate.

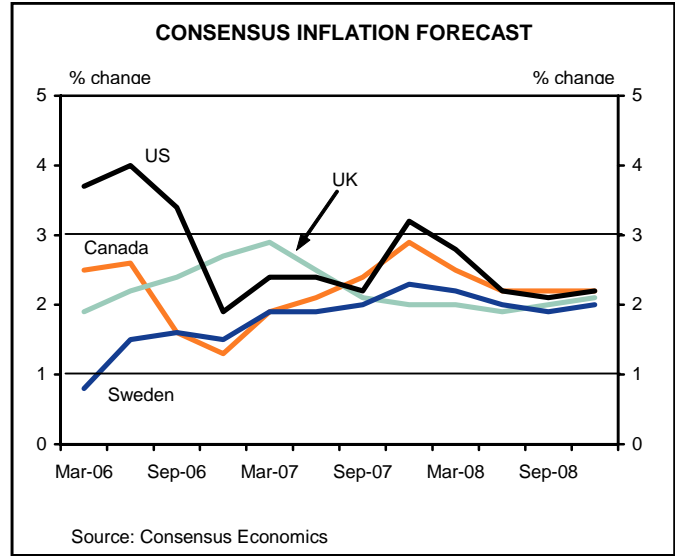


On the other hand, when the pressures to prices are pushing inflation below the range, a reduction in the rate would be correctly anticipated. In effect, IT ensures that surprises will be eliminated from the monetary policy decision-making process – thereby removing market uncertainty. Indeed, while this advantage is not exclusive to IT central banks, it is certainly enhanced by it.

Complementary to increasing the predictability of monetary policy, IT provides an anchor for inflation expectations. Like an anchored yacht resting in the lagoon, an inflation target will provide the requisite mainstay around which inflation expectations can be based. Therefore, if the central bank credibly commits to an inflation target, it presents the public with a nominal anchor on which their forecast for the future path of price inflation can be formed. The evidence points to the fact that economies with IT tend to have a lower level of inflation expectations than countries without explicit targets. For example, the consensus inflation forecasts for all three IT countries for the 2006-2008 period remains decidedly within the 1 to 3 per cent range set by the respective central bank, compared to the inflation expectations in the U.S. - where the consensus forecasts is consistently higher and more volatile. More importantly, the anchoring of inflation expectations has also resulted in reduced inflation compensation. This has surely been shown to be the case in the industrialised world where the spread between nominal government bonds and their inflation-indexed counterpart has been shown to be higher in non-IT economies – reflecting a higher compensation for inflation risks.

Along with the other industrialised countries, the Canadian experience with IT has been resoundingly successful. In fact, inflation expectations in Canada – measured by the consensus forecasts for the inflation rate – have fallen considerably from its high of well over 4.5 percent in 1994 and remained well within the control range of 1 to 3 percent. At the same time, the variability of the inflation forecasts has also declined significantly. To get a more direct market-based measure of inflation expectations, we also plot the inflation compensation for bonds – an implicit measure of the nominal/real bond spread – for Canada over the same period. Here again, the outcome is similar. The inflation compensation for government bonds in Canada has fallen significantly and stabilised within the control range set by the BoC. This observation has important relevance to the real economy since lower risk premium – in this case, inflation risk – has generally translated in lower borrowing costs, thereby fostering economic growth.

In other respects, the overall performance of the Canadian economy improved unambiguously as a result of the adoption of IT. For example, there have been dramatic reductions in both the average all-items and core inflation rates in the post-1992 period. In both cases, the average inflation rate fell by more than 50 percent (well over 2 percentage points) following the adoption of IT – with the average headline inflation rate falling to within touching distance of the 2 percent target set by the Bank. In addition to this, there were also dramatic improvements in the growth performance of the Canadian economy over the same period. The average quarterly growth rate of real GDP in Canada increased by as much as 0.22 percentage points since the introduction of IT compared to the 15 years prior to its implementation. Not only did the average rate of economic expansion increase in Canada under IT, but its variability also declined dramatically, fall-



ing by close to 50 percent over the period. This observation is particularly important since it indicates that there appears to be no trade-off between stabilising inflation and output under IT. According to the Bank of Canada, other anecdotal evidence such as the increase in the length of contracts and the decline in the use of inflation-indexed financial instruments also point to the improvements accruing to the Canadian economy, as a result of the adoption of the inflation targeting policy framework.

So far we have focused almost exclusively on the ability of IT to temper upward inflationary pressures by anchoring inflation expectations. However, with a modestly positive inflation target, it is also the case that IT will reduce the risk of deflation. As has been demonstrated in Canada, with symmetric treatment by the monetary authority to inflation approaching both outer bands of the control range, the risks associated with experiencing the harmful consequences of deflation can be eliminated. This outcome contrasts with the discretionary policy environment where the treatment of deflation and accelerating inflation may be asymmetric, and thus the occurrence of deflation (as in the case of the 1990-2005 Japanese experience) can become unavoidable. In fact, if Japan had IT (and a positive inflation target) in place, it is entirely conceivable that it would have been spared the deflationary spiral it experienced in the 1990s by compelling the monetary authority to pursue an expansionary monetary policy to combat the slumping prices and declining economy.

Finally, it has also become commonplace for central banks with IT to be more transparent in their operation and communication with the general public. The associa-

Canadian Economic Performance		
	1985-1991	1992-2007
<b>Average (%)</b>		
Headline inflation	4.563	1.866
Core inflation*	4.909	1.673
GDP	0.554	0.776
<b>Standard Deviation</b>		
Headline inflation	0.729	0.880
Core inflation**	0.733	0.730
GDP	0.882	0.477
* All-items excluding food and energy.		
** Ibid		

tion of improved transparency and communication with IT originates from the fact that IT central banks are not only expected to explain their policy responses (or lack thereof) to deviations from the inflation target, but it is also incumbent upon them to provide clear forecasts for the future path of inflation. This therefore makes it easier for the central bank's actions to be discerned and monitored by market participants. For example, the Governor of the Bank of England is mandated to write a letter to the Chancellor of the Exchequer each time the reported rate of inflation is more than 1 percentage point in either direction from the inflation target range (of 1 to 3 percent). In this letter, the governor is expected to explain (i) the reason the inflation rate missed the target, (ii) the requisite action(s) being taken to deal with it, and (iii) the time period in which it is expected to return to target. Indeed, while this procedure is not common among all IT central banks, it demonstrates the lengths to which some IT central banks go to maintain credibility, by communicating directly about their monetary policy framework.

### **The downsides to inflation targeting**

Despite its numerous benefits, the implementation and pursuance of IT has its inherent complications and deficiencies. In the first place, to effectively implement inflation targeting, the appropriate numerical value at which inflation is to be targeted must be determined. This is certainly no small matter. At the center of this choice is the determination of whether the inflation rate should be targeted at zero, or whether a moderate level of inflation in consumer prices, say of about 2 percent – as in the case of Canada – should be tolerated. The answer to this question has been biased towards the latter, with the average rate of targeted inflation for IT central banks in the industrialised economies being 2.1 percent. The final determination, however, is important since it will effectively be stating the level at which average consumer prices will be allowed to grow over time by the monetary authority. The choice of a low positive value for the inflation target is consistent with improving the efficiency in the functioning of the economy, and as such, contributes to longer-term economic growth. Additionally, it provides the requisite breathing room within which the monetary authority can guard against deflationary pressures.

Notwithstanding this decision, a more fundamental question that arises is whether the target should be the inflation rate or the aggregate price level (price level targeting -

PT) – which perhaps is a more rigid interpretation of the “price stability” objective, and is akin to targeting a zero percent inflation rate. This debate has gained much currency in the Canadian context as the discussions leading up to the 2011 renewal of the inflation target in Canada heats up. The central consideration here is determining whether the monetary authority should pursue absolute price stability. This approach has its benefits since it will essentially mean that the domestic currency will become a unit of account and standard for deferred payment with a constant value, and therefore all nominal values will become real values. The downside to this approach, however, is that it will introduce more volatility to output and the inflation rate in the short-run, compared to IT. This is because the central bank will be obliged to counter every shock to the price level by undertaking deflationary (inflationary) policies in response to shocks that move the price level above (below) the target.

One important drawback resulting from the adoption of an inflation target is the loss of monetary policy freedom. This emerges as a natural consequence of the fact that IT constrains the pursuance of monetary policy to a single variable – the inflation rate. Indeed, while this has been a major criticism of the IT policy regime, it can clearly be seen as a reflection of the fact that in the medium to long-run<sup>5</sup> monetary policy has no impact on the real economy. This loss of monetary independence is particularly important since it must be seen in the context of the targeting of inflation coming at the expense of greater volatility in output, as a consequence of the diminished weight given to it. Note, however, that stabilising consumer prices can be easily considered as providing the requisite platform for long-term economic growth – a fact that has not been lost on IT central banks. That is, targeting inflation is not only seen as a short-term end in itself, but also as the means to achieving the end of longer-term full employment.

### **Why hasn't the Fed fallen in line?**

Despite pursuing a de facto inflation targeting regime, the Fed is yet to formally adopt IT as its official policy. In fact, the discussion on the formal adoption of an inflation target in the U.S. has been ongoing for some time now. Lately, though, this debate received a shot in the arm with the confirmation of Ben Bernanke – an open advocate of inflation targeting – as the Chairman of the Board of Governors of the Federal Reserve System. However, despite his open advocacy of inflation targeting, the adoption is

not a done deal. Standing in its way is a number of important factors that would appear to work against its favour.

The first of these important impediments is – as always – political. The mandate for the Fed comes from the U.S. Congress, and there appears to be little support on Capitol Hill for a monetary policy regime which will give greater weight to “price stability” at the expense of the seemingly more important “maximum employment” – particularly with the Democratic Party in control of congress. In fact, the remark to the Financial Times newspaper by Rep. Bernie Frank – the Democratic chairman of the House financial services committee – that it would be a “terrible mistake” for the Fed to adopt an explicit target, since a target “would come at the expense of equal consideration of the other main goal, that is employment” is an indication that there is very little appetite for such a move on Capitol Hill. Moreover, there is also likely to be little public support for a shift away from the “ideal” of lower unemployment.

Secondly, the case for the adoption of IT in an environment where inflation has been “tamed” is a difficult one to make. As noted earlier, IT was adopted as a means of reducing the once prevalent high levels of consumer price inflation in the countries that implemented it. For example, at the time that IT was introduced in the three pioneering countries, the inflation rate was running at well over 7 percent. This is certainly not the case in the US. As such, the argument has been made by its opponents that there is little to be gained from a change in a policy that appears to be working.

Another important impediment is the fact that there is not unanimous support for the adoption of IT among Fed officials. Indeed, even though Chairman Bernanke – who has a number of supporters on his side – is an open advocate of IT, his deputy (vice-chair Kohn) is a staunch opponent of the framework. As such, given that the decision-making process at the Fed is driven by consensus, the opposition of Governor Kohn – along with Chicago Fed President Moskow – would appear to be an important barrier to the adoption of IT by the Fed. Needless to say, the majority of members appears to be in favour of implementing the policy framework.

Having said that, despite the success of the Fed in combating inflation there are still important benefits to be garnered by the adoption of IT. These can be summarised as: (i) increased clarity in communication with the public, and improved predictability of Fed actions, (ii) the anchoring of

inflation expectations which will invariably reduce the sensitivity of inflation expectations to news, (iii) the elimination of the possibility of the return to high inflation, and (iv) the reduction in the possibility of deflation. This has certainly not been lost on Fed Chairman Bernanke, and his open and vehement advocacy of its adoption by the Fed is indicative of his strong conviction – and that of his army of supporters in the Fed – that this framework would be beneficial to the U.S. economy. This would seem to suggest that the adoption of IT by the Fed will occur at some point in the future. The form that it takes, however, is likely to be different to that being pursued in Canada. The key difference is likely to be that even if the Fed adopts an explicit inflation rate target, it would conceivably still retain some flexibility on the full-employment front. This approach has been referred to as “constrained discretion” by the Fed Chairman. In the end, we expect the Fed to continue the incremental shift to the adoption of an inflation target – though a full-fledged conversion in the near term is unlikely.

The shift will be more meaningfully demonstrated in its communication strategy, with more emphasis being placed on its communication tools, and in particular, the codification of its “comfort zone”<sup>6</sup>. The revision of its communication strategy took center stage at the FOMC June 27-28, 2007 meeting when the Committee discussed the topic of monetary policy communications. The meeting was centered on the key elements of the Committee’s communications vehicles, namely: the FOMC meeting statement; the FOMC meetings minutes; and the Federal Reserve’s semi-annual monetary policy reports to the U.S. Congress. While no major decisions have emerged from this meeting, the subcommittee on communications issues was mandated to review the Committee’s discussions to date on these matters.

### **What does this all mean for the financial markets?**

In an industrialised economy like the US, where inflation is well-contained, and the Fed’s anti-inflation bias well documented, the switch in policy to inflation targeting may be considered as a mere formalisation of what many see as the de facto policy being pursued by the Fed. Indeed, with the Fed repeating its now famous line that “...the Committee’s predominant policy concern remains the risk that inflation will fail to moderate as expected”, there appears to be little doubt that the Fed has a strong anti-infla-

tion bias. Nevertheless, there are important considerations that need to be pointed out.

As argued above, the adoption of an inflation target will provide the general public with the precise measure used by the Fed to gauge inflationary pressures. To this end, the adoption of IT will provide greater clarity to what the “comfort zone” of the Fed is, and therefore increase the predictability of the Fed’s policy response to inflation data. The counterfactual question to be asked then becomes: what would the behaviour of the Fed be if it were part of the IT club? If we assume that the comfort zone for the Fed is 1 to 2 percent for the core PCE deflator – which is the consensus view of the markets – in terms of policy response, there may in fact have been very little difference in the policy decisions of the Fed in the recent past. However, the market reaction would have been decidedly different. For one thing, the “second-guessing” of the Fed’s policy stance would be unquestionably eliminated, since the market would have a clear idea of the Fed’s position on inflation, vis-à-vis unemployment. This would have certainly mitigated some of the market volatility and skittishness leading up to, and following the Fed’s FOMC meetings.

In addition to reducing market reaction to the Fed’s decisions, the predictability of monetary policy action by the Fed will reduce market volatility in response to economic news – particularly, news on consumer prices. With infla-

tion expectations more firmly anchored – as a result of the adoption of IT – the inflation compensation in the U.S. will fall, and its volatility reduced. This observation has important consequences for the real economy in the US, since it will lower borrowing costs as a result of the reduction in the inflation risk premium. In terms of real economic activity, lower borrowing costs will certainly translate into faster economic growth, and consequently, higher real return to investment.

### **The bottom line**

The countries that have adopted IT as their monetary policy framework have reaped the benefits of low inflation and firmly anchored inflation expectations, while increasing their credibility in the process. This has also resulted in improved economic performance in these countries. In terms of the US, despite already having low inflation, there are still important benefits to accrue to the U.S. economy from the adoption of inflation targeting. Foremost among these will be the lowering of nominal interest rates, as a result of a reduction in the inflation risk premium. Indeed, while a formal adoption may not necessarily change the policy response of the Fed – since it already acts as an IT central bank – it would undoubtedly have important ramifications for the markets, and the US economy as a whole.

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## Endnotes

- <sup>1</sup> In Appendix 1 we present a synopsis on the IT position of the members of the FOMC.
  - <sup>2</sup> This decision was followed by the Bank of Canada (BoC) in 1991 and the Bank of England in 1992 - who undertook a similar monetary policy stance.
  - <sup>3</sup> The list of industrialised countries pursuing IT is: Australia, Canada, Iceland, New Zealand, Norway, Sweden, Switzerland and the United Kingdom.
  - <sup>4</sup> A discretionary monetary policy framework is one where the policy choice of the central bank to shocks to the economy is driven by the objective function (judgement) of the policy maker(s). This approach contrasts with the rules-based framework – where the policy response is dictated by a preset rule or policy objective.
  - <sup>5</sup> The famous quote by the 1976 Noble laureate in economics that “... inflation is always and everywhere a monetary phenomenon” is indicative of the view in economics that in the long-run monetary policy only affects the rate of price inflation.
  - <sup>6</sup> The current market consensus for the Fed’s implicit comfort zone for core PCE inflation is 1 to 2 percent.
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## Appendix

Fact Sheet: Fed officials’ position on inflation targeting (IT)

### FED CHAIRMAN Ben Bernanke

#### Position on IT: Advocate

Chairman Bernanke is an open advocate of “constraint” inflation targeting, and is seen as the leading proponent for its implementation by the Fed. Prior to assuming the Chairmanship, he wrote numerous articles and books on the topic, suggesting that a target range of 1 to 2 percent may be appropriate for the US.

### FED VICE CHAIRMAN Donald L. Kohn

#### Position on IT: Opposes

Vice-chair Kohn is staunchly opposed to the idea of the Fed adopting an inflation target, in a speech at the National Bureau of Economic Research Conference on Inflation Targeting in January 2003, he is quoted as saying that “placing any number on an inflation objective – however much it would be surrounded with caveats – has the potential to constrain policy in some circumstances in which it would not be desirable to do so.”

### FED GOVERNOR Kevin M. Warsh

#### Position on IT: Not known

No public comments.

### FED GOVERNOR Randall S. Kroszner

#### Position on IT: Not known

No public comments.



**FED GOVERNOR Frederic S. Mishkin****Position on IT:** Advocate

Governor Mishkin has openly advocated the adoption of an explicit inflation target strategy. In a 2004 article he stated that “the Federal Reserve should adopt a flexible form of inflation targeting in the near future.”

**ATLANTA FED PRESIDENT Dennis P. Lockhart****Position on IT:** Not Known

No public comments.

**BOSTON FED PRESIDENT Cathy E. Minehan****Position on IT:** Not known

No public comments

**CHICAGO FED PRESIDENT Michael H. Moskow****Position on IT:** Sceptic

Moskow appears to be on the fence on the issue of the adoption of an explicit target by the Fed. In a September 2006 article he stated that the “proposals for flexible inflation targeting require further elaboration before they can be of practical use to policymakers.” While he agrees with the general principles of the policy framework, he claims that “there is not a pressing need to make a decision on inflation guidelines one way or the other.”

**CLEVELAND FED PRESIDENT Sandra Pianalto****Position on IT:** For soft target

In an April 2005 speech, Pianalto suggested that the adoption of a range for inflation around its long-run level makes sense. She goes on to claim that “we might gain some additional credibility with the public by simply being clearer than we are today and, at the same time, greater clarity might impose some extra self-discipline when we really need it.” She notes that her target for inflation is 1.5 percentages with a range of 1 percentage point spread above and below that level.

**KANSAS CITY FED PRESIDENT Thomas M. Hoenig****Position on IT:** Not known

No public comments.

**MINNEAPOLIS FED PRESIDENT Gary H. Stern****Position on IT:** Advocate

Stern indicated in a June 2005 article that establishing a regime of inflation targeting may be an effective means to formally institutionalize the low inflation policy that the Fed has followed implicitly over recent decades. His stated preference is for a “mildly positive rate of price increase on average.”

**NEW YORK FED PRESIDENT Timothy F. Geithner****Position on IT:** Unclear

In a 2005 speech in Brazil, he asserted that the adoption of an inflation target framework may help to improve central bank's credibility, though he stopped short of formally endorsing the framework.

**PHILADELPHIA FED PRESIDENT Charles I. Plosser****Position on IT:** Unclear

Since taking office in August 2006, FRB of Philadelphia President Plosser has avoided any mention of IT by the Fed. However, as a pioneer of modern real business cycle theory – which is built on the premise that monetary policy has no long-term impact on real variables such as employment – it would be no surprise if he favours IT.

**RICHMOND FED PRESIDENT Jeffrey M. Lacker****Position on IT:** Advocate

In a March 2005 speech, Lacker stated his strong support for IT. In it he stated that he “believes that the adoption and announcement of an explicit, numerical, long-run inflation target by the Fed would enhance the effectiveness of monetary policy.”

**ST. LOUIS FED PRESIDENT William Poole****Position on IT:** Advocate

Poole openly advocates a zero percent (properly measured) target for the inflation rate. In a February 2006 speech he stated that “a formal inflation goal should improve the coherence of internal Fed deliberations by focusing attention on *how* to achieve an agreed goal rather than on the goal itself.” While he has expressed a strong preference for a low inflation target, he appears open to a consensus view that is higher.

**SAN FRANCISCO FED PRESIDENT Janet L. Yellen****Position on IT:** In favour

Yellen is in favour of the adoption of an inflation target by the Fed. She claims that “a numerical objective might anchor inflation expectations, help with communication about likely future policy actions, and also provide greater clarity for Committee deliberations.”