Research [in] Brief

Did News of the Fed's Change to Flexible Average Inflation-Targeting Lift Expectations?

Primary issue

Expectations play an important role in determining the rate of inflation, which has been under the Federal Reserve's target rate of 2 percent for most of the past 12 years. Policymakers became concerned that if inflation stays at that level for too long, the public might start expecting inflation to remain below the target, making it more difficult for the Fed to achieve the target rate in the future. To guard against a decline in expectations and to raise them when appropriate, the Fed announced it would adopt a new approach called "flexible average inflation targeting," or FAIT.

Key findings

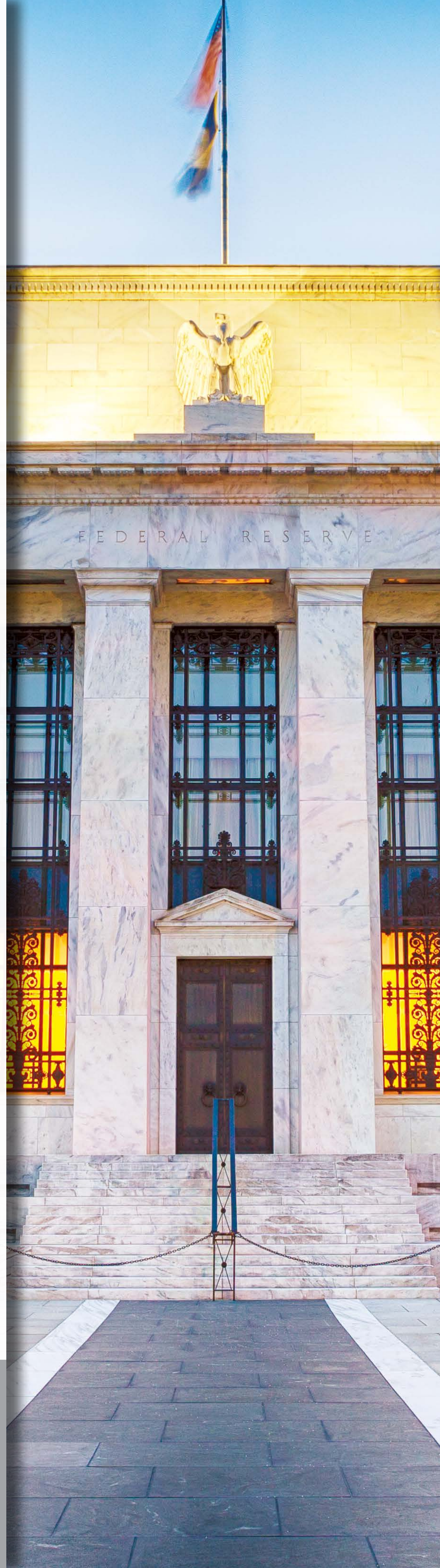
An analysis of professional forecasters' expectations for inflation shows that after the change to FAIT was announced, expectations did change.

- Forecasters who previously expected inflation to be lower than the target for 5 years starting 5 years from now typically raised their expected rate of inflation.
- Forecasters' expectations were also less varied than before the announcement and more concentrated near the target.

An analysis of expectations after the Fed announced a change to its monetary policy framework in 2012—the adoption of a target rate for inflation—shows that the effects of the change intensified as time passed. This fact suggests our conclusions should be viewed as tentative and that success of FAIT will be more fully informed by monitoring future developments.

The bottom line

The Federal Reserve adopted FAIT to help it guide the public's expectations for inflation toward the Fed's target rate. Forecasters' immediate reactions to the news of the change suggest that FAIT may be helpful in anchoring inflation expectations closer to the target.



Want the details? Read "Flexible Average Inflation Targeting and Inflation Expectations: A Look at the Reaction by Professional Forecasters" at **clevelandfed.org/ec202109**.

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