- **August 12, 2021**. Article. "The Fed's New Monetary Policy Framework One Year Later," Federal Reserve Bank of St. Louis *Regional Economist*, Third Quarter 2021. This article also appeared in the *St. Louis Fed On the Economy* blog, August 16, 2021.

  **The Fed's New Monetary Policy Framework One Year Later**

  The Federal Reserve has a mandate from Congress to promote stable prices and maximum sustainable employment.The mandate also includes promoting moderate long-term interest rates. The Federal Open Market Committee's (FOMC's) monetary policy framework spells out its strategy to achieve these goals over the medium and longer run.

  During 2019 and the first half of 2020, the Fed undertook a review of its monetary policy strategy, tools and communications. Following that review, the Fed introduced a new monetary policy framework in August 2020.Fed Chair Jerome Powell announced the new framework in [a speech on Aug. 27, 2020](https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm), at the Kansas City Fed's economic policy symposium in Jackson Hole, Wyo. Also see the FOMC's latest " [Statement on Longer-Run Goals and Monetary Policy Strategy](https://www.federalreserve.gov/newsevents/pressreleases/monetary20210127b.htm)." The one-year anniversary provides an opportunity to reflect on the FOMC's execution of the new framework so far, particularly with respect to inflation.

  *Some Key Changes to the Framework*
  The FOMC made [several key changes to its statement on longer-run goals and monetary policy strategy](https://www.federalreserve.gov/newsevents/pressreleases/monetary20200827a.htm), a few of which I will discuss here.Although this is not discussed in detail here, the FOMC also enhanced its references to financial stability as an important consideration in policy deliberations.

  Two of the main changes were related to the employment side of the Fed's mandate. In the updated statement, the FOMC stressed that the employment goal is broad-based and inclusive, affecting all parts of the labor market and

not just certain segments. The updated statement also suggests that monetary policy decisions will aim to reduce shortfalls—rather than deviations (as the prior statement said)—of employment from its maximum sustainable level. With this second change, the FOMC is stressing that it will react to high unemployment but not to particularly low unemployment unless inflation is threatening the economy.

Another key change to the statement on longer-run goals is related to how the FOMC aims to achieve the price stability goal. Under the new framework, the FOMC will focus on hitting an inflation rate of 2% on average over time. To do so, the FOMC will aim for inflation to run moderately higher than the 2% target for some time to make up for past misses of inflation to the low side of the target. This new strategy is referred to as flexible average inflation targeting, and it should help center longer-term inflation expectations at 2% and reinforce the inflation target.

*Importance of Credibility for Inflation Target*

The credibility of monetary policymakers is one of the most important aspects in central banking. In January 2012, the FOMC established an explicit inflation target of 2%, which is an international standard. But U.S. inflation generally came in below target over the next several years, with inflation averaging about 1.4% from 2012 to 2020 (as measured by the year-over-year percentage change in the price index for personal consumption expenditures [PCE]). This caused some concern on the FOMC that the 2% inflation target was losing credibility.

By making up for past misses under the new framework, the idea is that inflation will average 2% over time, which will enhance credibility for the inflation target. This also means that investors, businesspeople and consumers can confidently make economic decisions knowing what the inflation outcomes are going to be.

*Inflation Moderately Above Target for Some Time*

When the FOMC announced last year that we would allow inflation to run moderately above target for some time, many wondered how we would get inflation above target given that it had been below target for several years. As it turned out, we happen to be in a situation in the very first year of the new

framework in which inflation is actually above target and some measures of inflation expectations have moved higher. The graph below shows two such measures.

NOTES: The market-based inflation expectations shown in the graph are based on consumer price index inflation measures. I subtracted 30 basis points to roughly translate to a PCE inflation basis.

The  [FOMC's Summary of Economic Projections from June](https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20210616.htm)indicates that the FOMC expects that inflation will be above target for some time.FOMC participants' projections are made under their assumption of optimal monetary policy. Both headline PCE inflation and core PCE inflation are projected to be well over 2% in 2021 and continue to be over 2% in 2022 and 2023, according to the median projections among the FOMC participants. For instance, the median projections for core PCE inflation are 3.0% in 2021, 2.1% in 2022 and 2.1% in 2023. For illustration purposes, if those projections are realized, then inflation will have run above target for some time (in this case, three years) and would average about 2% from 2019 to 2023.

Of course, data are noisy, and other factors may affect inflation in unexpected ways over the next few years. But taking this simple calculation at face value illustrates what the FOMC is trying to do under the new framework, which is to allow inflation to run moderately above target for some time and hit an average inflation rate of 2% over time. Should this occur over the coming years, it would support the strategy of flexible average inflation targeting.

Endnotes

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The Regional Economist offers insights on regional, national and international issues. Views expressed are not necessarily those of the St. Louis Fed or Federal Reserve System.

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The text below, written by Federal Reserve Bank of St. Louis President James Bullard, first appeared as the President’s Message in the

[Regional Economist](https://stlouisfed.org/publications/regional-economist).

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*Notes and References*
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This blog offers commentary, analysis and data from our economists and experts. Views expressed are not necessarily those of the St. Louis Fed or Federal Reserve System.

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- **July 30, 2021**. Remarks. "European Economics and Financial Centre (EEFC) Virtual Event."
  Transcript (pdf) (bullard_eefc_transcript_july_30_2021pdf).