Release](https://www.stlouisfed.org/news-releases/2018/01/10/bullard-possible-new-approach)

St. Louis Fed President James Bullard said that despite low unemployment and accommodative monetary policy, U.S. inflation surprised to the downside in 2017. This has spurred talk of possible alternatives to inflation targeting. He noted one possible approach – price level targeting – would likely require lots of careful preparation and debate before any changes could be made. Under this framework, "deviations from target are overcome by allowing for higher or lower inflation in the future in such a way that the inflation target is maintained on average. In contrast, today's inflation targeting regime simply allows misses and does not do anything about them." Bullard spoke in St. Louis.

St. Louis Fed's Bullard Discusses a Possible New Approach to Inflation

ST. LOUIS—With inflation in the U.S. consistently falling below the Fed's target of 2 percent since 2012, Federal Reserve Bank of St. Louis President James Bullard discussed on Wednesday price level targeting as a possible framework for conducting monetary policy. In his presentation, titled ["A Primer on Price Level Targeting in the U.S.,"](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_cfa_stlouis_10_january_2018.pdf)Bullard said considerable study would be needed before such an approach could be implemented.

Speaking to the CFA Society of St. Louis, he said, "While price level targeting has been considered and could continue to be considered as a policy option by the Federal Open Market Committee (FOMC), it would likely take a lot of careful preparation and debate before any changes could be made." Bullard is a participant on the FOMC, the Federal Reserve's monetary policymaking body.

Bullard also pointed out that price level targeting is just one possible alternative to inflation targeting. He also briefly mentioned nominal income targeting. "Why is price level targeting a possible alternative? It is because price level targeting or its close cousin, nominal income targeting, constitutes optimal monetary policy in many macroeconomic models," he said.

The 2017 Inflation Surprise

For most of the time since 2012, the U.S. inflation rate has been below the target of 2 percent. 1Data on inflation during 2017 "surprised to the downside," given the environment of low unemployment and accommodative monetary policy, Bullard stated.

"This has led to reflection within monetary policy circles on possible new approaches to hitting and maintaining the inflation target," he added.

What Is Price Level Targeting?

In this approach, the FOMC would commit to keeping the price level on a path defined by a 2 percent inflation rate, Bullard said. The inflation target would have to be hit on average over the medium term, he said.

Under such a framework, "deviations from target are overcome by allowing for higher or lower inflation in the future in such a way that the inflation target is maintained on average," he said. "In contrast, today's inflation targeting regime simply allows misses and does not do anything about them."

The appropriate starting point for a price level path, he said, is 1995. At that time, U.S. inflation converged near 2 percent, a path that was maintained until 2012—despite the global financial crisis during the intervening years. "This could be interpreted as optimal monetary policy during this period," Bullard said.

Since then, however, the U.S. has fallen away from this path because inflation has been below target almost all that time, he said. The current differential between the 2 percent price level path and the actual price level path is about 4.6 percent, Bullard said.

"The low inflation drift" may be harming inflation expectations, Bullard noted. "The private sector expectation may be that U.S. policymakers will allow average inflation to be lower than the stated target over the medium term," he said.

Getting Back on Track

To return the economy to the 2 percent price level path would require above-target inflation for some time, Bullard said.

"There are many ways to achieve this, but to get an idea of magnitude, let's consider a 2.5 percent inflation rate," he said. "How long would it take to return to the price level path if the inflation rate going forward was 2.5 percent? The answer is about 10 years."

He said it would take a decade to return to the price level path "because for the past five years in a row, the inflation target has been missed to the low side, and this has opened up a substantial gap between the actual and desired price level."

He added that 2.5 percent inflation is not too different from the average inflation rate during the 2004-2007 period.

Other Considerations

Inflation targeting has become an international standard, with many central banks adopting a 2 percent inflation target over the last 25 years. "This standard has been successful in keeping inflation low and stable," Bullard stated.

Unlike inflation targeting, price level targeting has not been implemented at major central banks in the modern era, Bullard said. "However, it could become a focus of future monetary policy arrangements."

Bullard noted that even if formal adoption of price level targeting is not realistic in the near term, the ideas behind it could influence near-term policy.

"Generally speaking, this would suggest leaning toward inflation somewhat in excess of the stated inflation target to help make up for past misses on the low side," he said. He added, "The FOMC's current Summary of Economic Projections does show some, but not much, projected inflation in excess of the stated inflation target."

Bullard concluded that price level targeting and nominal income targeting are alternative approaches "that have considerable appeal, but whose formal adoption would require further study."

1 The inflation target is in terms of the annual change in the price index for personal consumption expenditures (PCE).

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- **January 4, 2018**. Speech. "Allan Meltzer and the Search for a Nominal Anchor," delivered at "Meltzer's Contributions to Monetary Economics and Public Policy," Philadelphia, Pa.
Speech (pdf) (bullard_allan_meltzer_search_for_nominal_anchor_jan_4_2018_speechpdf) | Supplemental Slides (pdf) (bullard_allan_meltzer_search_for_nominal_anchor_jan_4_2018_slidespdf).
Related article in Federal Reserve Bank of St. Louis *Review*, Second Quarter 2018, Early Edition.

Allan Meltzer and the Search for a Nominal Anchor

January 4, 2018

Speech: pdf | text (below) | Supplemental Slides (pdf)

In a speech in Philadelphia, St. Louis Fed President James Bullard paid tribute to the late Allan Meltzer, a monetary economist, economic historian and "a great friend of the St. Louis Fed." Bullard cited Meltzer's research on the run-up to the Great Inflation of the 1970s and early 1980s and contrasted that period with the inflation targeting era of the past two