# ECOWEEK

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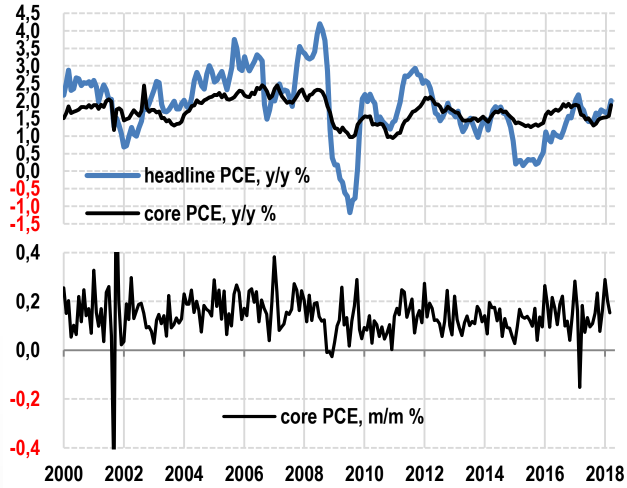
# Federal Reserve: the challenges of a symmetric inflation goal

**■ Inflation in the US is very close to the Fed's goal and the FOMC expects it will remain like that for quite some time ■ The FOMC insists that its inflation goal is symmetric. This gives more leeway in managing the tightening cycle ■ If inflation is overshooting, it would imply a higher market sensitivity to upside inflation surprises**

Core and headline inflation have picked up in recent months and the statement after this week's FOMC meeting duly noted that "*On a 12-month basis, both overall inflation and inflation for items other than food and energy have moved close to 2 percent.*" Mission accomplished it seems. Normally this would fuel anticipations of a stepped-up tightening cycle so as to avoid that inflation would continue to rise. The FOMC has addressed this risk by insisting that "*inflation on a 12-month basis is expected to run near the Committee's symmetric 2 percent objective over the medium term*". The message is twofold. Firstly, it is confident that inflation will not rise too much. The chart shows that core inflation since 2000 has been fluctuating in a band of 1%-2.5%. At the peak of the previous cycle it was slightly below 2.5% so it is tempting to assume that moving beyond this level will be difficult. The view that inflation will not accelerate too much fits with the message from the March Survey of Economic Projections of the FOMC members: despite an unemployment rate running well below the long-term projection, inflation is expected to stay around 2.0%. Secondly and more importantly, there is the mention that the inflation goal is symmetric. To get the message across, the statement says that the *"Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal.*" The reference to symmetry echoes a comment by Fed chair Powell during his press conference after the March meeting.

UNITED STATES: INFLATION




Source: BEA, BNP Paribas

Under an asymmetric goal, a central bank would try to have inflation converge towards the objective whilst avoiding to move beyond. Markets might very well expect that the central bank would react rather quickly when inflation is on the rise. This market action could lead to a premature tightening of financial conditions which might imply the risk that the inflation goal will never be reached. Under a symmetric goal, accepting some degree of overshooting allows to keep policy easier for longer which increases the likelihood that the goal will be reached. However, to some degree, this is merely postponing the problem: markets will want to know where the true limit is. This also implies a far higher sensitivity to inflation surprises when inflation is already above the 2% target with investors speculating on a more aggressive tightening. Whereas this higher sensitivity to inflation surprises is relevant for financial markets and not so much for the real economy, both would be impacted if the central bank would strongly react to an excessive overshooting.

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