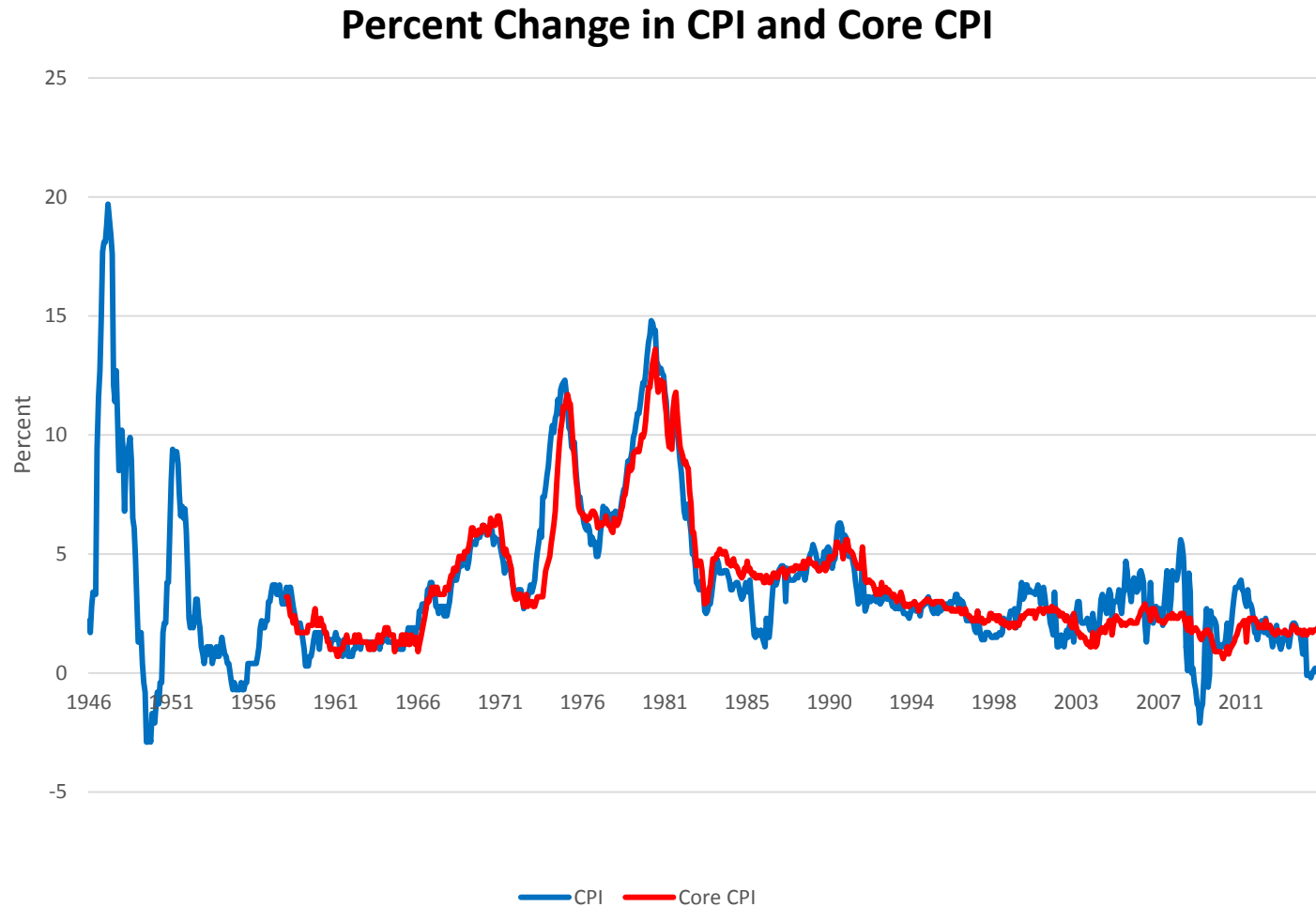


Low Inflation in the United States

Michael Kiley
Federal Reserve Board

Banque de France
December 17, 2015

Inflation has fallen to a 50-year low



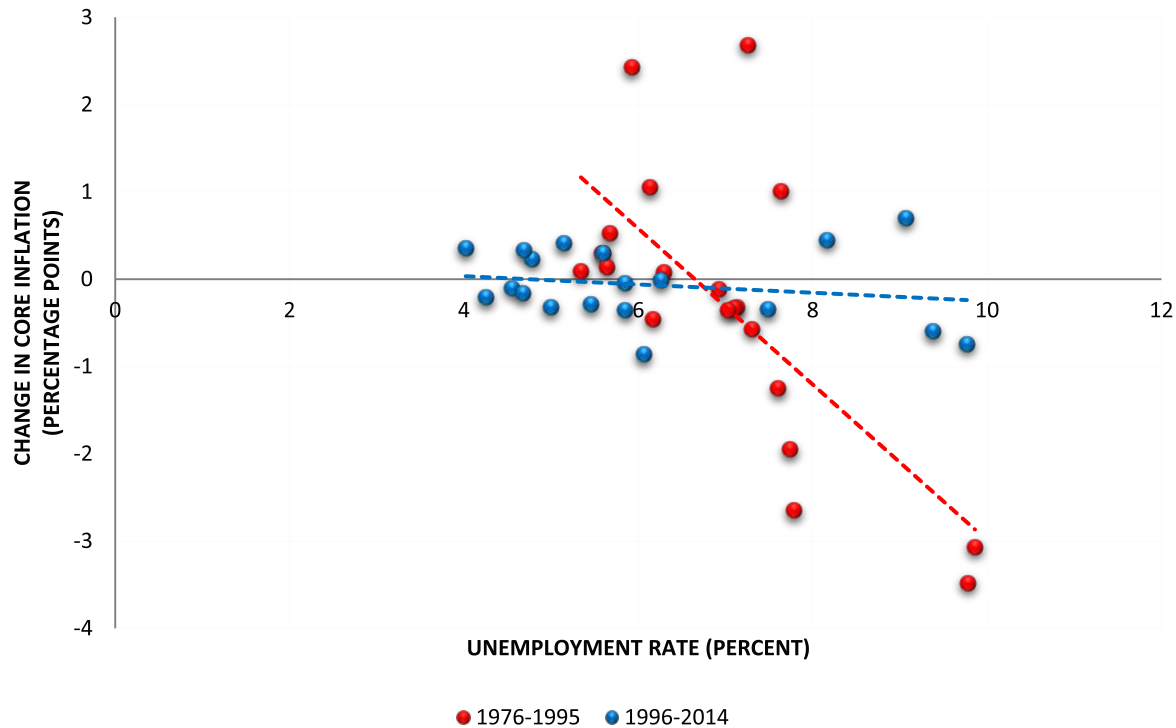
Note: Percent change is the change over the previous twelve months. The data shown in the figure spans the period from January 1946 to September 2015.

Source: Department of Labor, Bureau of Labor Statistics

Why has inflation fallen? A Phillips curve perspective

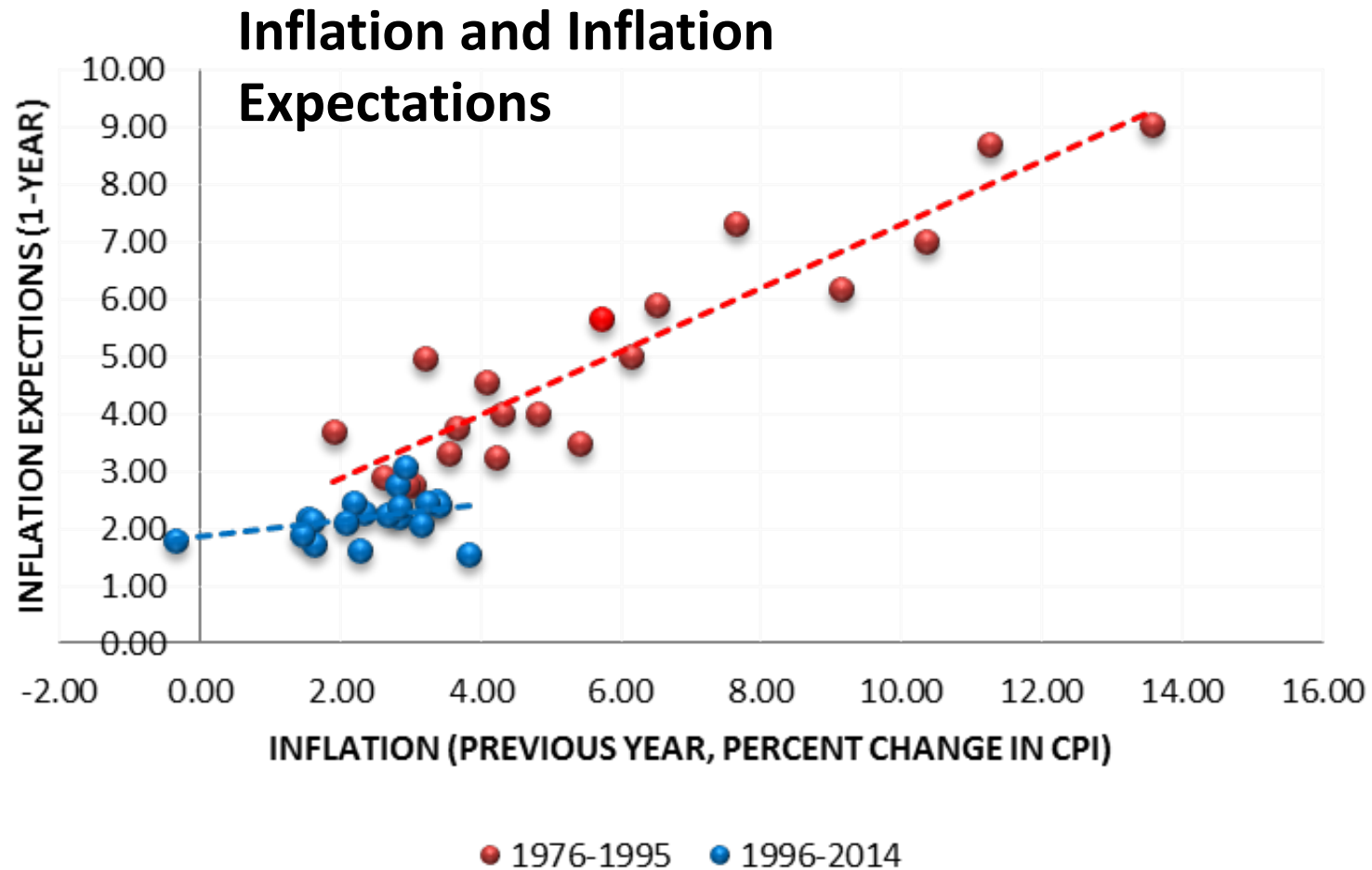
- A simple accelerationist Phillips curve

$$\pi(t) = \pi(t - 1) - \kappa[U(t) - U^*(t)] + e(t)$$



Note: Core inflation is measured by the percent change in the annual average of the CPI from its level in the previous year.
Source: Department of Labor, Bureau of Labor Statistics and author's calculations.

Factors limiting disinflation #1: Anchored inflation expectations



Note: Inflation in the previous year is measured by the percent change in the annual average of the CPI from the level in the previous year. Inflation expectations (1-year ahead) are measured by the one-year expected inflation in GDP prices for the 1976-1995 period, as reported in the first-quarter Survey of Professional Forecasters. For the 1996-2014 period, inflation expectations are measured by the one-year expected inflation in the CPI from the Survey of Professional Forecasters.

Source: Department of Labor, Bureau of Labor Statistics and Federal Reserve Bank of Philadelphia.

Factors limiting disinflation #2: Flatter slope or limited slack

- The Phillips curve appears to have flattened
 - A consequence of low and stable inflation? (e.g., Ball, Mankiw, and Romer , '88 or Kiley, '00)
 - Downward nominal wage rigidity (Daly and Hobijn, 2014)
- The financial crisis may have raised costs, despite high unemployment (Gilchrist et al, '15)
- The natural rate of unemployment may have risen
 - Elevated long-term unemployment (Ball and Mazumder, '10)
 - Shift in Beveridge curve
- Recent work and experience casts doubt on a rise in the natural rate (Kiley, '15; Figura and Ratner, '15)
- Erceg and Levin ('14) – unemployment understates slack

Policy implications

- Low inflation and low equilibrium real interest rate imply that effective lower bound on nominal interest rates may bind more frequently
- Flat Phillips curve implies that pursuing a high pressure economy has a lower inflation cost
 - But it also implies a higher unemployment cost to lower inflation if inflation gets high
 - And the Lucas critique lurks in the background