DATE: OCTOBER 12, 2010
TO: FEDERAL OPEN MARKET COMMITTEE
FROM: SANDY PIANALTO
SUBJECT: A BACKGROUND MEMO ON INFLATION RATES IN THE CONTEXT OF PRICE LEVEL AND INFLATION TARGETING REGIMES

Following the September FOMC meeting, my staff worked on evaluating the likely paths of inflation that might occur around price level and inflation targets, should one be adopted. Their work estimates a range of overshooting that might be anticipated for both types of targets. I found this to be helpful background information for thinking about potential options for explicit numerical targets. The inflation dynamics built into most forecasting models would lead to a significant degree of overshooting with either type of target. I thought it would be helpful to provide my staff’s initial estimates of how much overshooting could occur in price level or inflation targeting regimes.