

# Should Full Employment Be a Mandate for Central Banks?

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April 12, 2013

*The data in this speech have been updated to reflect revisions to the data series that occurred after it was delivered. These updates were made because the speech was being prepared for publication in an issue of the Journal of Money, Credit, and Banking.*

# Role of Unemployment in Monetary Policy

- Most advanced economies have very elevated unemployment rates
- How should central banks respond to weak labor markets?
- What should be the mandate of the central bank? Should other central banks adopt a dual mandate?
- My answer is an emphatic yes!

# Dual Mandate Aids Communication with the Public

- FOMC statements make clear the importance of the dual mandate
  - Continue purchases, “until the outlook for the labor market has improved substantially in a context of price stability”
  - Maintaining interest rates at exceptionally low levels will be appropriate, “at least as long as the unemployment rate remains above 6.5 percent.....and longer-term inflation expectations continue to be well anchored”

# The SEP and the Dual Mandate

- Tying the trajectory of policy to data and published forecasts for economic outcomes clarifies things for the public
- During period where inflation is low and unemployment is high, including in our SEP forecasts, the need for accommodation is clear
- Single mandate makes announcements less straightforward and understandable

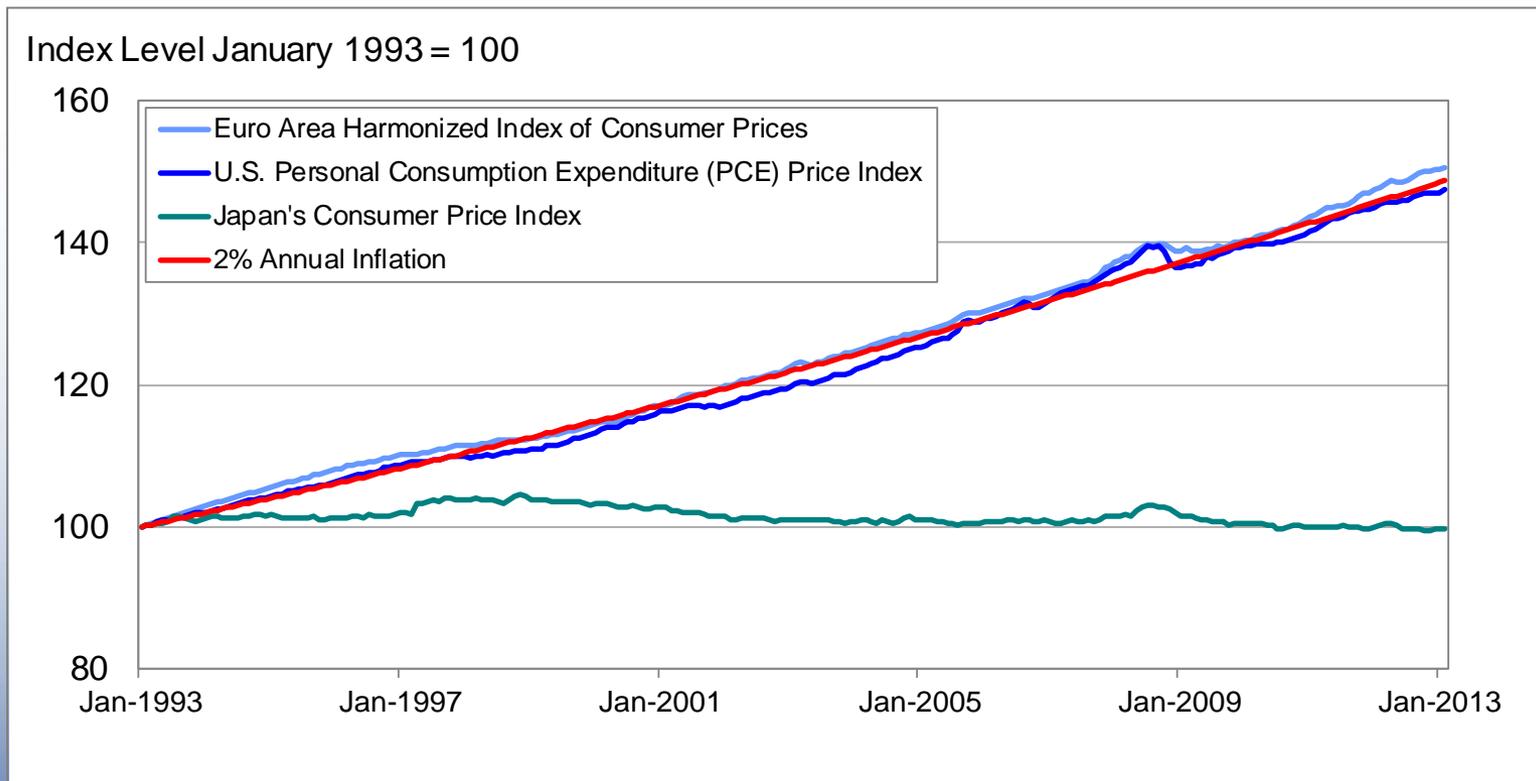
# Do Different Mandates Improve Economic Outcomes?

- Examine price level path over past 20 years
  - inflation experience of single mandate versus dual mandate countries
  - Surprisingly, most countries fit a pattern of price level targeting surprisingly well – large increases or decreases in inflation offset in future periods to maintain an average of 2 percent
  - United States performs quite well relative to other countries

# Figure 1

## Price Level Path in Europe, the United States and Japan

January 1993 - February 2013

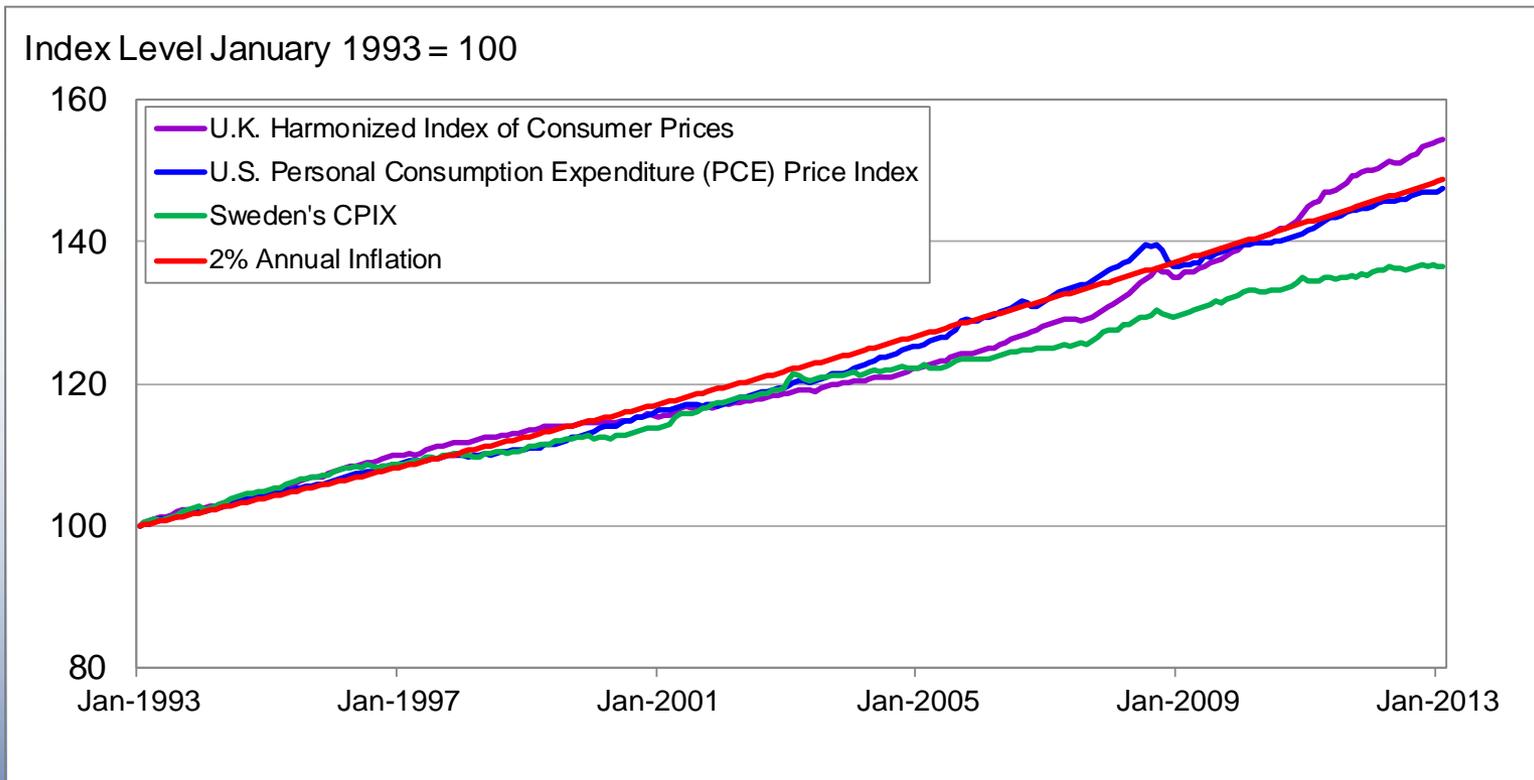


Source: Eurostat, BEA, Japan's Ministry of Internal Affairs and Communications / Haver Analytics

# Figure 2

## Price Level Path in Sweden, the United Kingdom and the United States

January 1993 - February 2013



Note: Sweden's CPIX is the National CPI excluding mortgage interest and adjusted for taxes and subsidies.

Source: Sweden's Statistiska Centralbyran, U.K. Office for National Statistics, BEA / Haver Analytics

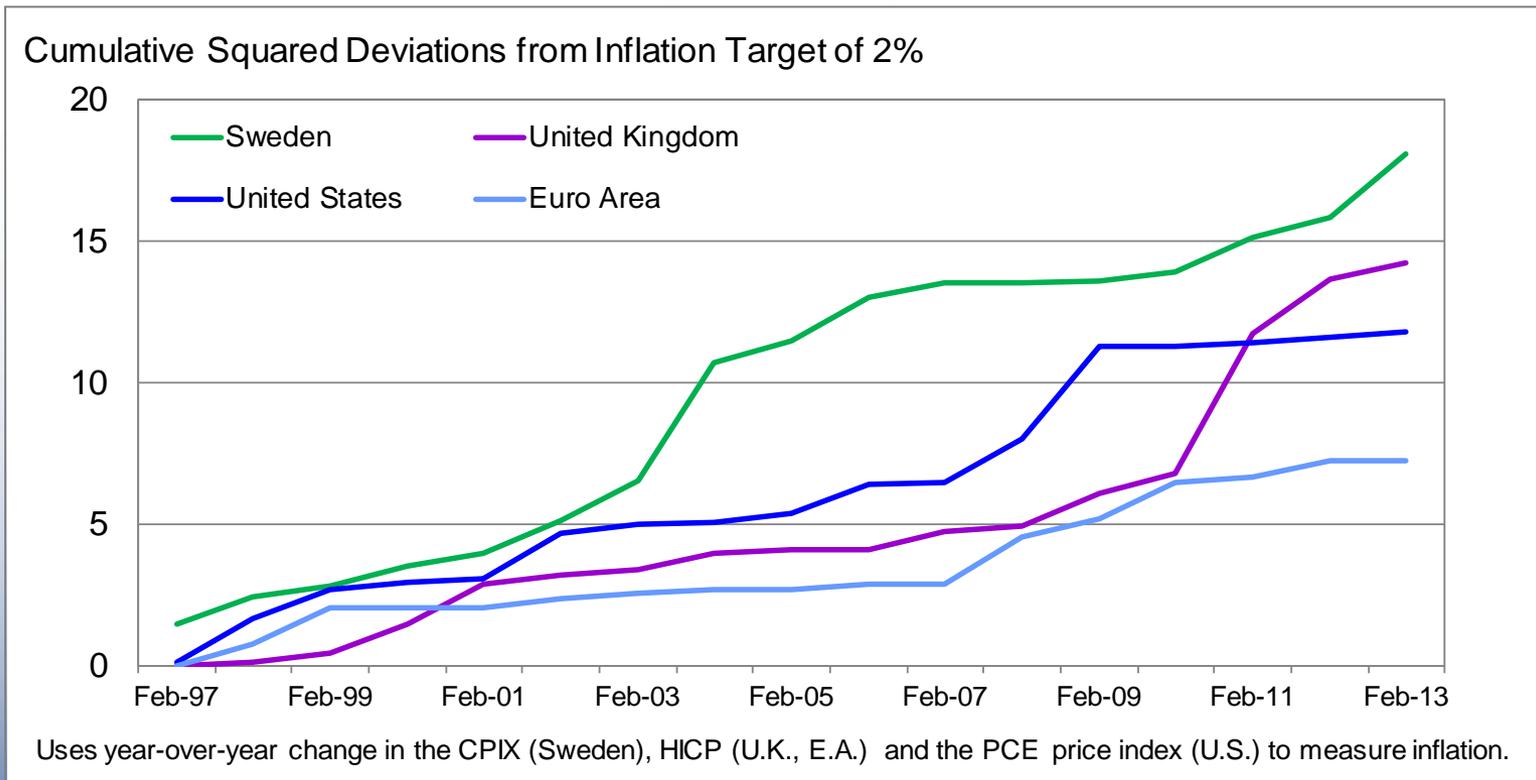
# Compare Simple Loss Functions

- Examine cumulative squared deviation of the annual year over year inflation rate from a 2 percent target
- Large misses get large weight
- Symmetric above and below 2 percent

# Figure 3

## Deviations from Inflation Target in Sweden, the United Kingdom, the United States and the Euro Area

February 1997 - February 2013

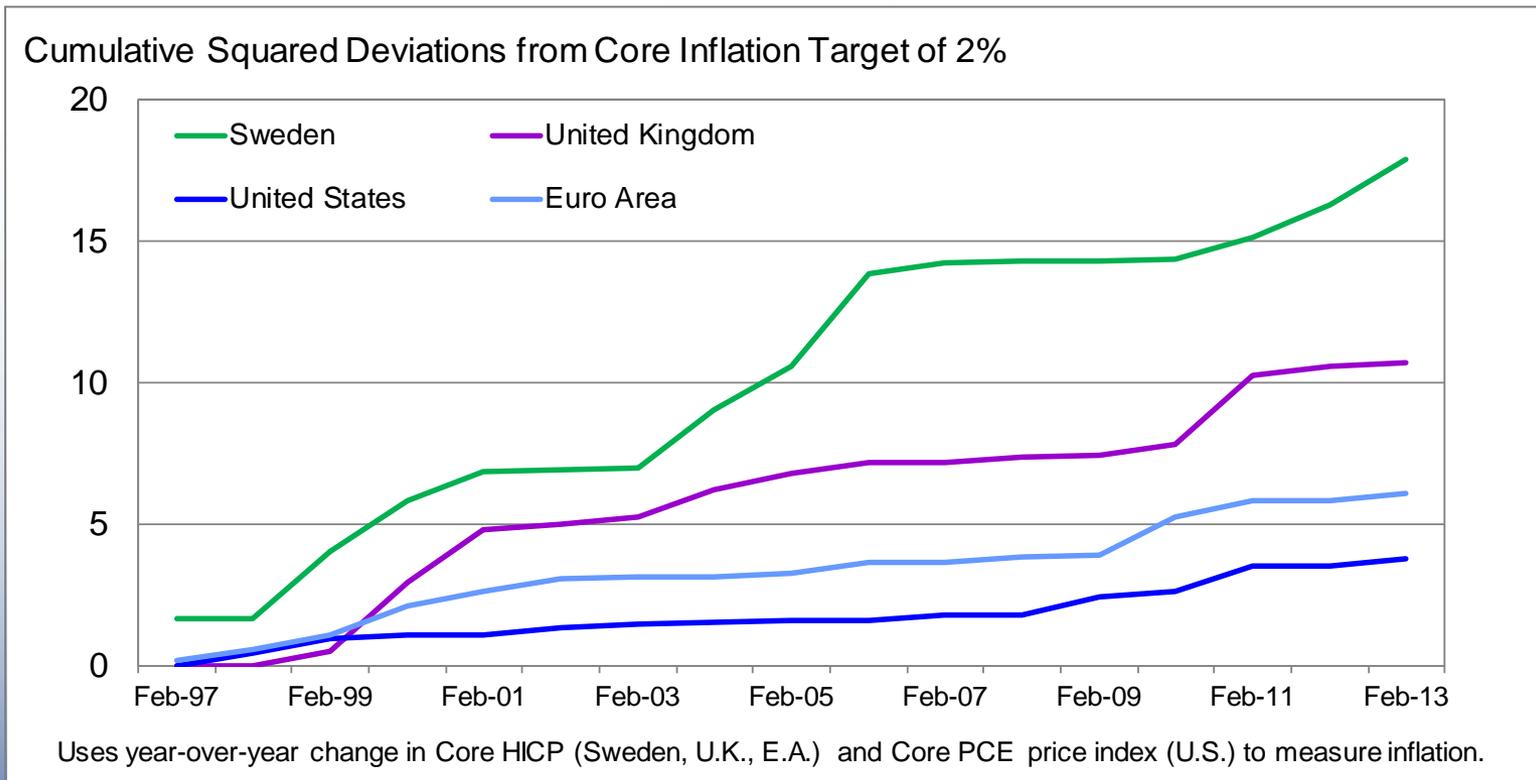


Source: Sweden's Statistiska Centralbyran, U.K. Office for National Statistics, BEA, Eurostat / Haver Analytics

# Figure 4

## Deviations from Core Inflation Target in Sweden, the United Kingdom, the United States and the Euro Area

February 1997 - February 2013

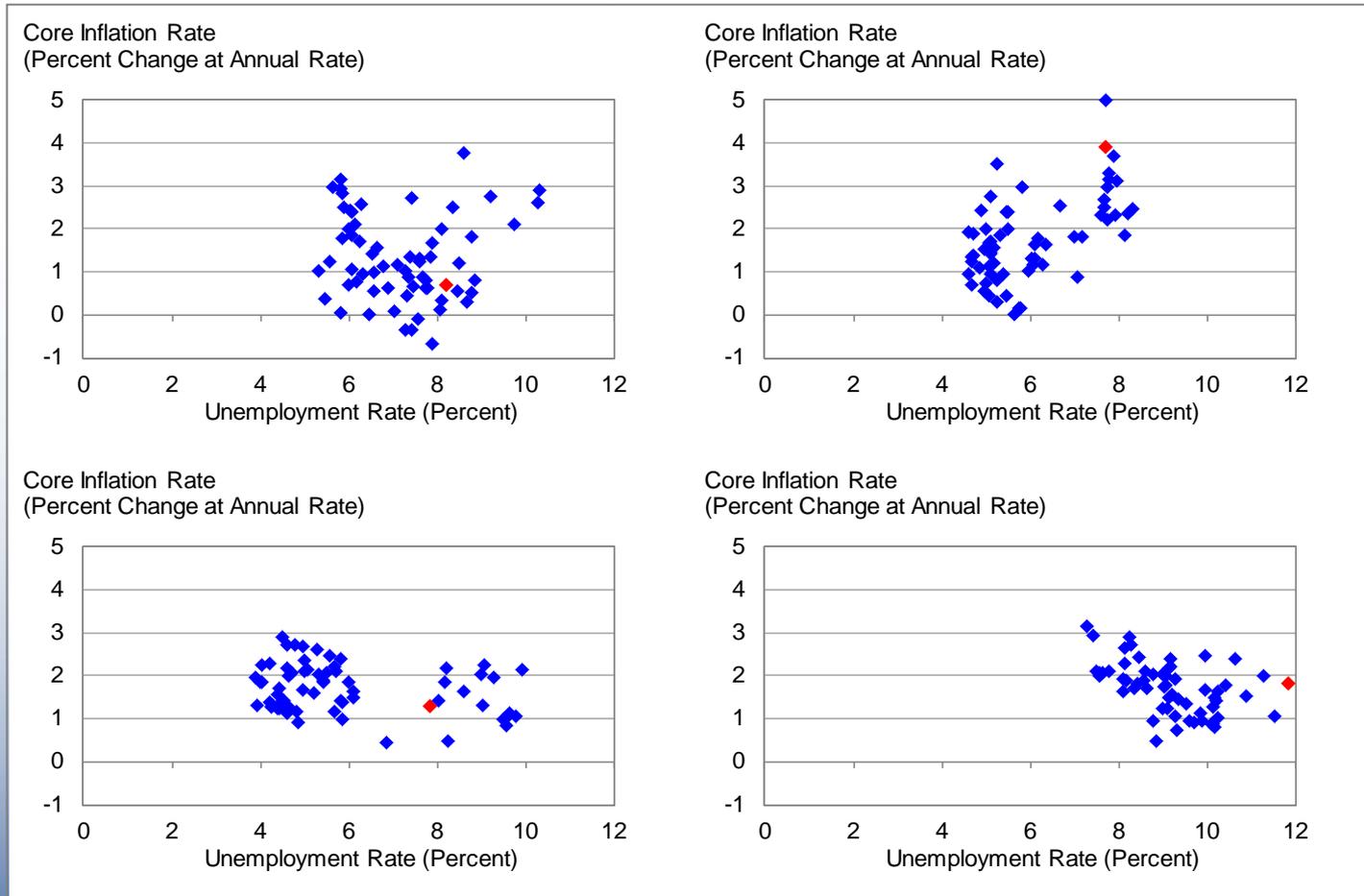


Source: BEA, Eurostat / Haver Analytics

# Figure 5

## Unemployment Rate versus Core Inflation Rate

Quarterly, 1997:Q1 - 2012:Q4



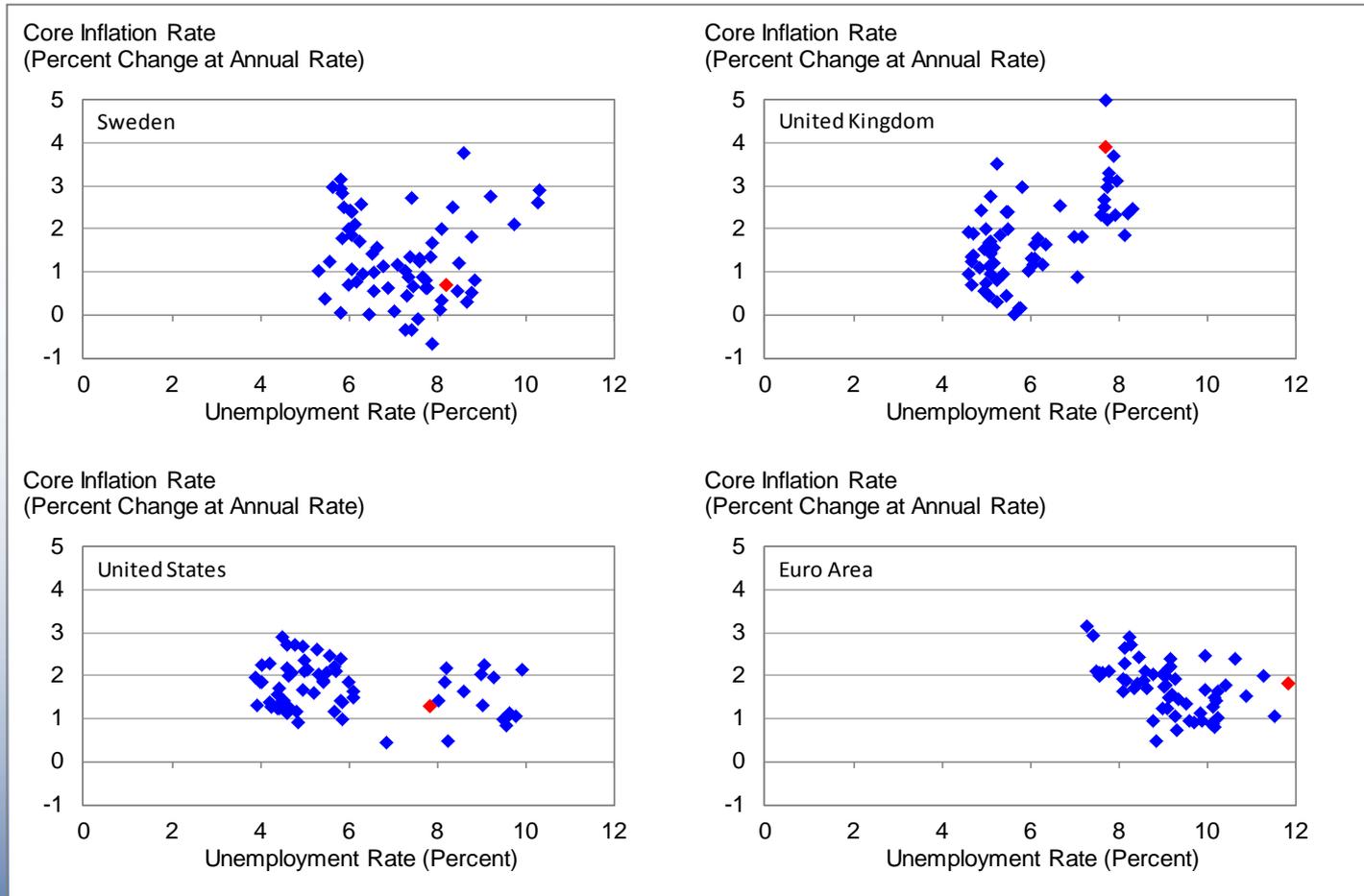
Source: Eurostat, BEA, BLS / Haver Analytics

Note: Most recent observation in red

# Figure 5

## Unemployment Rate versus Core Inflation Rate

Quarterly, 1997:Q1 - 2012:Q4



Source: Eurostat, BEA, BLS / Haver Analytics

Note: Most recent observation in red

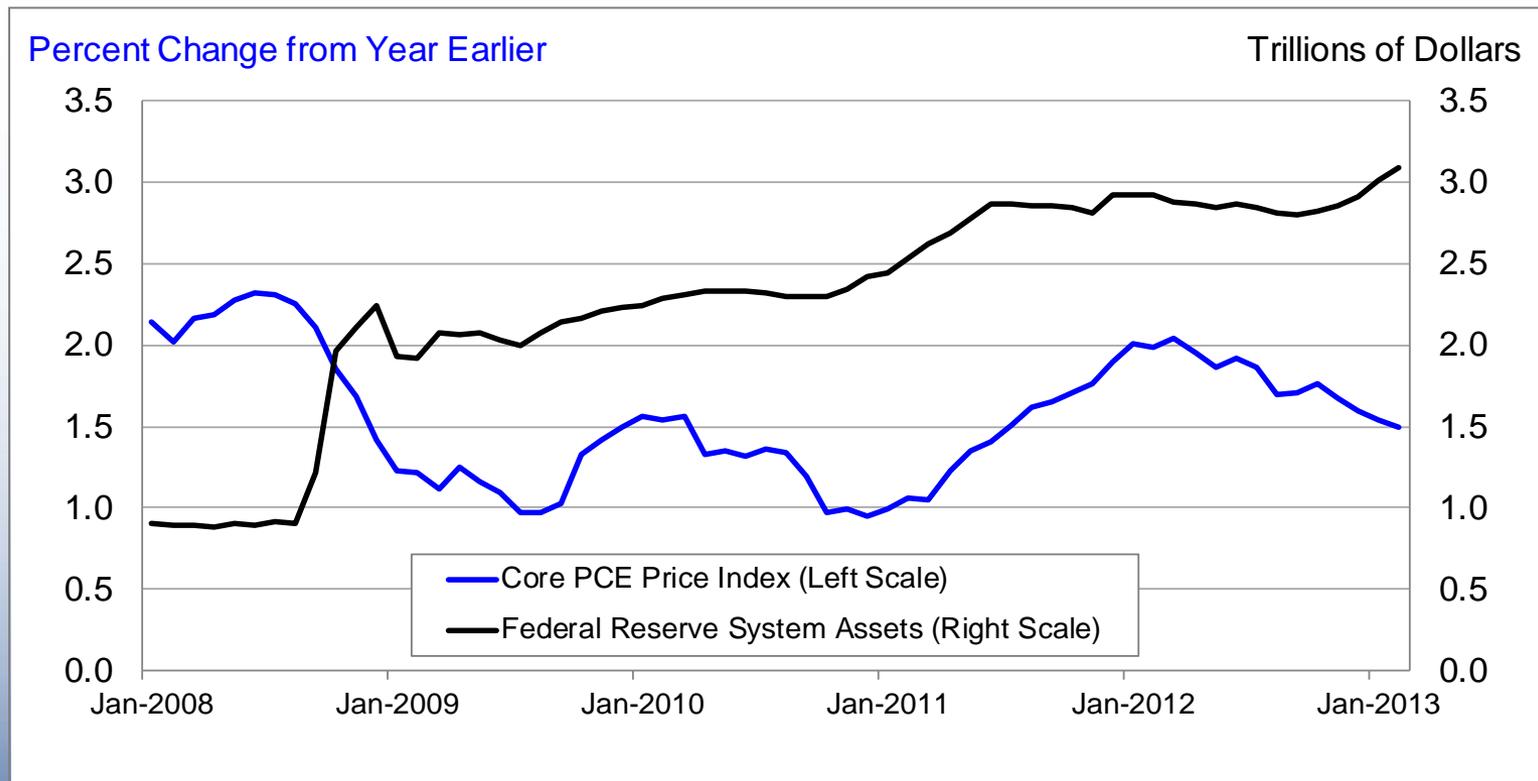
# Central Bank Actions When Inflation Exceeds Target

- Easing in a single mandate country when unemployment is high and inflation is above target relies on a forecast that inflation is expected to fall (possibly because of slack resources)
- Dual mandate central banks can directly appeal to elevated unemployment rate

# Figure 6

## Central Bank Assets and Inflation: United States

January 2008 - February 2013

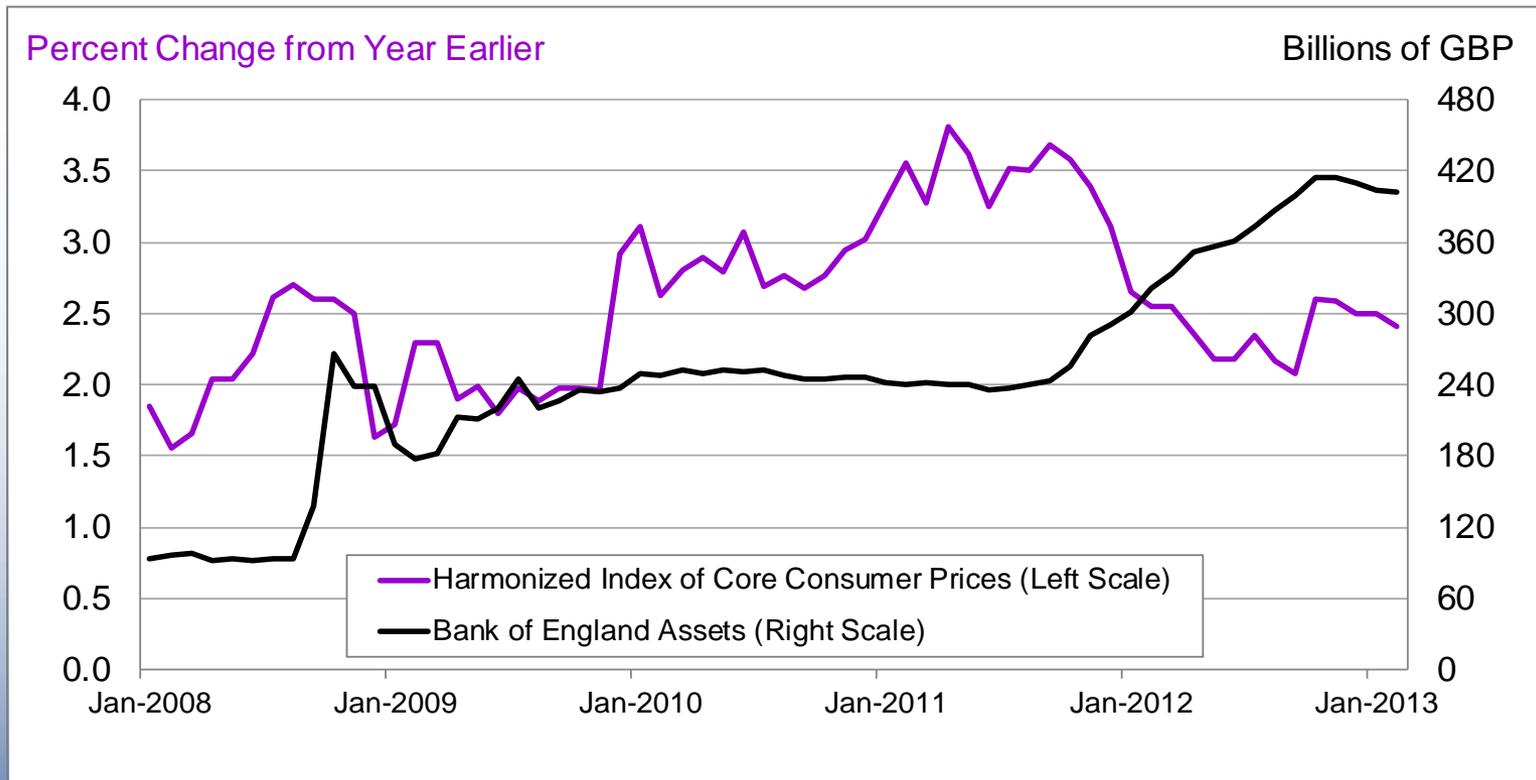


Source: BEA, Federal Reserve Board / Haver Analytics

# Figure 7

## Central Bank Assets and Inflation: United Kingdom

January 2008 - February 2013

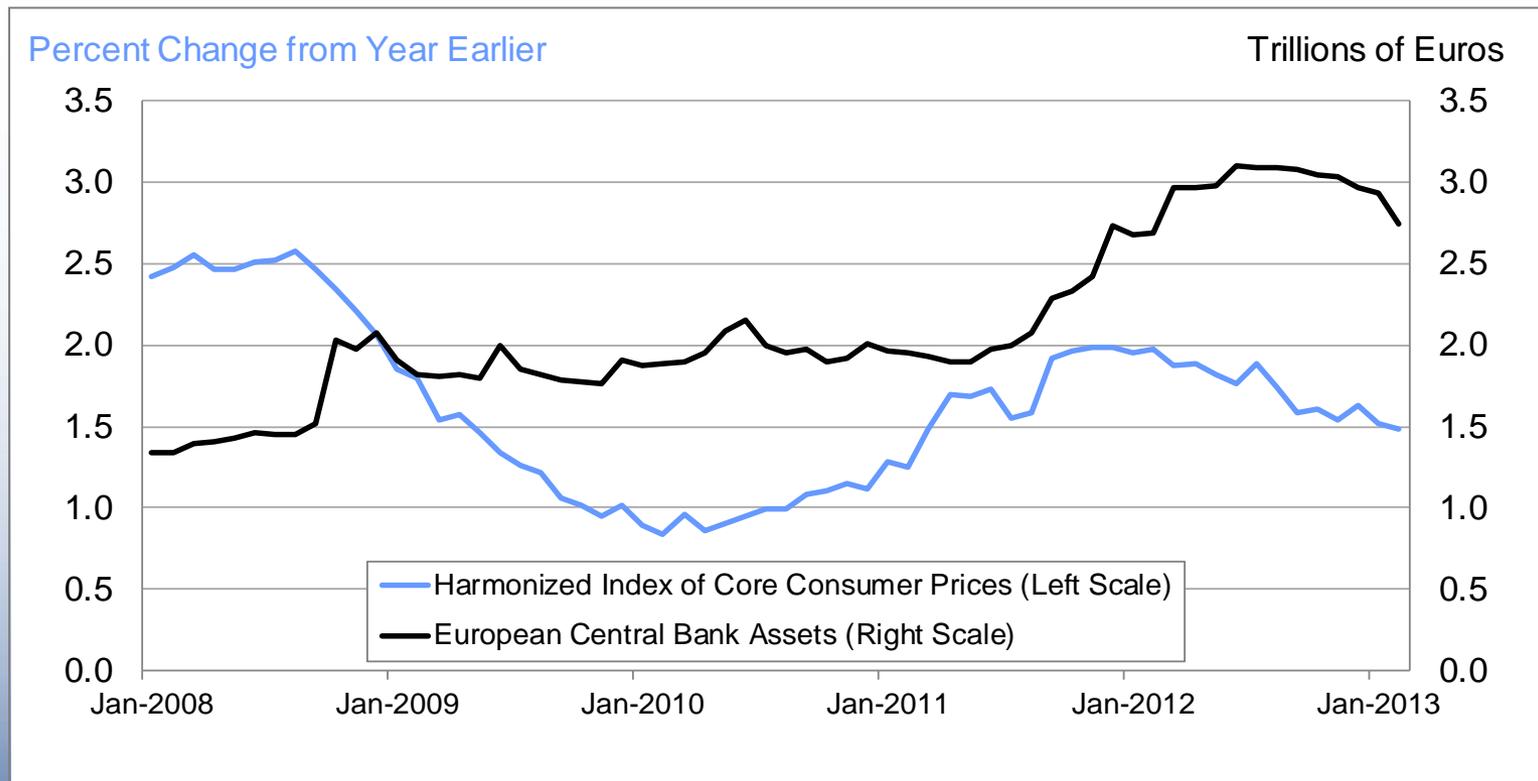


Source: Eurostat, Bank of England / Haver Analytics

# Figure 8

## Central Bank Assets and Inflation: Euro Area

January 2008 - February 2013

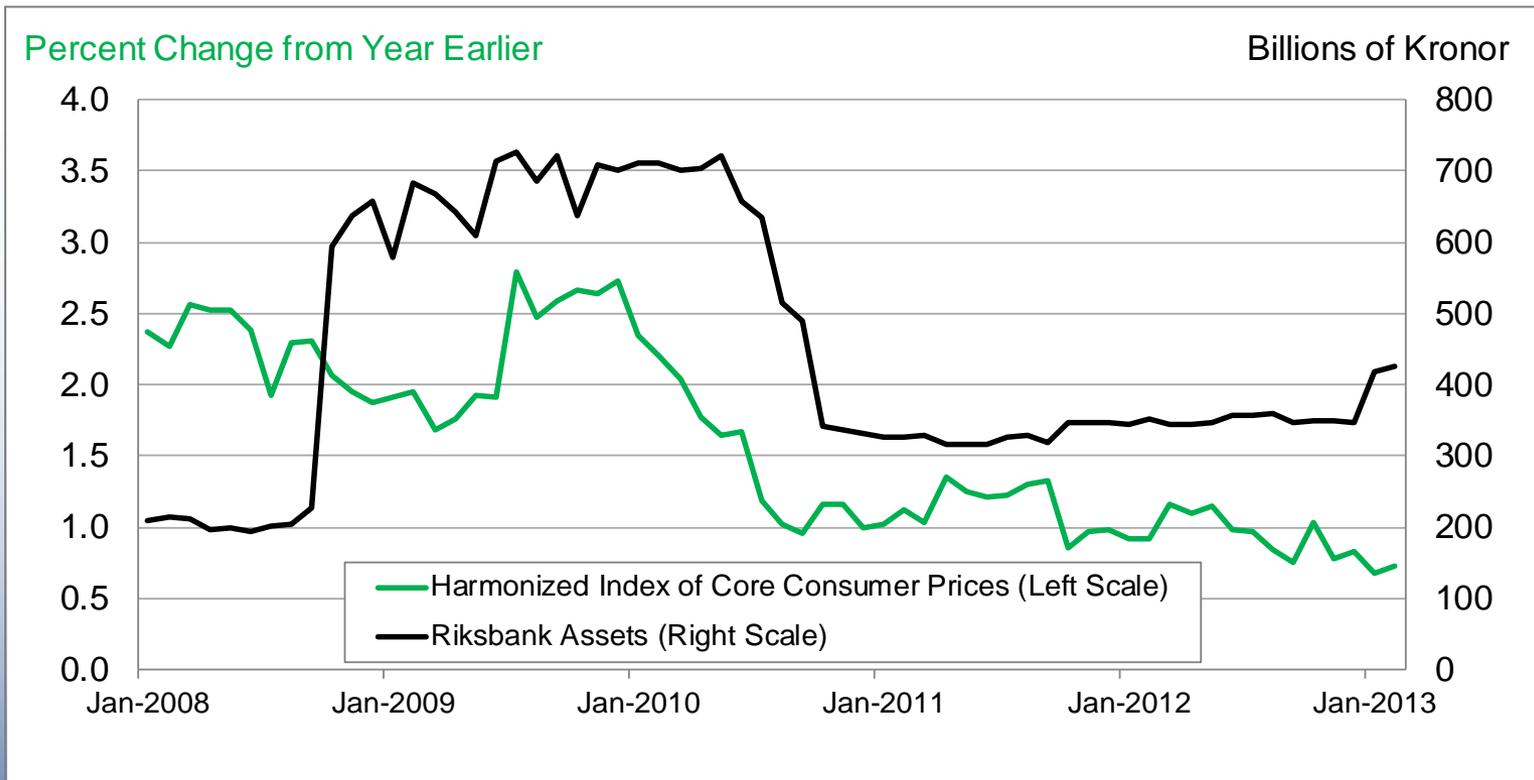


Source: Eurostat, European Central Bank / Haver Analytics

# Figure 9

## Central Bank Assets and Inflation: Sweden

January 2008 - February 2013

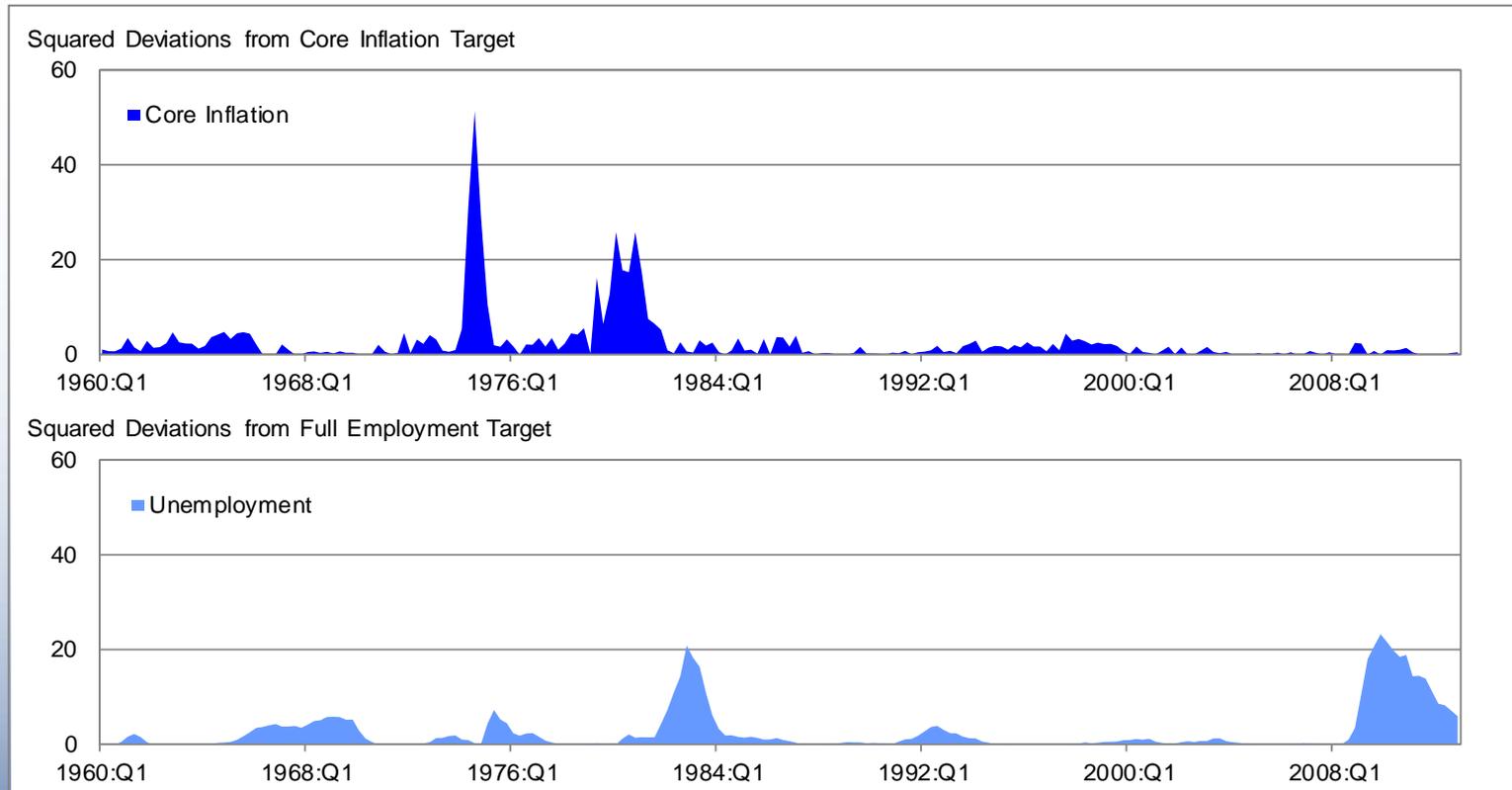


Source: Eurostat, Riksbank / Haver Analytics

# Figure 10

## Deviations from Full Employment and Core Inflation Targets in the United States

1960:Q1 - 2012:Q4



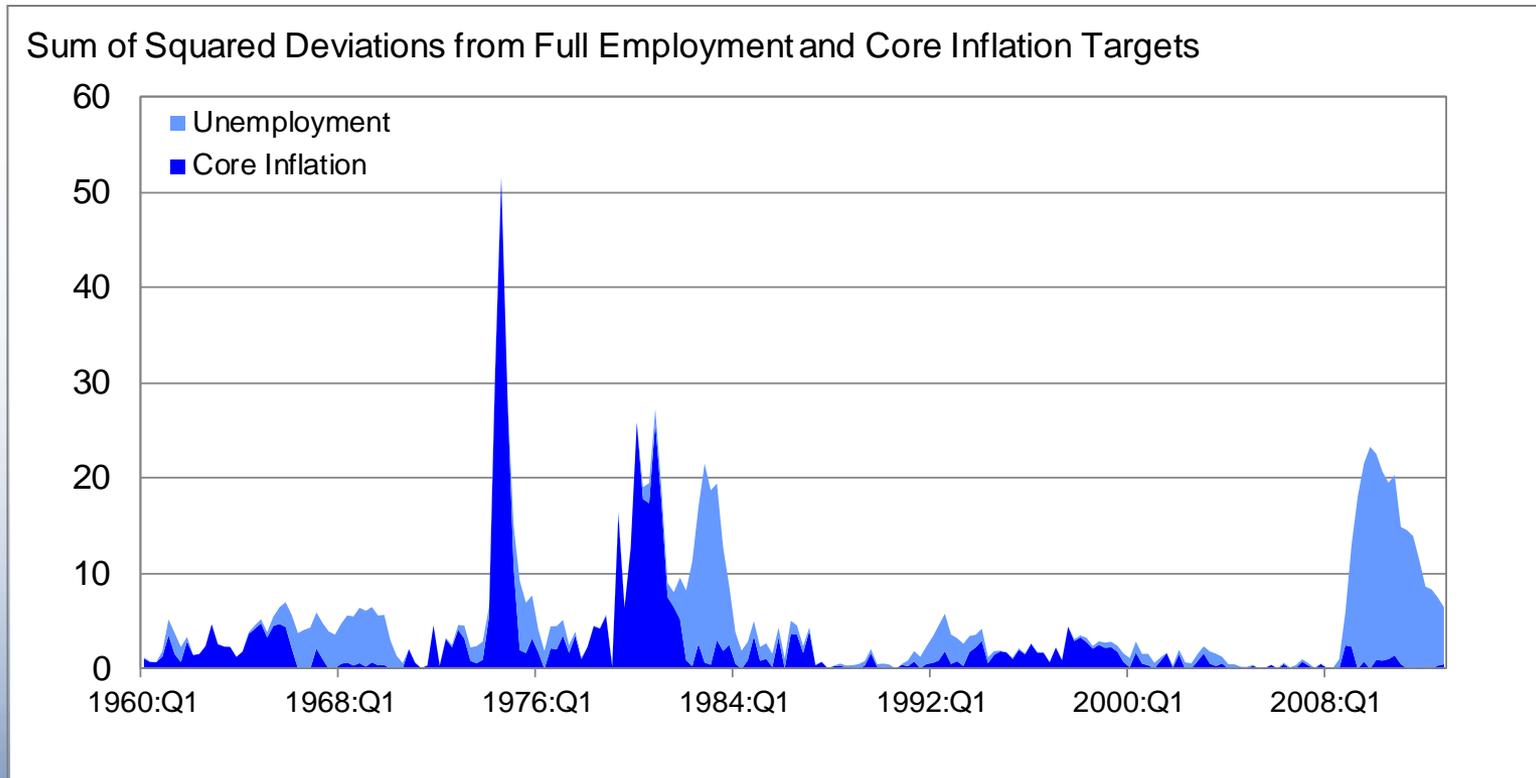
Note: Full employment is the CBO estimate of the natural rate of unemployment. Inflation target is 2% in recent periods but ranges from 2% to 5% prior to mid 2005 based on a filter employed to provide smoothed estimates.

Source: BEA, BLS, CBO / Haver Analytics

# Figure 11

## Stacked Deviations from Full Employment and Core Inflation Targets in the United States

1960:Q1 - 2012:Q4



Note: Full employment is the CBO estimate of the natural rate of unemployment. Inflation target is 2% in recent periods but ranges from 2% to 5% prior to mid 2005 based on a filter employed to provide smoothed estimates.

Source: BEA, BLS, CBO / Haver Analytics

# Policy Implications

- Large misses in the 1970s and early 1980s: too little weight on inflation misses
- Large misses recently: too little weight on unemployment rate misses
- With unemployment at 7.5 percent and the PCE inflation at 1.5 percent the dual mandate provides clear, transparent rationale for highly accommodative policy as appropriate and necessary

# Concluding Observations

- U.S. inflation outcomes as good as, if not better than, single mandate countries
- Many single mandate countries have expanded monetary policy accommodation despite exceeding their inflation target
- Dual benefits to dual mandate
  - Clearer communication, especially when there is significant slack
  - When unemployment is major economic woe it gets the appropriate attention