

A Model of the Fed's View on Inflation

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Third MMCN Conference

Goethe University, Frankfurt – 13-14 June , 2019

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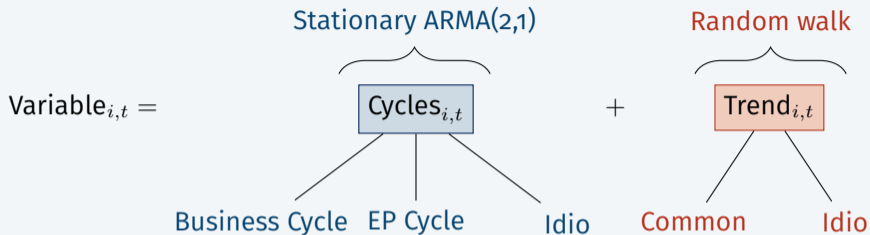
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How do we **model** this **view on inflation**?

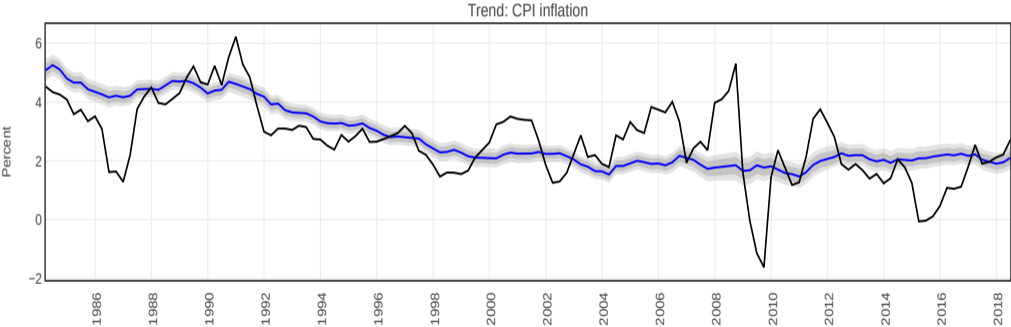
- A **semi-structural** unobserved components **Trend(s)-Cycle(s) model**
- **Informed** by **New Keynesian** theory
- ... employing **survey data on inflation**
- ... encompasses **full information rational expectations (FIRE)** but allows for **deviations**

The Model in a Nutshell



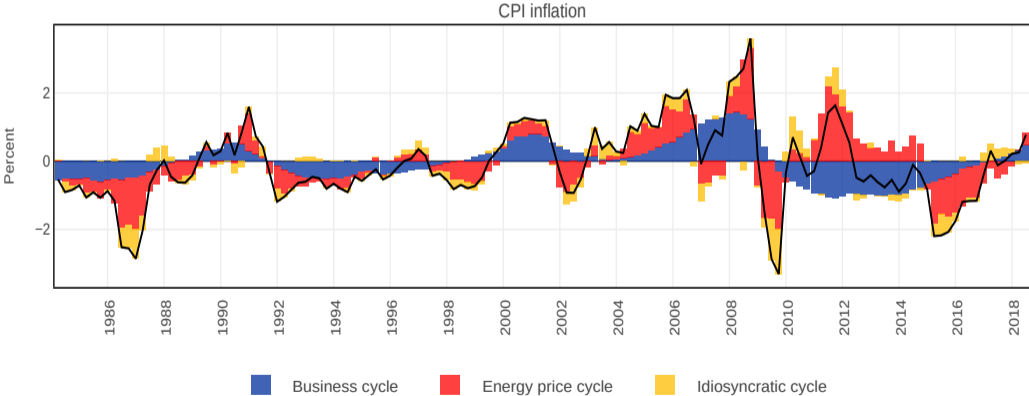
Variable	Transformation	Loads on		
		BC Cycle	EP Cycle	Common Trend
Gross Domestic Product	Levels	✓	✗	✗
Employment	Levels	✓	✗	✗
Unemployment Rate	Levels	✓	✗	✗
WTI Spot Oil Price	Levels	✓	✓	✗
CPI: All Items	YoY	✓	✓	✓
Core CPI	YoY	✓	✓	✓
UoM: Expected Inflation	Levels	✓	✓	✓
SPF: Expected Inflation	Levels	✓	✓	✓

Trend Inflation



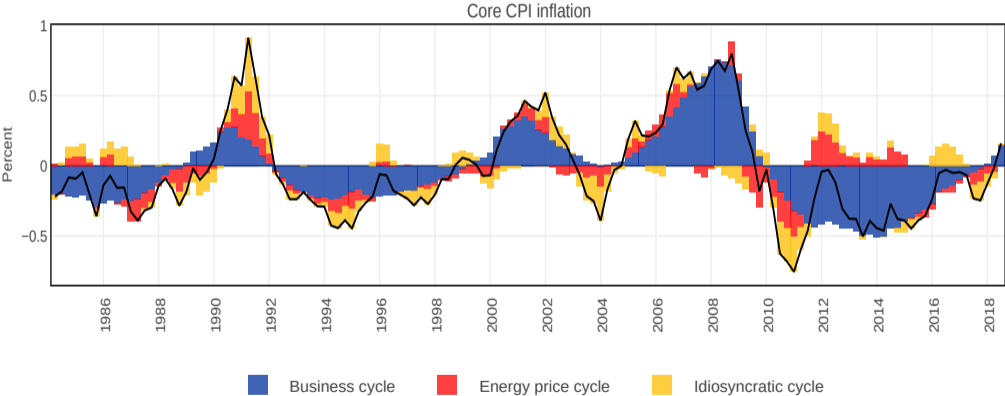
Historical Decomposition of the Cycles

Headline CPI



Historical Decomposition of the Cycles

Core CPI



This Paper

- **New model** explicitly recovering of **trends & cycles**
- Allows for **deviations** from **full information and perfect rationality**
- Similar to **VARs** but **informed by Economic theory**
- Does not need tight parametrisation as **DSGE models**

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