Working Paper 1042
Keep in mind



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A raise in inflation targets would be viable if implemented strategically, that is, at the time of a pickup in demand. Policy interest rates would not be constrained by the zero-bound as the result of a balance between two forces: first, policy interest rates must drop under a raise in the inflation target; and second, policy interest rates must rise under a pickup in demand. We use a simple new-Keynesian, semi-structural model to find the natural rate as well as other non observables, including inflation expectations, for a group of advanced economies. We also use the model to explain the role of demand and monetary policy in the evolution of inflation and the output gap. The document shows how a sizable drop in the natural rate pushed policy interest rates against the zero-bound.

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