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Markets | Sat Aug 29, 2015 11:04am EDT

# Raising inflation target won't help much now: researchers

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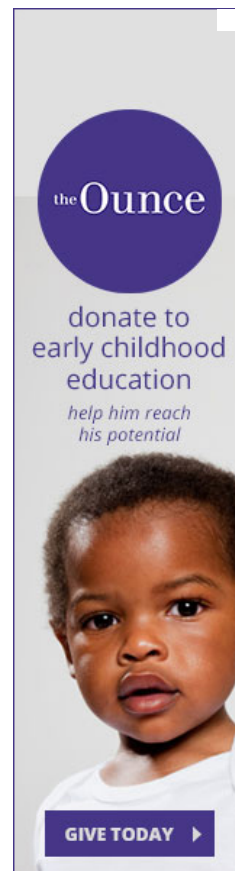
A detail from the front of the United States Federal Reserve Board building is shown in Washington October 28, 2014. REUTERS/GARY CAMERON

The Federal Reserve could have cut short the Great Recession by a year if it had set a 4 percent inflation target in 1984, but raising the target now would probably do little to help the economy, researchers said on Saturday.

Boston Fed President Eric Rosengren and Minneapolis Fed President Narayana Kocherlakota recently have floated raising the U.S. central bank's current 2 percent inflation target to give it more room to cut rates during economic downturns.

The idea has not gained much traction in part because the Fed does not want to be seen as fickle about its commitments.

In a paper presented at the Fed's global central banking conference here, S. Boragan Aruoba of the University of Maryland and Frank Schorfheide of the University of Pennsylvania showed how setting a 4 percent inflation target in 1984 would have allowed the Fed to cut rates more sharply than it was able to do during the 2007-2009 financial crisis.



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Under that scenario, they said "the return of inflation to average levels is even quicker and recovery of GDP takes about a year less than under the historical policy."

But they added that the benefits of raising the target inflation rate depend heavily on the likelihood of a shock pushing the economy to the point where near-zero interest rates are needed.

That probability, the authors said, is very small: less than 0.1 percent in the model they used. When they ran simulations of the economic response to raising the inflation target in early 2014, they found very little benefit.

"While the change in the target inflation rate affects

interest rate and inflation dynamics, the path of GDP is largely unaffected," the researchers wrote.

"Thus, this analysis suggests that if the central bank raises the inflation target now, even if it is able to communicate and convince the public about the credibility of this new policy, there does not seem to be much real effects of this policy change to make it desirable."

Aruoba and Schorfheide are known for their research on monetary policy when interest rates are at or near zero, and their models for tracking business cycles and gross domestic product growth are published by the Philadelphia Fed.

(Reporting by [Ann Saphir](#); Editing by Paul Simao)

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