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Abstract

This paper examines the effectiveness of central bank forward guidance under inflation and price-level targeting monetary policies. The results show that the beneficial effects of forward guidance increase if a central bank pursues price-level targeting instead of inflation targeting. Output and inflation respond more favorably to forward guidance with price-level targeting than inflation targeting. A monetary policy rule that aggressively reacts to inflation and includes interest rate inertia narrows the performance gap between the two policy regimes. However, forward guidance with price-level targeting is still preferred to forward guidance with inflation targeting after performing multiple robustness checks.

Keywords: Forward Guidance, Inflation Targeting, Price-Level Targeting, Monetary Policy.

JEL classification: E30, E31, E50, E52, E58, E60.

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