

## **Strict and Flexible Inflation Targets: An Empirical Investigation**

Glenn Otto, *University of New South Wales*

Graham Voss, *University of Victoria*

February 2009

### **Abstract**

We examine whether standard theoretical models of inflation forecast-targeting are consistent with the observed behaviour of three central banks: Australia, Canada, and the US. The target criteria from these models restrict the conditionally expected paths of variables targeted by the central bank, in particular inflation and the output gap. We estimate various moment conditions, providing a description of monetary policy for each central bank under different maintained hypotheses. We then test whether these estimated conditions satisfy the predictions of models of optimal monetary policy. The overall objective is to examine the extent to which and the manner in which these central banks successfully balance inflation and output objectives over the near term.

For all three countries, we obtain reasonable estimates for both the strict and flexible inflation forecast-targeting models, though with some qualifications. Most notably, for Australia and the United States there are predictable deviations from forecasted targets, which is not consistent with models of inflation targeting. In contrast, the results for Canada lend considerable support to simple models of flexible inflation-forecast targeting.