Abstract

The flattening of the Phillips curve in the United States has attracted considerable attention and anchored expectations hypothesis, the view that the increase in central bank transparency has achieved well-anchored expectations and stable inflation dynamics, has been supported as one plausible explanation for this phenomenon in central bank circles. However, empirical studies has increasingly argued that inflation expectations are not anchored. Against the background, we theoretically explore the new policy channel of the improvements in central bank transparency for inflation dynamics. We develop a general equilibrium model where firms flexibly set their prices under imperfect information about their aggregate conditions. A central bank attempts to control aggregate conditions aiming at achieving its inflation target. Under the framework, we analytically show two novel results. First, even without nominal price rigidity, the Phillips curve includes not only the term of output gap, but also that of firms’ expectations on the bank’s targeted inflation. Second, greater transparency about its inflation target makes the slope of the Phillips curve flatter.

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