

The 2021–2023 test

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Abstract

What drove the inflation surge, whether the anchor held, what the fast disinflation showed, how the frameworks changed, and an exercise on expectations data.

Between early 2021 and late 2022 inflation rose to 9 percent in the United States and above 10 percent in the euro area and the United Kingdom, the first serious test of inflation targeting since the frameworks were built. This lesson reads the episode through the concepts of the course.

What drove it

Bernanke and Blanchard decomposed US inflation with a small model of prices, wages and expectations (Bernanke & Blanchard, 2023). Their reading: the initial surge in 2021 came from supply shocks, energy and food prices and sectoral shortages, not from an overheated labour market; the labour market's contribution grew through 2022 as tightness persisted; and the risk that expectations would de-anchor was real but did not materialise. The decomposition matters because it says the early inflation was largely the kind a central bank can look through, while the later persistence was the kind it must act against. The mistake, on this reading, was not the initial patience but its duration.

In the euro area the energy shock of 2022 was larger relative to the economy and the labour-market component smaller, which is why the ECB's inflation fell faster once energy prices reversed.

Did the anchor hold?

Reis warned in 2021 that several early-warning signs were present: the right tail of the distribution of expectations had fattened, the dispersion across forecasters had widened, and market-based measures had started to react to news again (Reis, 2021). The indicators from Anchored expectations were flashing.

They then stopped. Long-run professional expectations in the United States moved by a few tenths and returned; five-year break-evens rose to about 3 percent in early 2022 and fell back; household five-to-ten-year expectations rose and then drifted down. The Phillips-curve arithmetic of The Phillips curve shows why this mattered: with π^{LR} stable, the persistence of inflation came from the lagged term and from the tight labour market, both of which could be unwound without a change in regime.

The disinflation

Inflation fell from 9 percent to about 3 percent in the United States between mid-2022 and end-2023 with unemployment rising less than one percentage point. By the standards of Credibility and disinflation this is a sacrifice ratio near zero, and it is the strongest evidence for the value of the anchor that thirty years of targeting had built. Three qualifications belong beside it: much of the disinflation was the supply shocks reversing; the labour market's contribution unwound partly through falling vacancies rather than rising unemployment, which the nonlinear Phillips curve predicts; and the fast tightening of 2022, over four percentage points in a year, was itself part of what kept expectations in place.

How the frameworks changed

The episode exposed the asymmetry in the 2020 Fed framework described in Flexible targeting and its alternatives: it prescribed patience after shortfalls and said nothing about overshoots, and its “shortfalls” language discouraged pre-emptive tightening. In August 2025 the FOMC revised the statement, returning to a flexible inflation-targeting formulation with a symmetric 2 percent goal and dropping the averaging and shortfalls language. The ECB’s 2021 strategy, with its symmetric target and explicit allowance for forceful action in either direction, needed less repair (European Central Bank, 2021). Neither bank changed the number, which is the answer to the question in Why two percent?: the anchor held, so the number stayed.

An exercise

Compare three measures of expectations through the episode. The series are on FRED; the code needs pandas and pandas-datareader.

```
import pandas as pd
from pandas_datareader import data as pdr

start = "2019-01-01"
bei5 = pdr.DataReader("T5YIE", "fred", start)           # 5-year break-even inflation,
    ↪ daily
bei5y5 = pdr.DataReader("T5YIFR", "fred", start)         # 5-year, 5-year forward
    ↪ break-even
mich = pdr.DataReader("MICH", "fred", start)             # Michigan 1-year expected
    ↪ inflation, monthly
cpi = pdr.DataReader("CPIAUCSL", "fred", start)          # CPI, monthly
infl = 100 * (cpi / cpi.shift(12) - 1)

df = pd.concat({
    "cpi_yoy": infl.iloc[:, 0],
    "bei_5y": bei5.resample("ME").mean().iloc[:, 0],
    "bei_5y5y": bei5y5.resample("ME").mean().iloc[:, 0],
    "michigan_1y": mich.iloc[:, 0],
}, axis=1).dropna()
print(df.loc["2021-01":"2023-12"].round(2).iloc[:, :3])
```

Look at the difference between the 5-year break-even and the 5-year-5-year forward in 2022: the first rose with current inflation, the second barely moved. That gap is the anchor in a single table. Then look at the Michigan series, which rose more and stayed up longer, the household pattern from Measuring expectations.

What the episode settled and what it did not

- Anchored expectations are worth what the theory says: a large shock, a fast disinflation, little unemployment.
- Patience with supply shocks is right until the labour market tightens; the framework must allow for the second case as well as the first.
- Makeup strategies designed for shortfalls need a symmetric counterpart or they become an excuse.
- Whether the anchor would have survived another year of 8 percent inflation is unknown, and nobody proposes to find out.

Bernanke, B. S., & Blanchard, O. (2023). *What caused the US pandemic-era inflation?* (Working Paper 86). Hutchins Center on Fiscal; Monetary Policy, Brookings Institution.

European Central Bank. (2021). *The ECB’s monetary policy strategy statement*. Press release, 8 July. https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_stateme nt.en.html

Reis, R. (2021). Losing the inflation anchor. *Brookings Papers on Economic Activity*, 2021(2), 307–361.
<https://doi.org/10.1353/eca.2022.0004>