Regime Shifts in U.S. Trend Inflation: Pre-Volcker to Post-Great Moderation

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We revisit U.S. trend inflation dynamics since the 1960s to 2020s by estimating a non-linear, non-stationary Markov-switching New Keynesian model, in which trend inflation evolves as a latent Markov process. In our model, firms' price-setting behavior follows the standard Rotemberg (1982) framework, but we explicitly allow trend inflation to shift over time.

Our estimation result can be summarized as threefold; (i) it confirms the Volcker disinflation as a regime shift from high to mid-level trend inflation between 1980 and 1987; (ii) it shows that trend inflation remained stable around 2.8% during the Great Moderation and beyond, despite major disruptions such as the Global Financial Crisis and the COVID-19 pandemic; and (iii) it identifies a persistently hawkish monetary policy regime after 1982, with temporary softening during zero lower bound periods—while inflation expectations remained well anchored.

Overall, our evidence suggests that U.S. trend inflation was not well anchored before the Volcker era. However, from the Volcker era through the Greenspan, Bernanke, and Yellen eras, trend inflation seems to have been stable and well anchored, even amid significant economic disruptions.