Controlling Inflation with Central Bank News

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This paper studies how central bank announcements can influence inflation and the economy when people and firms do not have perfect information. In our model, the central bank not only sets interest rates to stabilise inflation but also conveys information about future economic conditions through policy surprises—the so-called Fed information effects. When the central bank unexpectedly raises interest rates, markets interpret this as a signal that future output will be stronger, leading people to adjust their expectations and spending decisions. This communication channel helps coordinate beliefs and determines a unique path for inflation and output, resolving the classic problem that conventional inflation targeting monetary policy alone may leave inflation indeterminate. In this way, the paper identifies a new role for central bank information: it can serve as a mechanism that anchors expectations and ensures stability in the economy.