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nflation targeting: a success story

- (lexible) inflation targeting tends to be viewed as state of the art when it comes to the conduct of monetary policy.
- any central banks describe themselves as inflation targeters or aspire to become inflation targeters one day.
- nflation targeting has helped countries who initially experienced a high rate of inflation to gradually bring it down.
- nflation targeting has evolved over the years, and it will undoubtedly continue to do so in the future (see ishkin in *estschrift*).

nflation targeting: open issues

- hould the target be in terms of headline or core (or)?
- hat is the optimal rate of inflation? (see oodfriend in *estschrift*)
- hould the central bank publish the interest rate path?
- hould bygones be bygones?
- s price stability enough? (see hite in *estschrift*)
- hat role for the exchange rate?
- ow should the output gap be measured?

he ambiguity of inflation targeting

- either the ed, nor the , nor the describe themselves as inflation targeters.
- or does the .
- nflation targeting means different things to different people
- f inflation targeting means achieving and maintainig a low rate of inflation, i.e. price stability, then *we are all inflation targeters*.
- n fact, in this sense, the has nearly *always* been an inflation targeter, ever since its inception over one hundred years ago (see ordo and ames in *estschrift*).

eyond inflation targeting

- nflation targeting is undoubtedly an appropriate strategy when the initial conditions include a high rate of inflation and the central bank wants to lower it gradually in order to achieve price stability over the medium term.
- ixing yearly targets is helpful to guide the public expectations and to make the central bank accountable.
- *nflation targeting* describes a transitional phase, though. t becomes a misnomor once that the central bank has graduated from the inflation targeting class, for the name of the game should then be *maintaining price stability.*
- he term *inflation targeting* conveys the unfortunate impression that the central bank aims at producing inflation.

nflation targeting and policy discretion

- nflation targeting is generally understood to mean that the target can be changed from time to time.
- he notion that the inflation target can get revised according to circumstances conveys the regrettable idea of discretion in setting policy (independently of whether the target is set by the central bank, the government or the parliament).
- hat is more damaging, missing the target or moving the goal posts as one pleases? (urkey as a case in point).

he objective vs. the operational framework

- he term *inflation targeting*, in the mind of most economists, is understood to imply that the central bank produces an inflation forecast and uses it as a guide to set its policy (nominal) interest rate.
- hat is, the general description of the objective of monetary policy (price stability) comes loaded with an operational concept.
- his is not helpful and it can confuse the issues, for which operational framework is best suited to achieve price stability should be treated as a separate question.

voiding the mistakes of the s

- .n principle, price stability can be achieved in many different ways: monetary control, exchange rate control, interest rate control, …
- . ominal interest control makes for a fundamentally unstable dynamic process.
- . well calibrated reaction function (e.g. a aylor rule) will restore stability to the system.
- he danger, though, is that policy makers will become complacent and rely exceedingly on their own intuition.
- .s it too late already?

nflation targeting: the stress test

- nflation is on the rise nearly everywhere, due to high capacity utilisation and high energy, commodity and food prices.
- nflation expectations might be drifting upwards.
- orld activity is slowing.
- he stability of the financial system is under threat.

wo features of the monetary policy concept might prove to be helpful in passing this test.

o yearly targets dictated by an outside authority

- he *wiss ational ank ct* requires the to maintain price stability.
- t is the who defines the meaning of price stability (a rate of headline inflation between % and % over the medium term).
- t would be inconceivable for the to alter its definition of price stability without sound scientific justification, i.e. simply to suit the circumstances.
- onsequently, medium-term inflation expectations remain firmly anchored, even though inflation has recently been increasing and will most likely exceed % in .

n automatic monetary stabiliser

- he uses the -month ibor as its operational target…
- … and the (mostly -week) repo rate as its instrument.
- s risk premia increased during the past year, the automatically had to reduce the repo rate, thereby insulating the nonfinancial sector from the financial market turmoils.
- ven though neither the nor the formally changed their monetary stance between eptember and une , the outcome, *de facto*, has been quite different.
- n the wiss case there thus is no need for an *ad hoc* fix of the reaction function (aylor, úrdia and oodford); this enhancs credibility.

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3M-Libor in CHF and Repo rate

Overnight — 1 Week — 2 Week — 3M-Libor — Target range

%

3.25
3
2.75
2.5
2.25
2
1.75

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3M-Libor in EUR and ECB min bid rate

3M-Libor — ECB min bid rate
1 Week weighted average allotment rate

%

5
4.8
4.6
4.4
4.2
4

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hank you for your attention !