

The future of inflation targeting and the present at the Riksbank

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Flexible inflation targeting

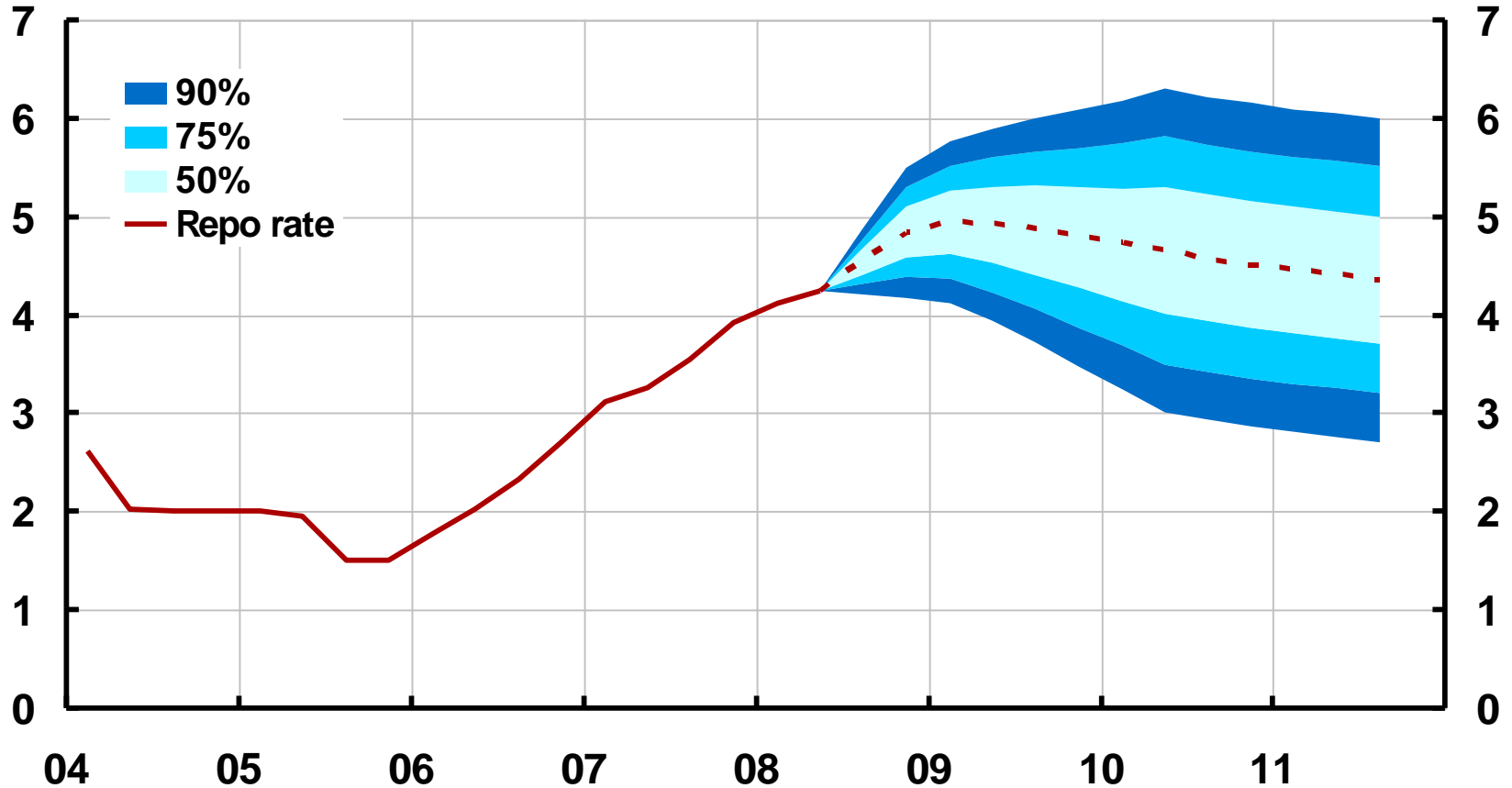
- Stabilize both inflation around target and resource utilization
- “Forecast targeting:” Choose an instrument-rate path such that the forecast of inflation and resource utilization “looks good”
- “Looks good:” Inflation goes to target and resource utilization goes to normal at an appropriate pace
- Publish and motivate instrument-rate path and forecast of inflation and real economy
- “Management of expectations” par excellence

Publishing the repo-rate path

- Repo-rate path “integral part of the monetary policy stance,” necessary for inflation and output-gap forecast
- Policy discussion more about path than current repo rate
- Six-member committee can easily agree on path
- “Forecast, not commitment”
- Mean forecast with uncertainty intervals

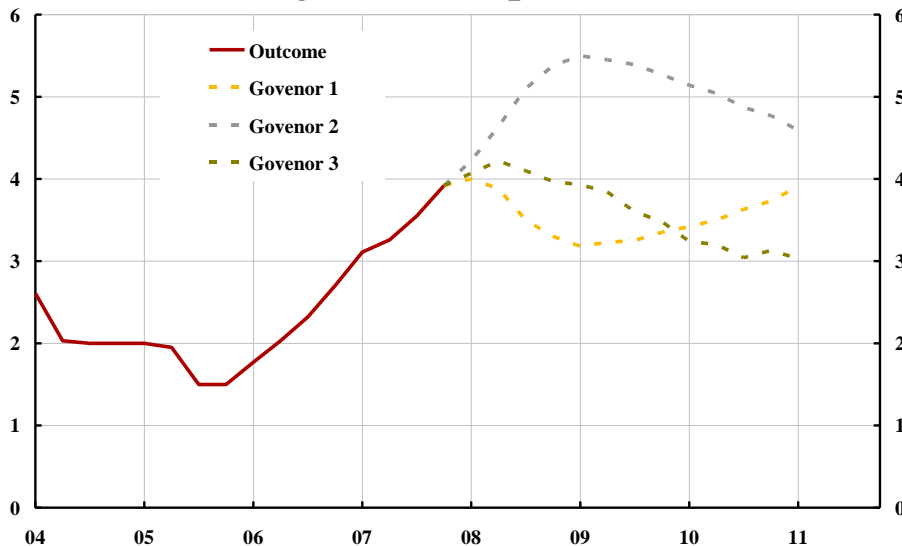
Repo rate with uncertainty bands, July 2008

Per cent

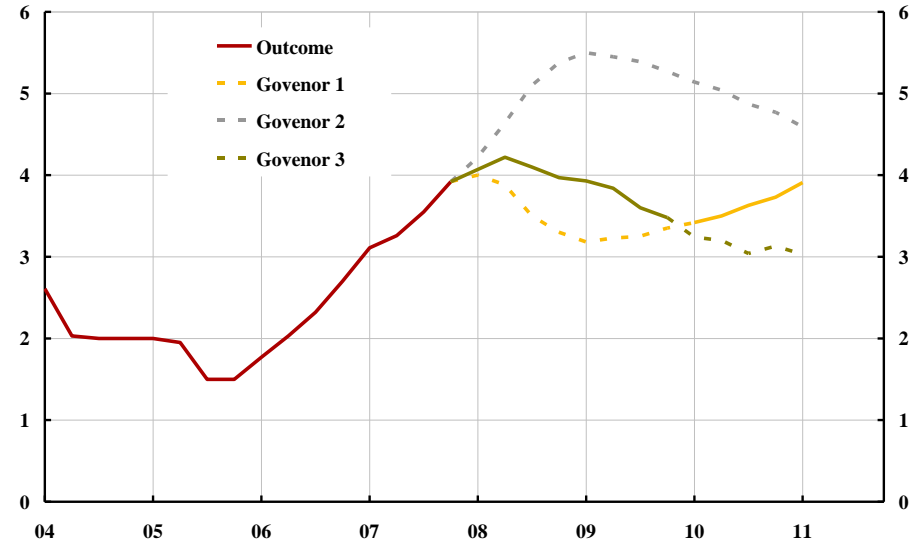


Deciding on a repo-rate path: Median path?

Individual repo-rate paths 3 governors, percent

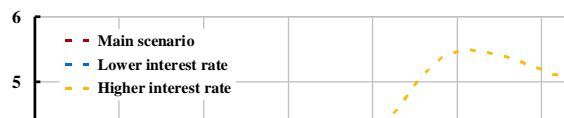


New repo-rate path Percent



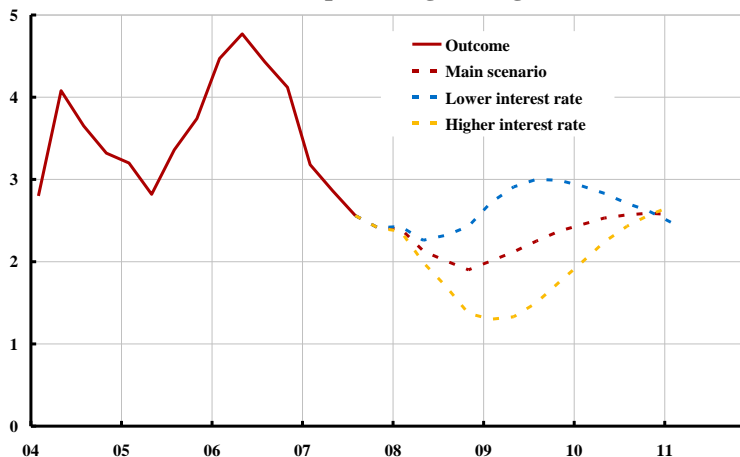
Deciding on a repo-rate path: Just vote among a few alternatives

Repo rate
Per cent



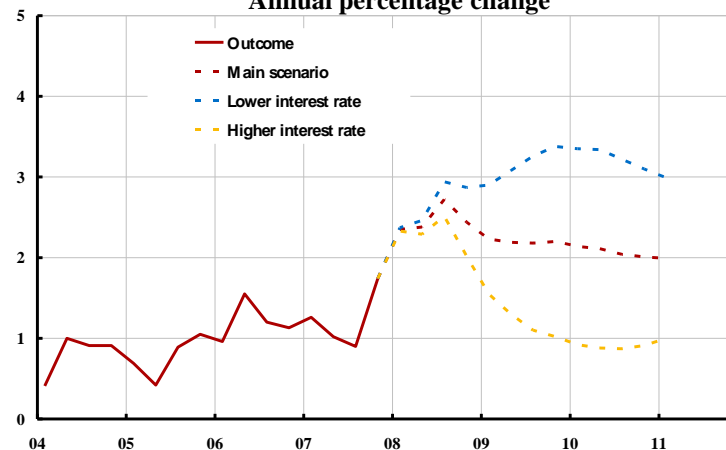
GDP growth

Annual percentage change



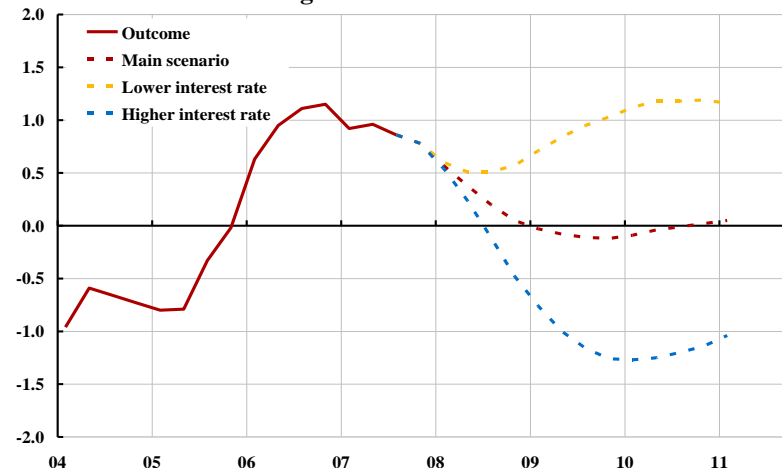
CPIX

Annual percentage change



Output gap

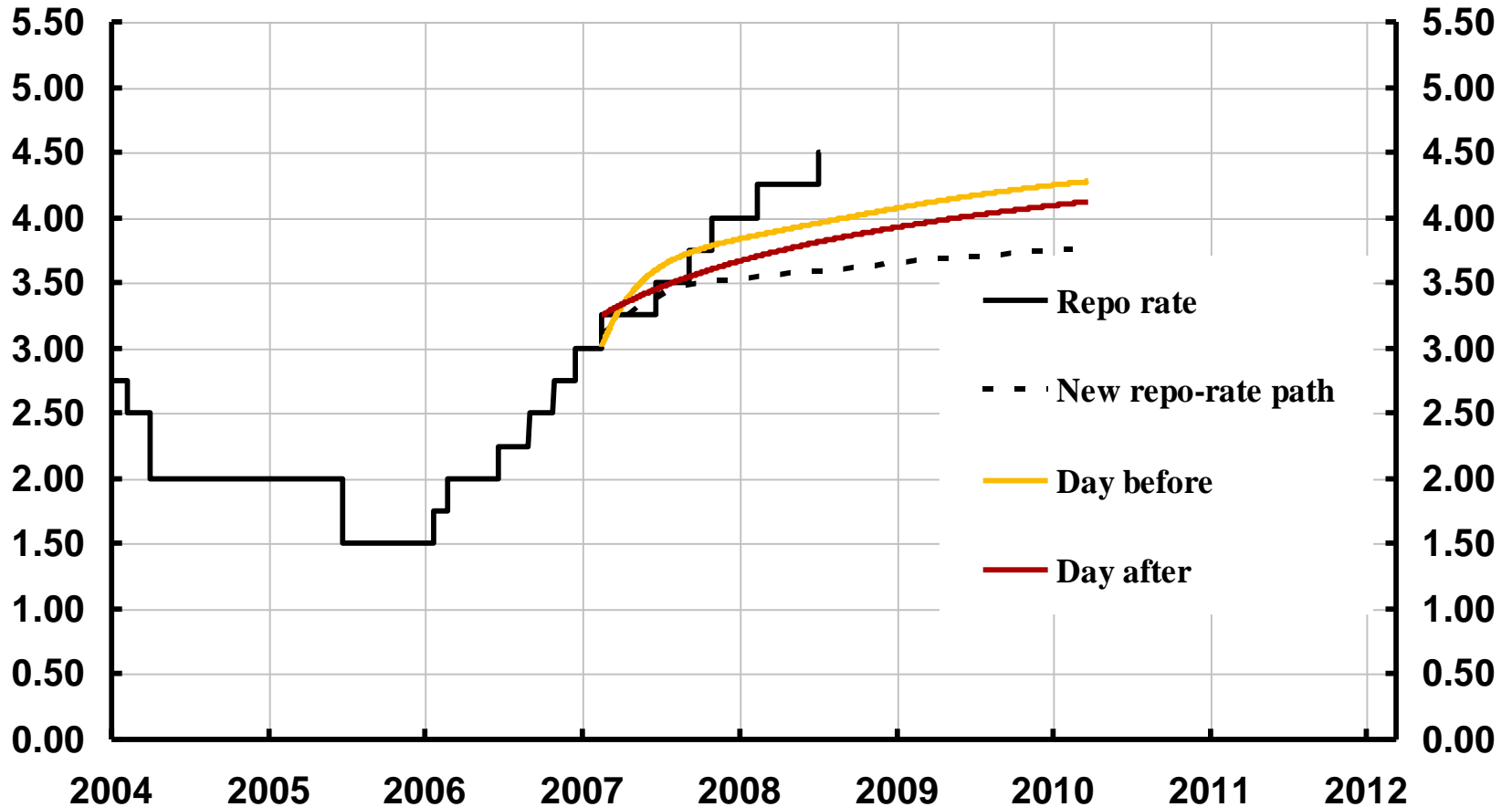
Percentage deviation from the HP trend



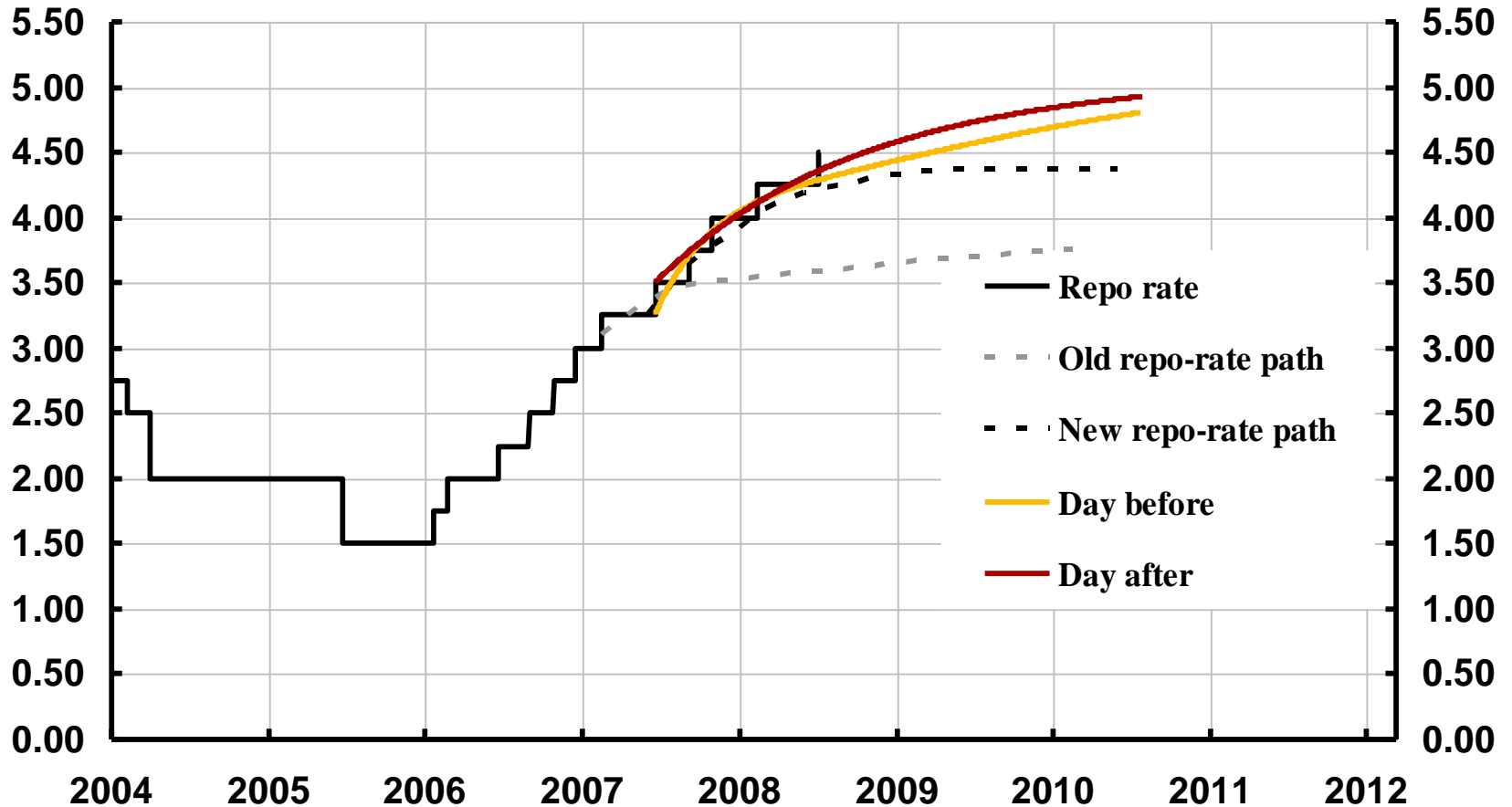
Management of interest-rate expectations

- Publish and motivate inflation, real-economy, and repo-rate forecast
- Compare repo-rate path and market forward rates before and after announcement

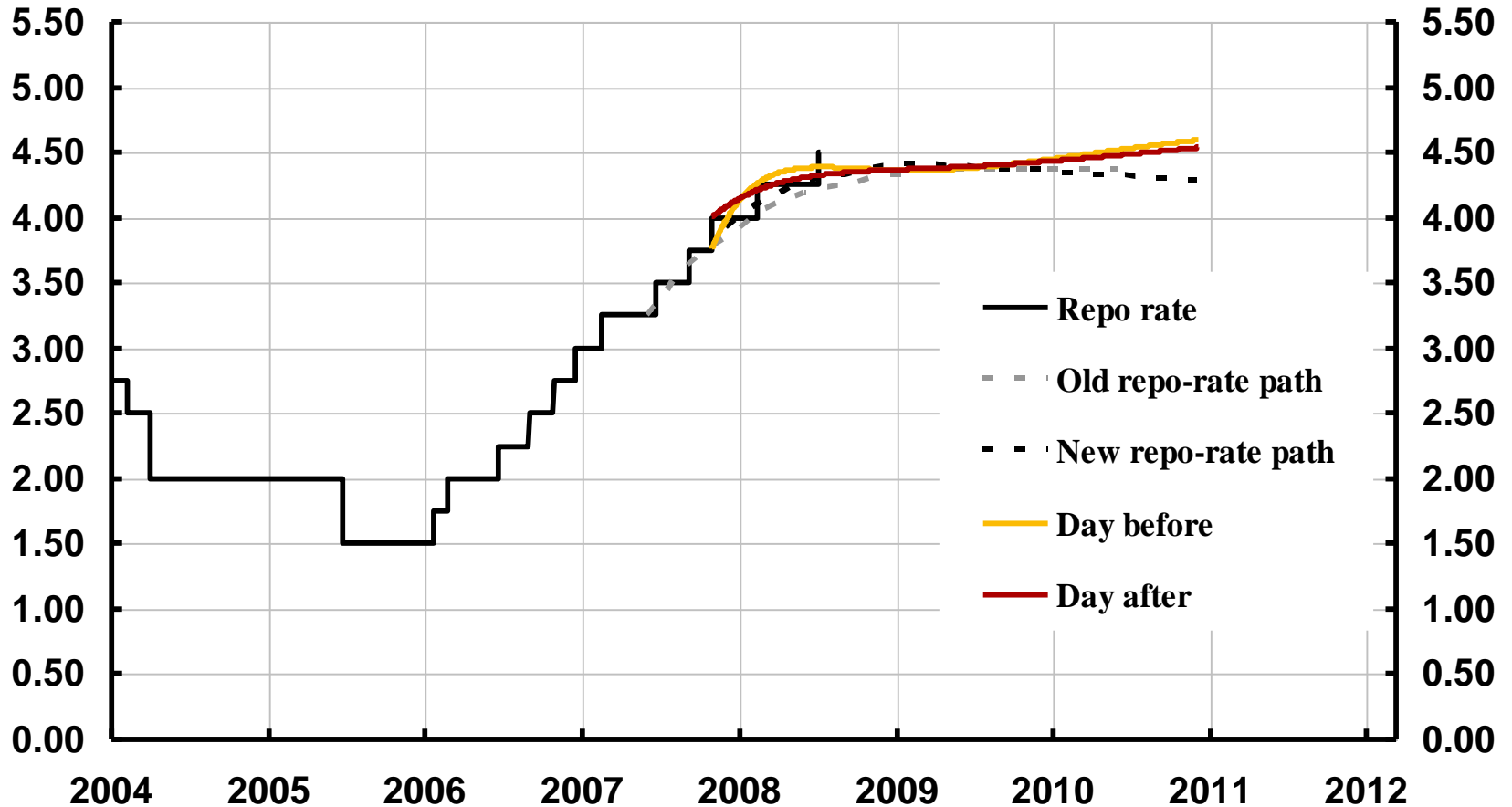
Repo-rate path and market forward rates February 2007



Repo-rate path and market forward rates June 2007

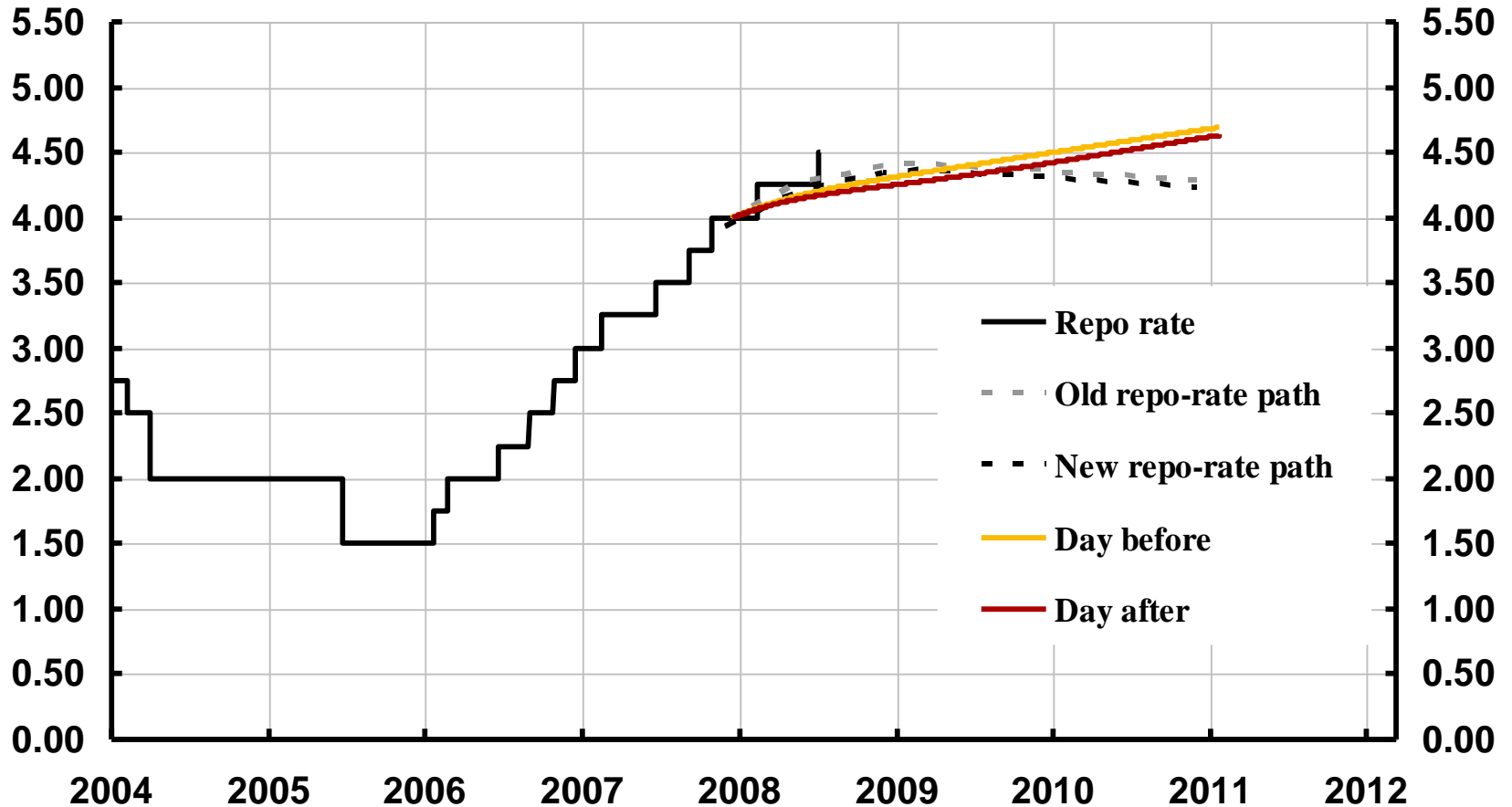


Repo-rate path and market forward rates October 2007

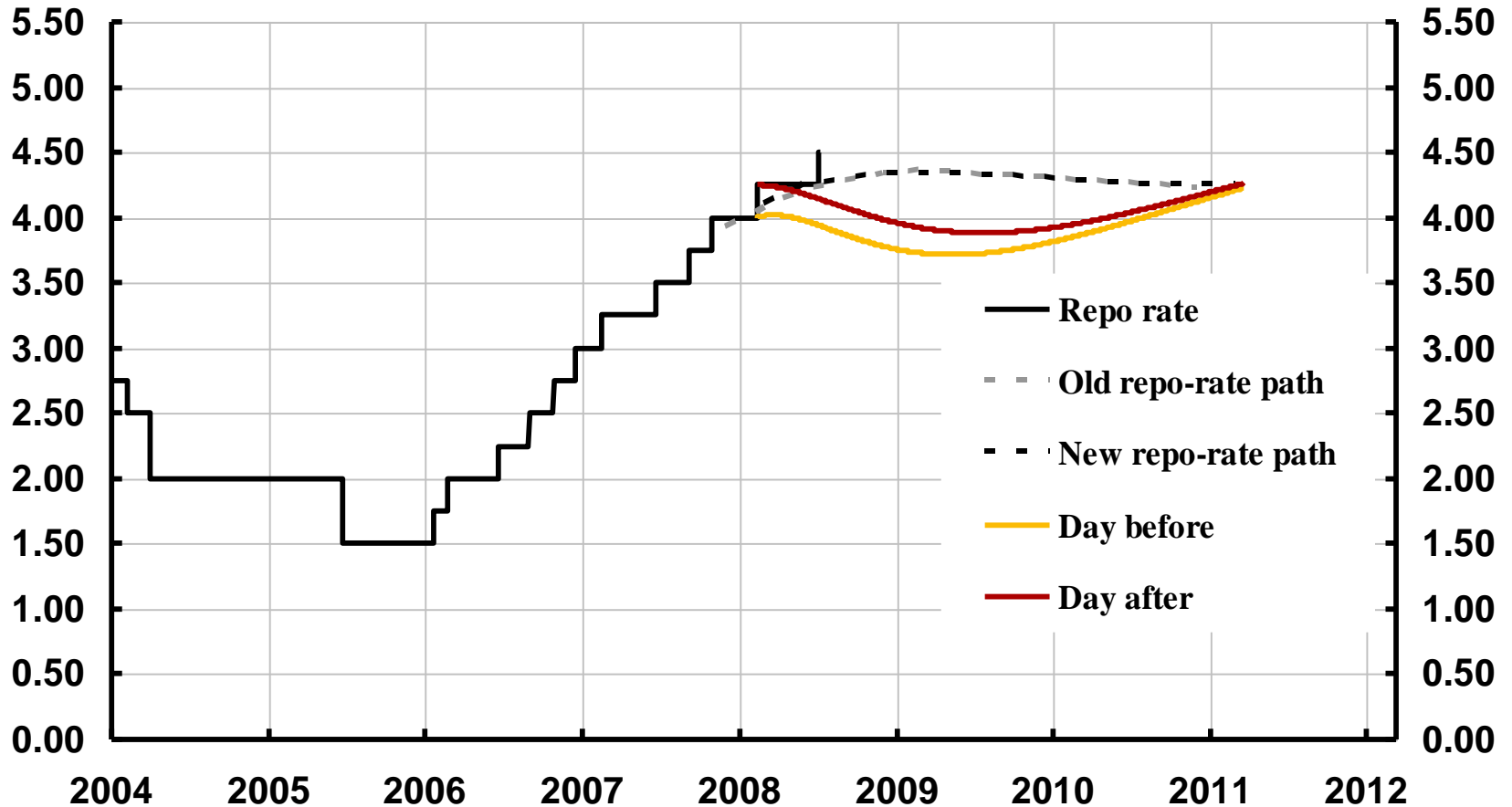


Repo-rate path and market forward rates

December 2007

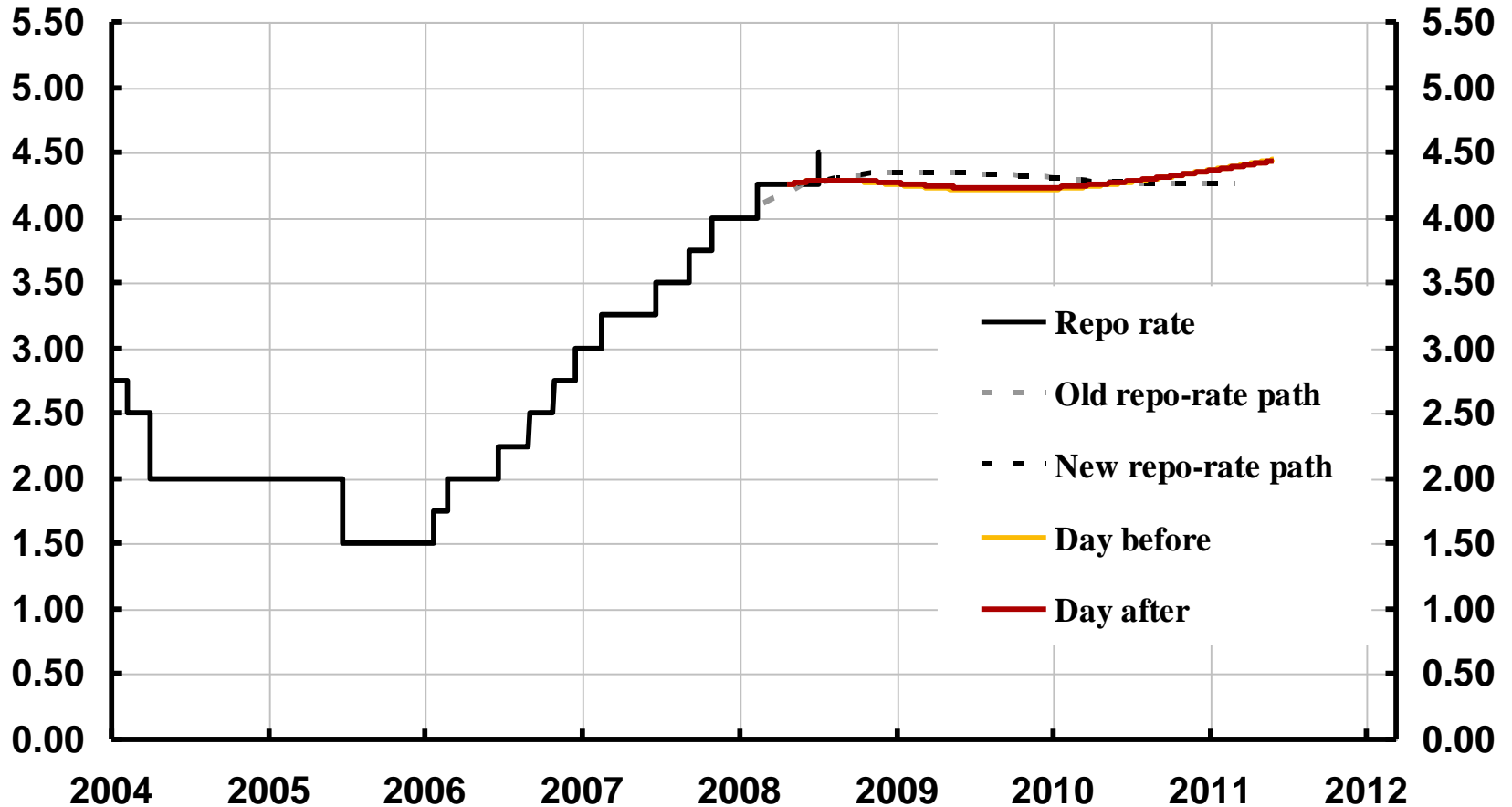


Repo-rate path and market forward rates February 2008



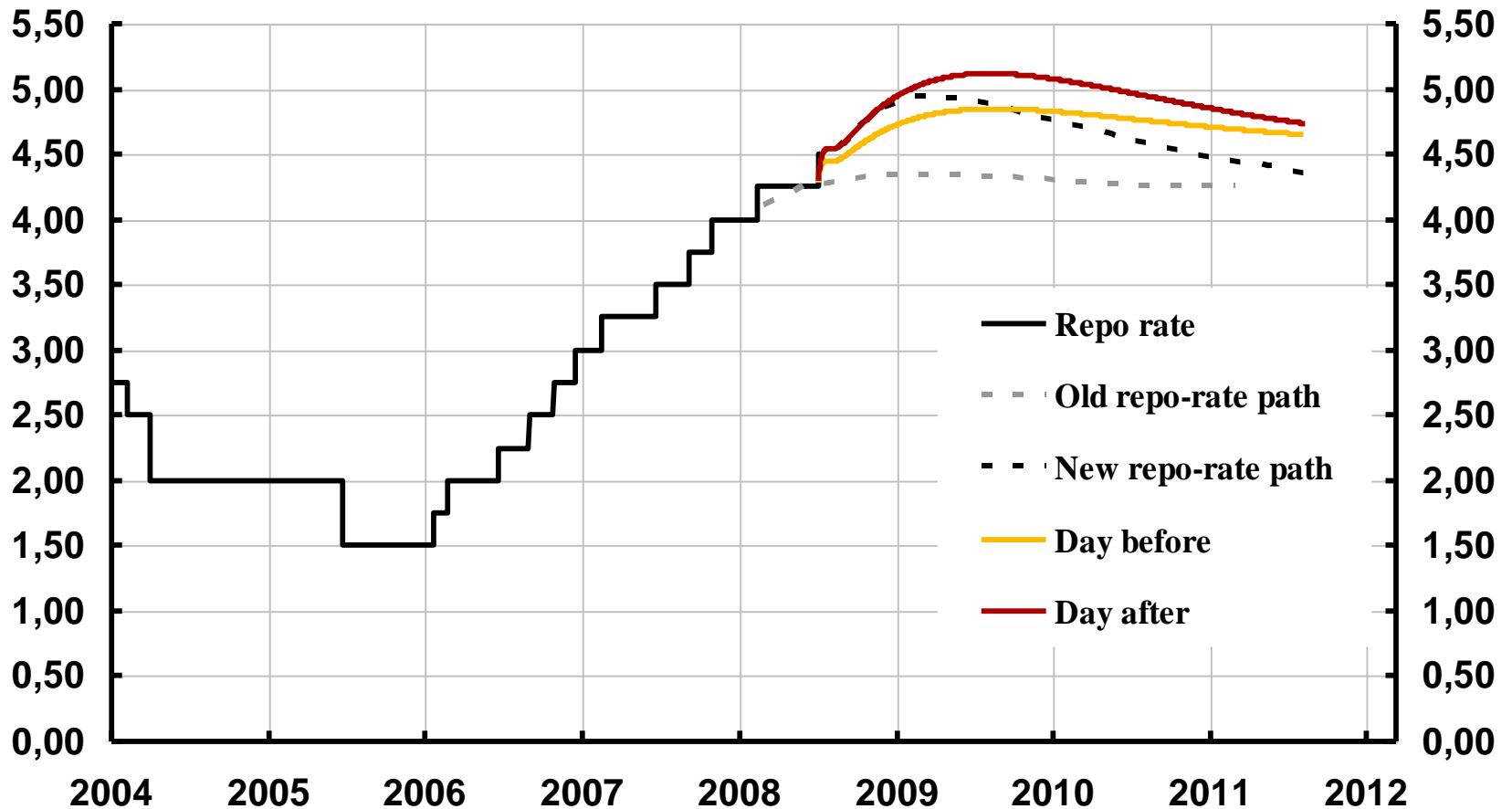
Repo-rate path and market forward rates

April 2008



Repo-rate path and market forward rates

July 2008



Decision process at the Riksbank

- 6-member Executive Board
- 6 policy decisions per year (3 reports, 3 updates)
- Interaction between staff and EB results in main and alternative combinations of forecasts of repo rate, inflation, and real economy
- At final policy meeting EB discusses and votes on decision and report/update
- Majority decision published day after policy decision
- Attributed minutes, including any dissenting views, published 2 weeks after policy decision

Individualistic committee

- Individual accountability
- Members appointed by Parliamentary committee
- Regular hearings in Parliament, expert evaluation every 4th year (Giavazzi-Mishkin 2006)
- Attributed minutes, dissenting views
- No free riding/social loafing; better preparation
- Less free discussion?
- Less group-think?

Individualistic committee: Cacophony problem?

- No:
- After decision, before minutes: Majority view
- After minutes: Individual members clarify their individual views and position at last decision
- No info about future decisions beyond published repo-rate path and Monetary Policy Report/Update
- Except some comments on new data relative to previous forecast and possible policy tradeoffs

To be done:

The near future

- Better measures of resource utilization, output gap, potential output
- Potential output, not HP: Flexprice, conditional or unconditional, relation to Pareto-efficient output
- Optimal policy, minimize quadratic loss function, commitment: Main and alternative repo-rate paths
- Alternative repo-rate paths: Simulate as anticipated, not unanticipated (not Leeper-Zha modest interventions)
- DSGE models w/ better financial sector, labor market

To be done:

The not so near future

- Price-level targeting

$$L_t = (p_t - p_t^*)^2 + \lambda(y_t - \bar{y}_t)^2$$

$$p_t^* = p_{t-1}^* + \pi^*$$

- Less long-run price-level uncertainty than inflation targeting
- If credible, inherent stabilization of inflation expectations:

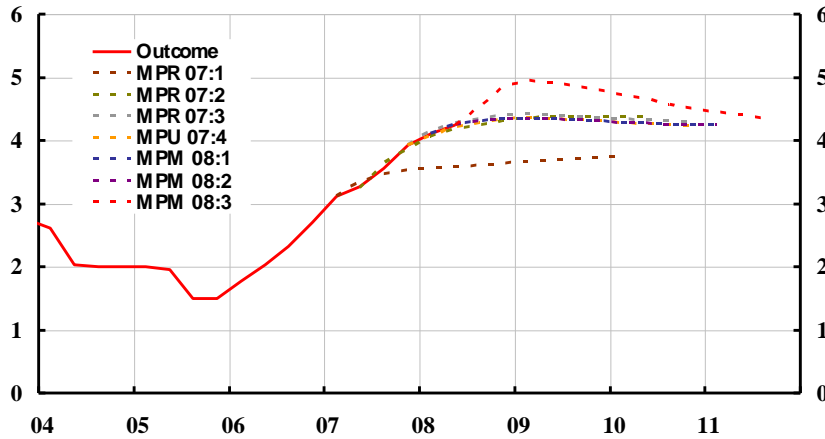
$$p_t \uparrow \Rightarrow \pi_t^e \downarrow$$



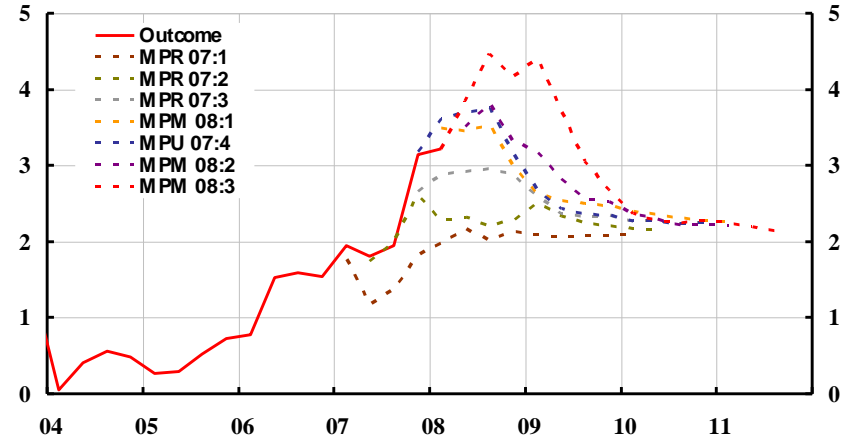
Decisions

January 2007-July 2008

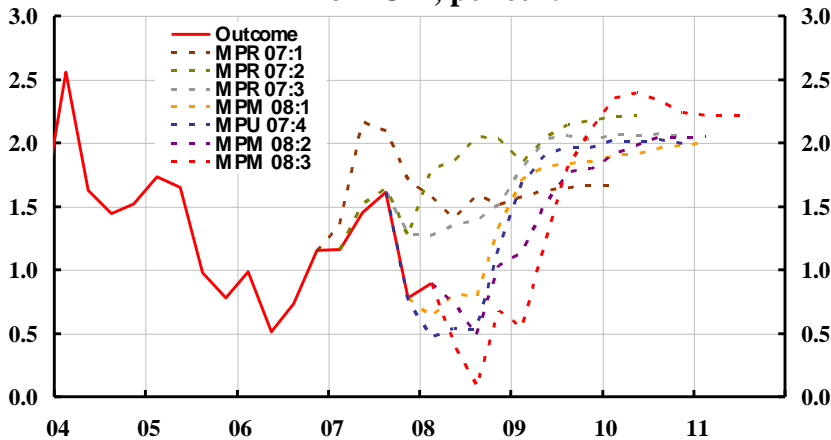
Repo rate
Per cent



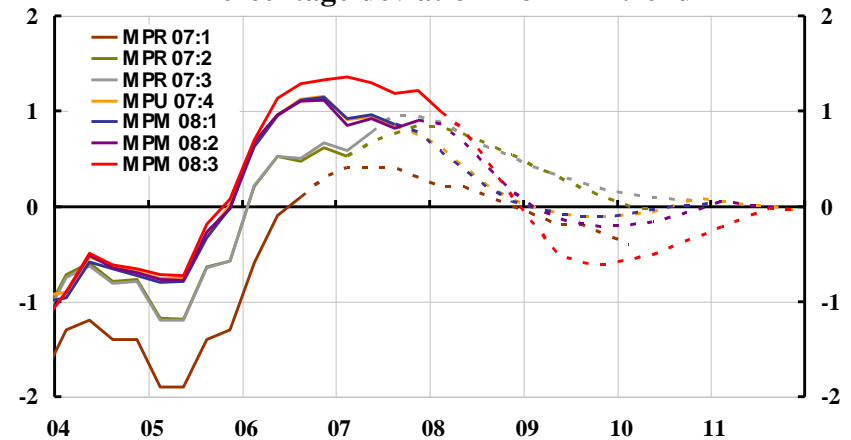
CPI
Annual percentage change



Real repo rate
From CPI, per cent



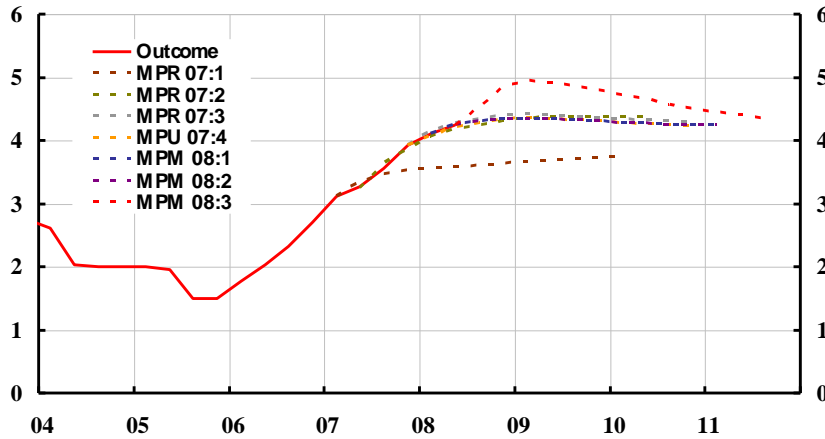
Output gap
Percentage deviation from HP trend



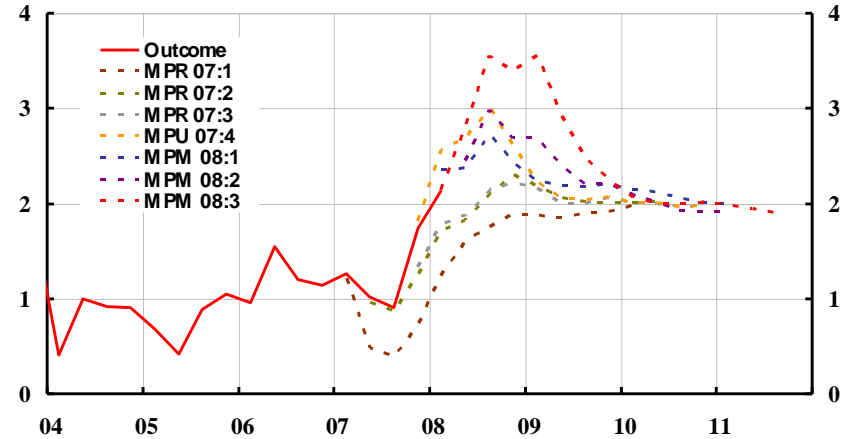
Decisions

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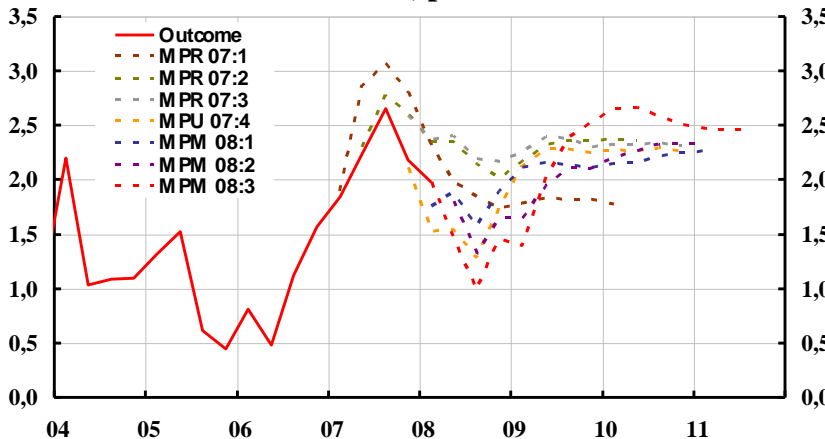
Repo rate
Per cent



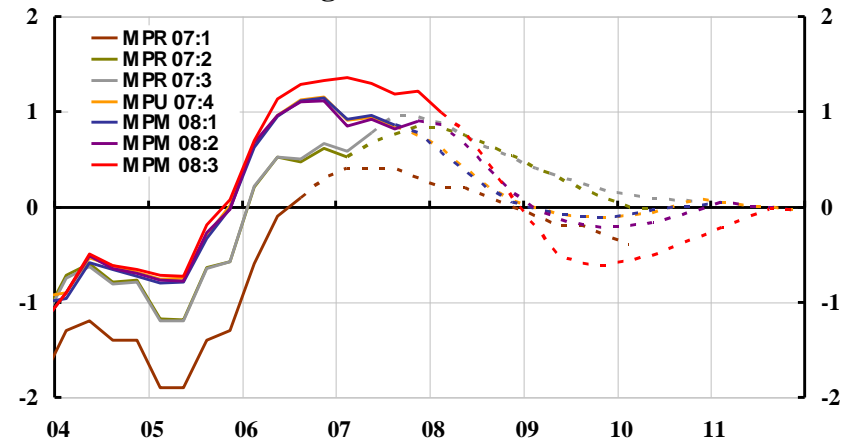
CPIX
Annual percentage change



Real repo rate
From CPIX, per cent

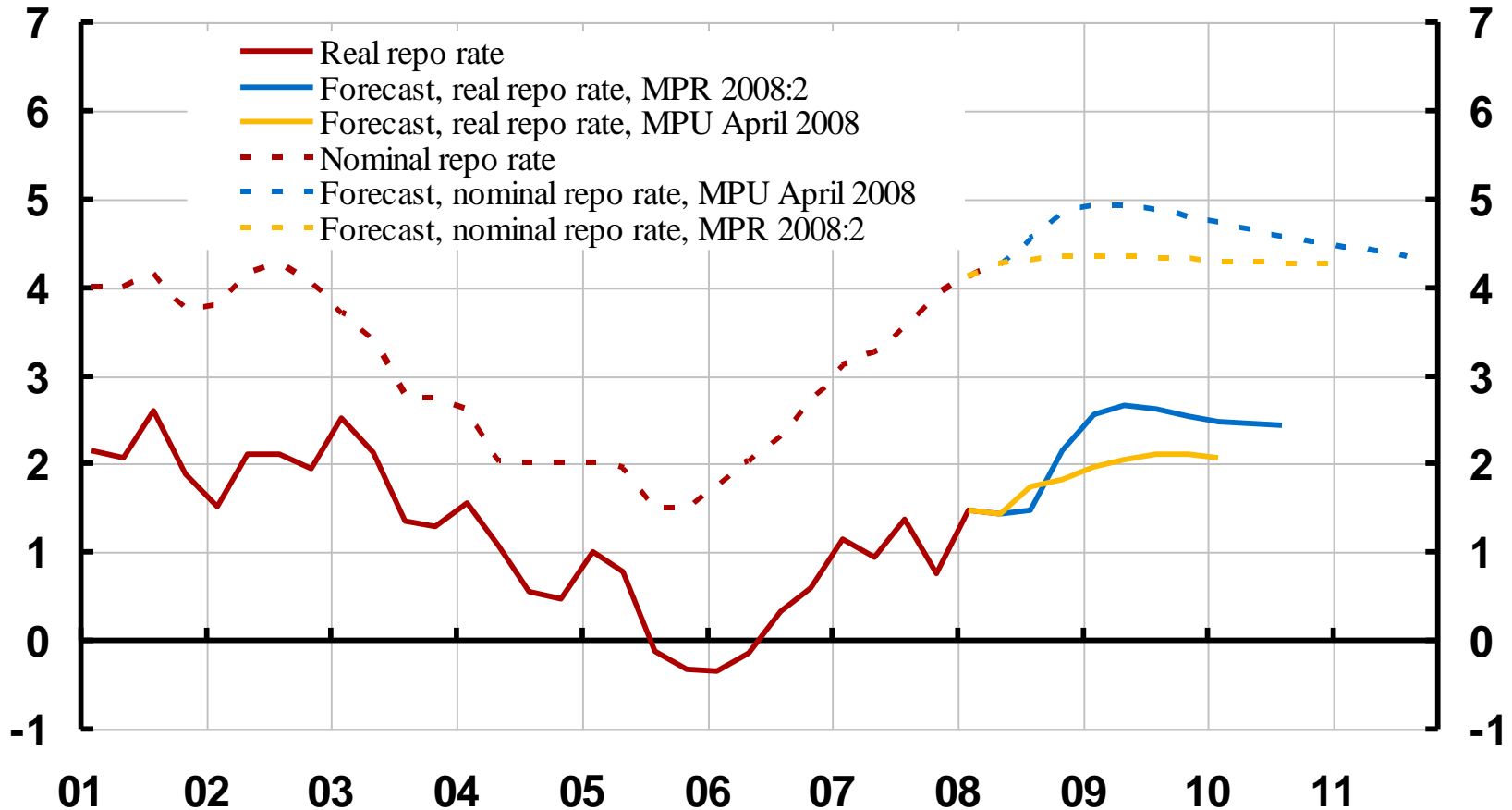


Output gap
Percentage deviation from HP trend



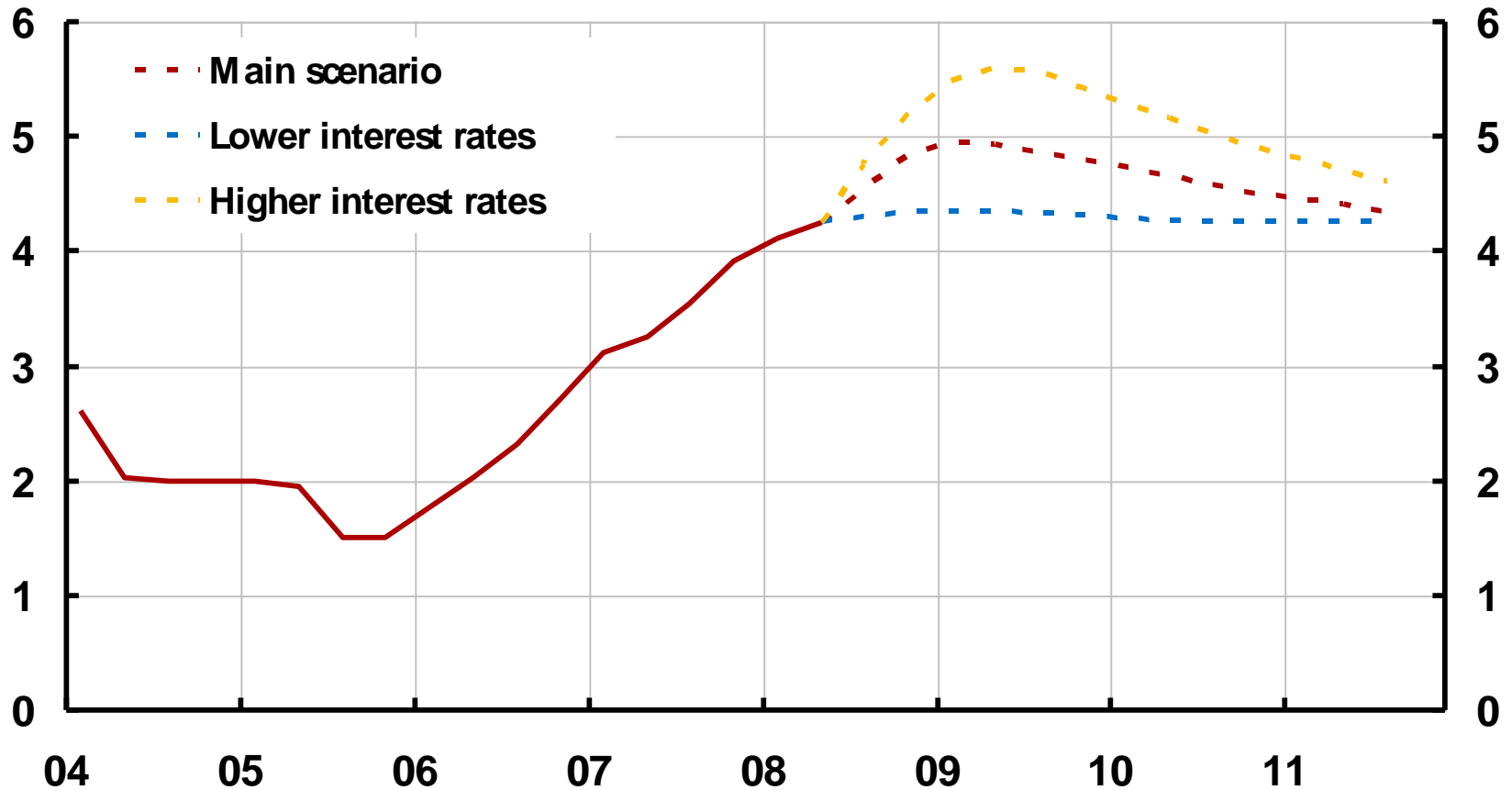
Nominal and real repo rate, April and July 2008

From 4-qtr CPI forecast, per cent



Alternative repo-rate paths

Per cent, quarterly averages

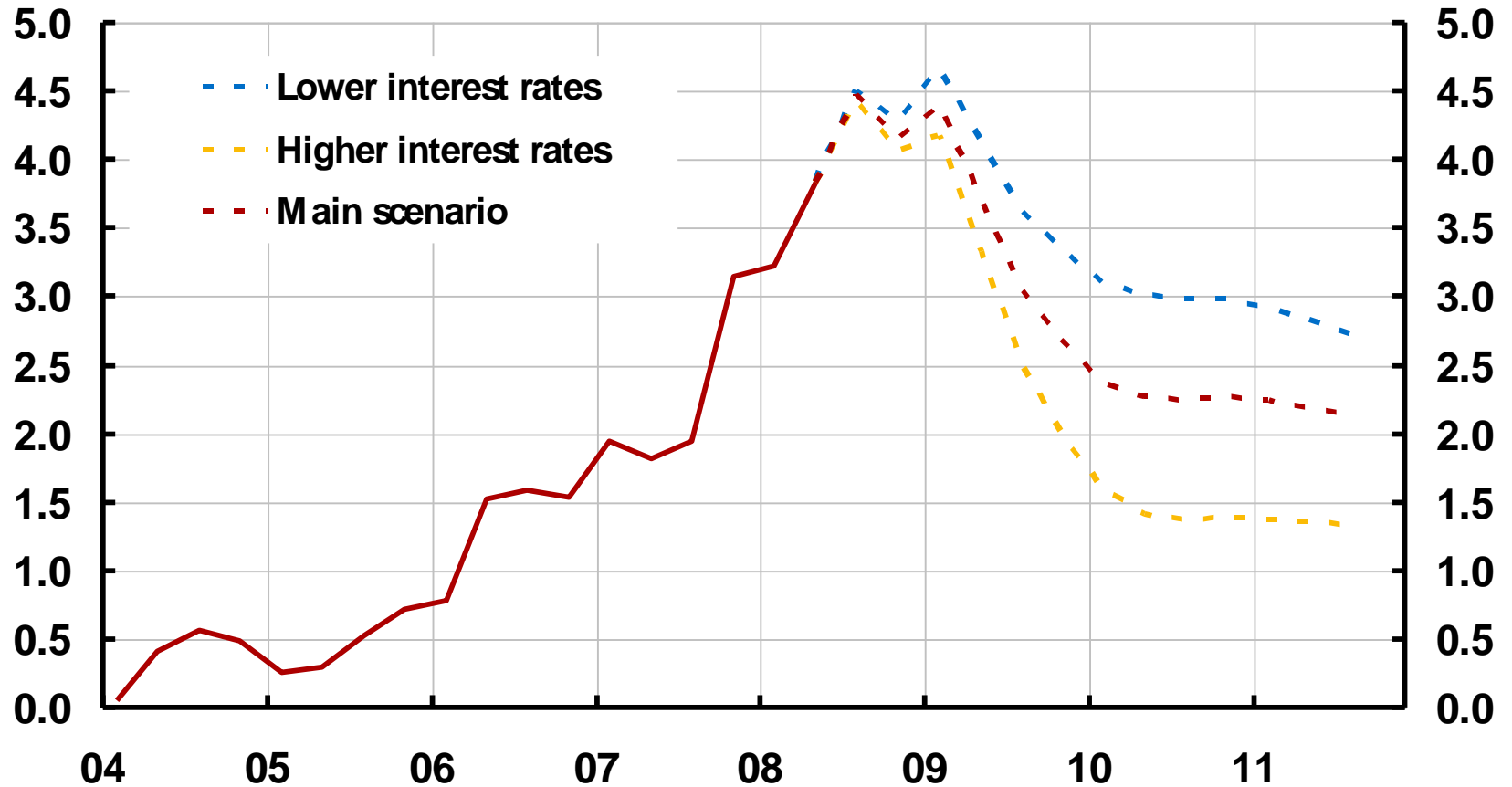


Note. Broken lines represent the Riksbank's forecast.

Source: The Riksbank

CPI

Annual percentage change

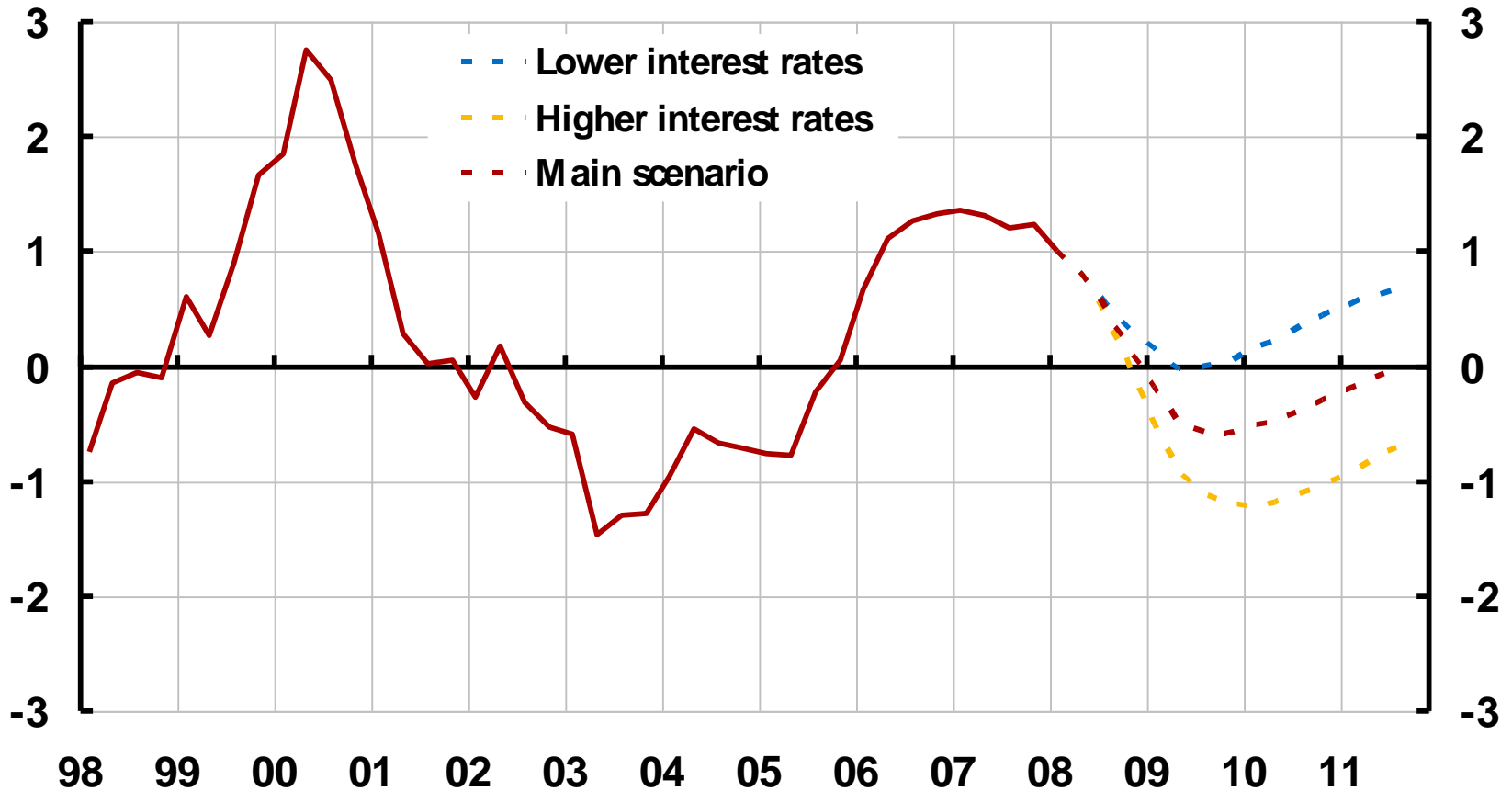


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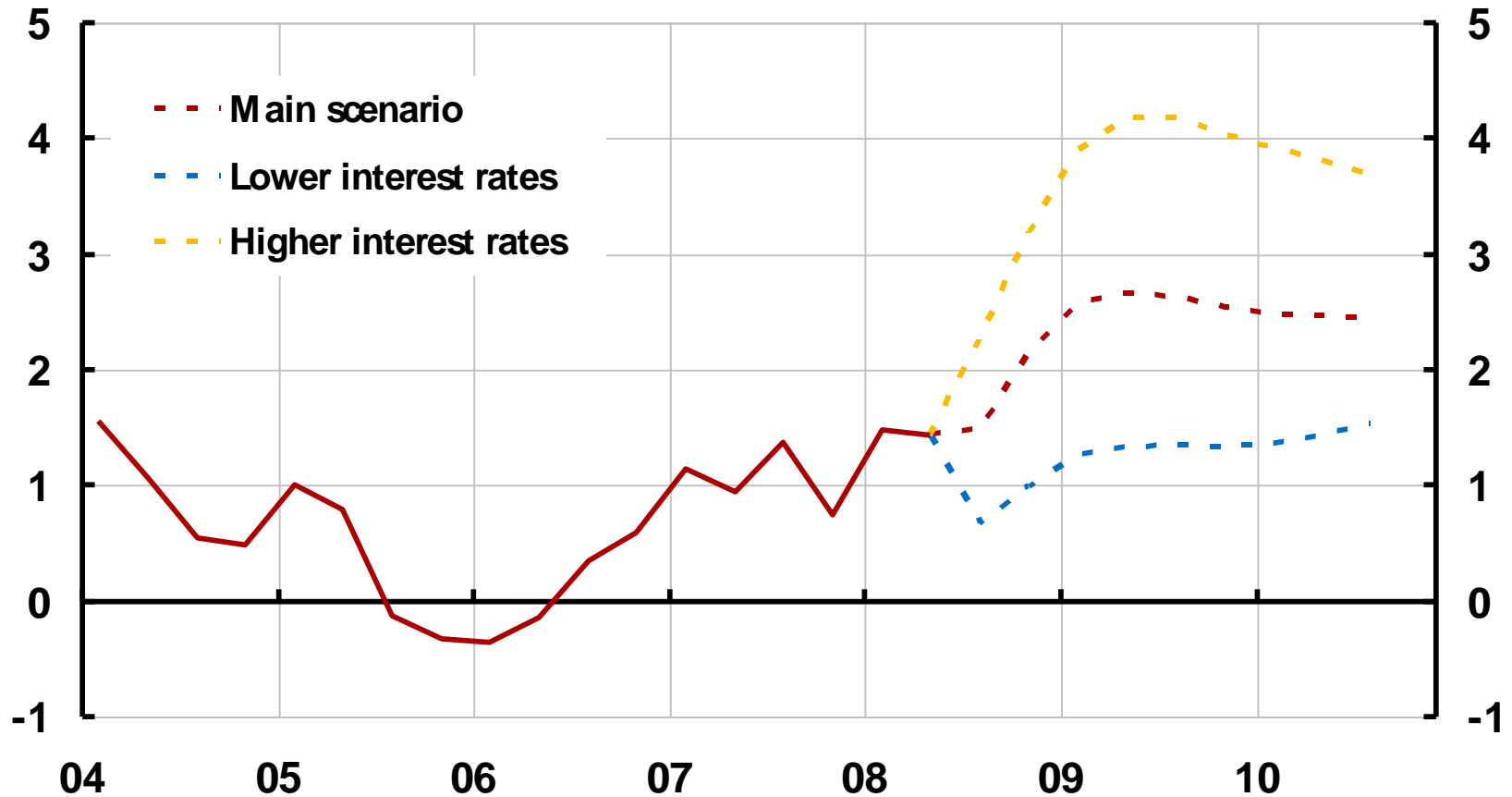
Output gap

Percentage deviation from the HP trend



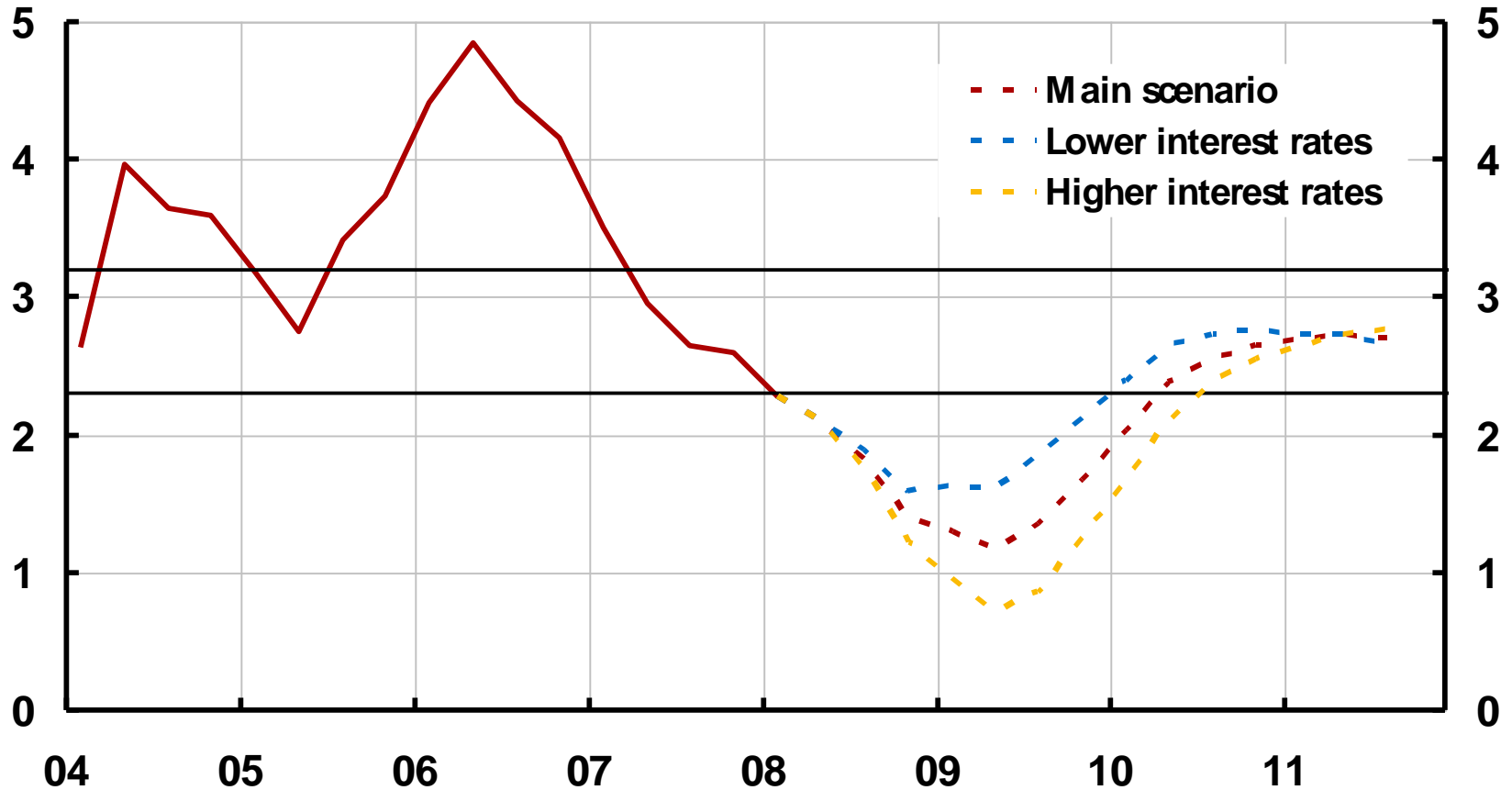
Real repo-rate paths

From 4-quarter CPI forecast, per cent



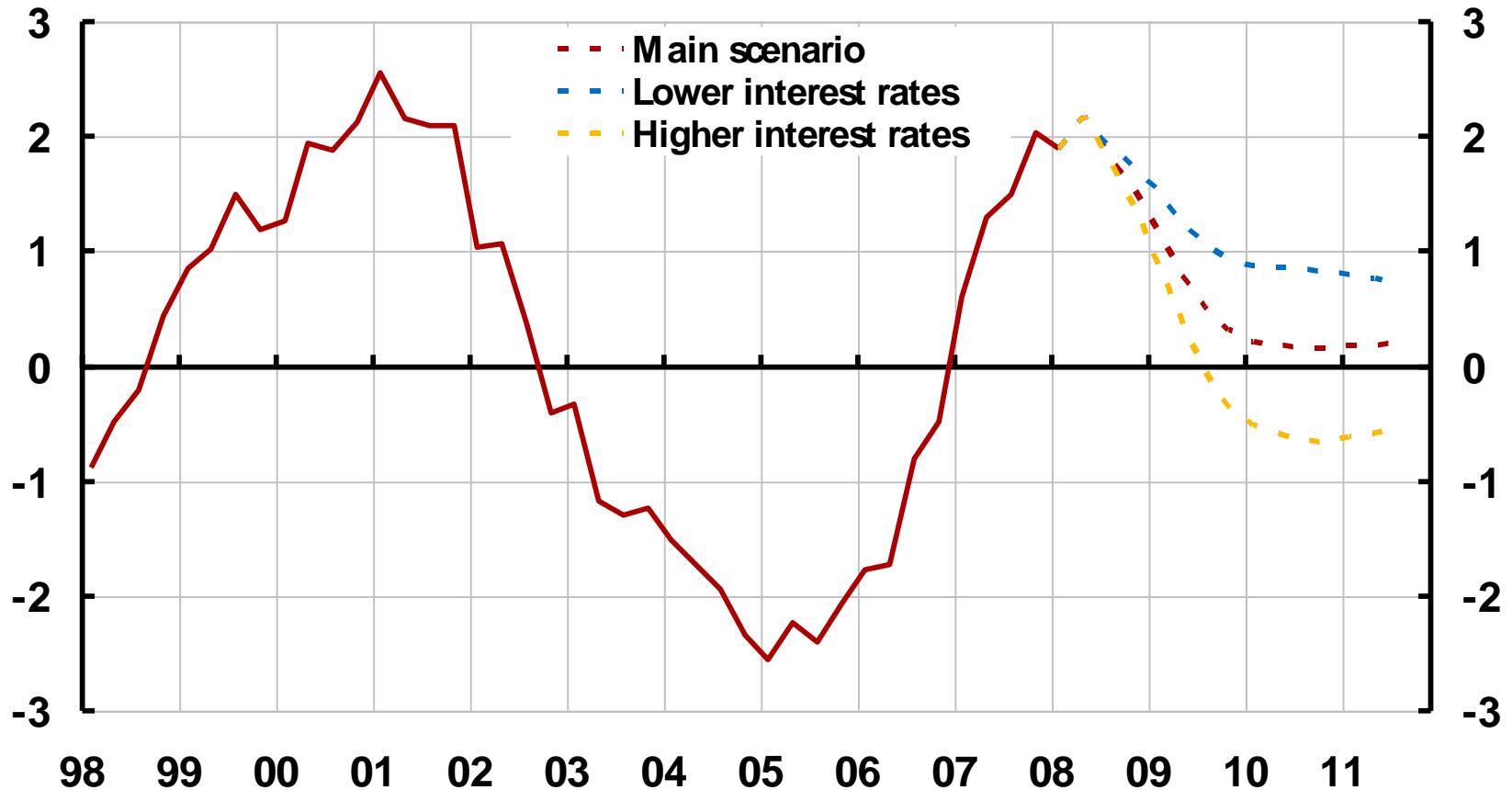
GDP growth

Annual percentage change, seasonally adjusted data



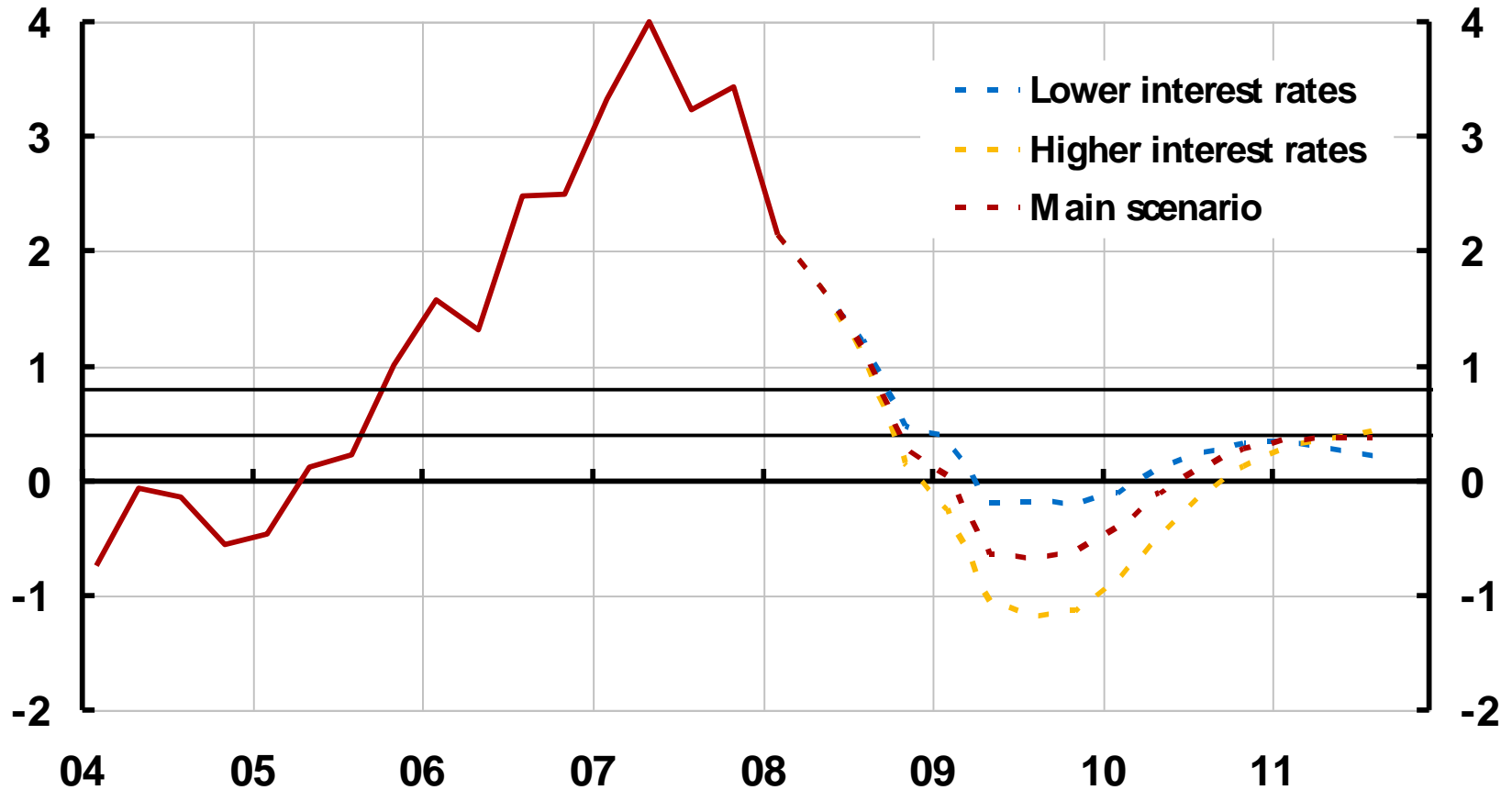
Hours gap

Percentage deviation from the HP trend



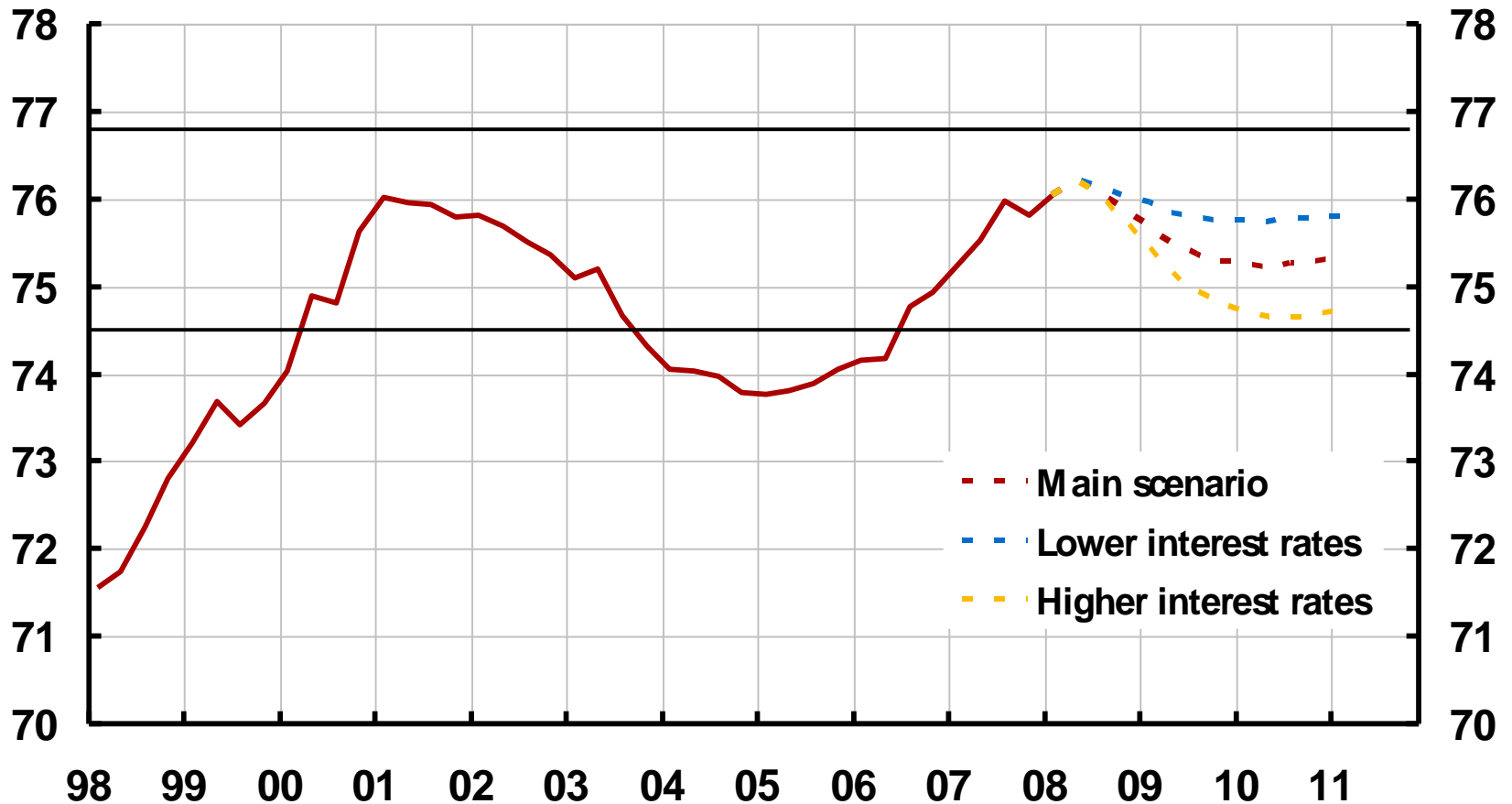
Hours growth

Annual percentage change, seasonally adjusted data



Employment rate

Per cent, seasonally adjusted



Unemployment rate

Percentage of the labor force, seasonally adjusted

