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Inflation targeting and private sector forecast - comment on paper by S. Cecchetti and C. S. Haikko

Steinar Holden

Department of Economics, University of Oslo

http://folk.uio.no/sholden/

Norges Bank

12 June 2009

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Research question

- Does increased transparency – in the form of Inflation Targeting – lead to lower dispersion of private sector inflation forecast?

Motivation:

- Morris & Shin: Greater transparency may be harmfull if private agents overreact to signals from CB
- Svensson; Woodford: Theoretical result, with little practical relevance
- Yet policymakers worry that more information may cause coordination of private expectations, making the economy more exposed to commons shocks.

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Research question – II

- Link to Morris & hin is not convincing
- Arguments of Svensson & Woodford are forceful
- Coordination of inflation forecasts seems beneficial
  - Coordination errors are costly
  - One of the gains of lower inflation is less inflation uncertainty
  - Private information can be gathered in other ways, e.g. by regional networks
- Still interesting to know effects of IT on dispersion of inflation forecasts

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Empirical results

SUR estimates

- Most countries: no significant effect of IT
- More forecast dispersion under IT in Spain, Norway and Switzerland

Panel regressions:

- Small negative effect of IT on forecast dispersion with fixed effects
- Mixed results with random effects

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Why doesn't Inflation Targeting lead to lower forecast dispersion?

- Chance: More shocks under IT period
  - Compare with forecast properties of univariate AR
- Can inflation be more difficult to predict even if it is more stable?
  - Assume that inflation depends on wage growth and exchange rate
  - Effect of wage growth easier to predict than effect of exchange rate
  - IT leads to less volatility of wage growth and more volatility of exchange rate
  - May make inflation less volatile but more difficult to predict
- Long run inflation credibility allows for less aggressive IT in the short run
  - More difficult to predict inflation

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Conclusion

- Fine paper, with useful empirical evidence on very interesting issue
- Suggest change of motivation for paper
- Explore effect of IT on different sources of inflation variability

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