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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

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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 harmful 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 common 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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