

## **A Commentary by Söderström and Vredin confirms my estimate**

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A recent commentary by Söderström and Vredin (1) argues that my estimate of the average unemployment cost of average inflation 0.6 percentage points below target during 1997-2011 is too large (2). They use the Riksbank's DSGE model Ramses to conduct an experiment where unanticipated shocks to the Riksbank's policy rule reduce CPIF inflation by 0.2 pp during 15 years, the length of the period 1997-2011. They find that average unemployment increases by 0.25 pp, about a third of my estimate of 0.8 pp. However, unanticipated shocks to the monetary-policy rule that reduce average CPIF-inflation over 15 years reduce CPI inflation by the same amount, in this case 0.2 pp. The relevant experiment to scrutinize my estimate would be to let unanticipated shocks to the policy rule reduce CPI and CPIF inflation by 0.6 pp, three times as much. In that case, the average unemployment also increases three times as much, that is, by about 0.75 pp. This is obviously very similar to my estimate, about 0.8 pp. Thus, Söderström and Vredin actually confirm rather than disprove my result. (3)

1. Söderström, Ulf, and Anders Vredin (2013), "Inflation, Unemployment and Monetary Policy," Economic Commenary No. 1, 2013, [www.riksbank.se](http://www.riksbank.se).

2. Svensson, Lars E.O. (2013), "The Possible Unemployment Cost of Average Inflation below a Credible Target," working paper, [www.larseosvensson.net](http://www.larseosvensson.net).

3. During 1997-2011, when average real time CPI inflation was about 1.4 percent, average CPIF inflation would have been about 1.8 percent, 0.4 pp higher ("would have been" is appropriate, since the CPIF index was constructed in 2008 and did not exist in real time before then). The reason for the difference is the downward trend in mortgage rates during the period, which is a reflection of the global downward trend of real interest rates and could not have been prevented by Swedish monetary policy. Changes in housing costs due to mortgage-rate changes are included in the index CPI but excluded from the CPIF. For average CPI inflation to equal 2 percent during 1997-2011, average CPIF inflation would have had to be 2.4 percent, 0.6 pp higher than 1.8 percent.