Two and a half years of the Eurosystem
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Points to assess
– Goals
– Framework for policy decisions
– Communication: Forecasts
– Actual instrument setting

Goals
– Current:
  * “Annual HICP increases below 2%”: 0 ≤ ? < inflation < 2%
  * M3 reference value: Inflation target 1.5%
– Problems:
  * Ambiguous
  * Asymmetric
  * Zone of indifference?
  * Thresholds for policy adjustment?
– Better
  * Point inflation target: 1.5% (possibly tolerance interval: ±1%)
  * Unambiguous and symmetric
  * Better anchor for inflation expectations
  * No thresholds, gradual policy

Framework for policy decisions
– Efficient in collecting, processing information, reaching decisions?
– Effective in achieving goals?
– Because of lags: Inflation forecast ≈ 2 yrs ahead, conditional on alternative interest rate paths
– Set interest rate so conditional inflation forecast meets target
– Riksbank: “If inflation forecast 1–2 years ahead above (below) target, raise (lower) instrument rate”
– No reason for separate monetary pillar (incorporate in inflation forecast)

Communication
– Effective in motivation decisions, simplifying evaluation, increasing public understanding?
– Explain and motivate policy in terms of inflation forecast
– Publish inflation forecasts, including assumptions, inputs, uncertainty (distribution)

Current forecasts
– Every 6 months: Eurosystem forecasts

Problems
– Every 3 months better: ECB forecast between Eurosystem forecasts
– Inconsistent assumptions
  * 3-month interest rate: constant
  * long interest rates: market expectations
  * exchange rate: constant
– Brief/superficial report (longer report to GC)
– Minimal information
  * Table, average annual percentage changes
  * No graphs
– Rudimentary uncertainty discussion/reporting
– Learn from Bank of England, Riksbank, RBNZ, Bank of Norway

Inflation Report (quarterly)
– Current inflation relative to previous inflation forecast
  * Reasons for deviations
– Updates of inputs in inflation forecast
  * Current inflation, output gap, unemployment gap, inflation expectations, wages, imported inflation, etc.
– Update of inflation forecast
  * Risks, uncertainty, distribution
  * Policy alternatives
– Output-gap forecast, avoid unnecessary variability

Restructure Monthly Bulletin
– Every 3rd: Inflation Report
– Between: Articles, report data

Restructure monetary policy decisions/meetings:
Quarterly, mid-quarter update
• Actual instrument setting
  – Appropriate, given goals and ex ante information?
  – Interest-rate decisions 1999 to now?
    * Absent internal forecasts, not enough information
  – Ex post evaluation: Not easy, due to unanticipated shocks
    * Current inflation: Affected by instrument settings ≈ 2 yrs ago
    * In retrospect: policy initially too expansionary

**Governance**

  – Strengthen center
    * 6+12 too large, too decentralized
    * Enlargement of EMU
  – Monetary policy decisions in Executive Board
  – Decision-makers need to be experts