

Two and a half years of the Eurosystem

Lars E.O. Svensson
www.iies.su.se/leosven

- Points to assess

- Goals
- Framework for policy decisions
- Communication: Forecasts
- Actual instrument setting

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- Goals

- Current:
 - * “Annual HICP increases below 2%”: $0 \leq ? < \text{inflation} < 2\%$
 - * 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: $\pm 1\%$)
 - * Unambiguous and symmetric
 - * Better anchor for inflation expectations
 - * No thresholds, gradual policy

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- 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)

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- 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)

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- 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

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- *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

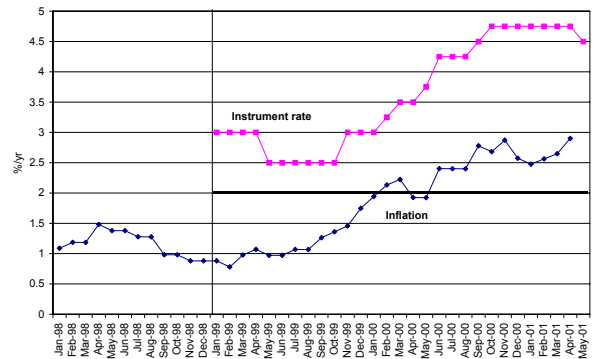
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- Actual instrument setting

- 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 \approx 2 yrs ago
 - * In retrospect: policy initially too expansionary

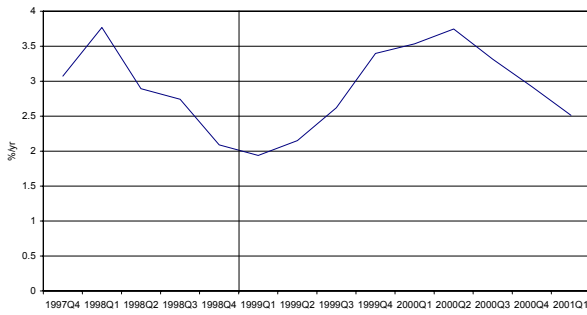
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Instrument rate and inflation in the euro area



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Real GDP growth in the euro area



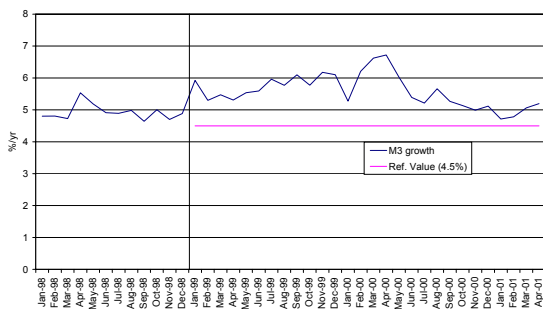
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The nominal effective exchange rate of the euro (BIS)



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Annual growth rate of M3



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- Governance

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

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