Discussion of Anne Sibert, “Monetary policy with uncertain central bank preferences” by Lars E.O. Svensson

- Elegant and thorough analysis of the effect of unobservable central bank preferences
- Questionable model and assumptions
  - Loss function
  - Finite horizon
  - Separating equilibria
- More relevant models and assumptions available

\[ L_t = \frac{1}{2}(\pi_t - \pi^*)^2 + \epsilon_t \]

- Indifferent to output variability (counterfactual)
- More output always better, constant marginal benefit (counterfactual?)
- Always average inflation bias (when \( \chi > 0 \)) (counterfactual)
- Equilibrium inflation independent of (current) \( \pi_t^c \) (credibility) (counterfactual?)

\[ \pi_t = \pi^* + \epsilon_t \]

- More “conservative”
  - Lower \( \chi \) (“Flexible”: \( \chi > 0 \))
  - Lower \( \pi^* \)
  - Lower \( y_t^* \) (default: equal to potential)

- Horizon, finite or infinite. Unobservable CB preferences, constant or time-varying
  - Backus-Drifill 1985, Vickers 1986, finite horizon, constant unobservable CB preferences
  - Sibert 2001, also changing preferences
  - Cukierman-Meltzer 1986, infinite horizon, time-varying unobservable CB preferences
    - Stochastic steady state
    - Loss function linear in output
    - Confusion of control/observation errors
    - Faust-Svensson 2001
      - Loss function quadratic in output
      - Distinguish control/observation errors
      - Dynamics of inflation, output, credibility, reputation
      - Transparency as a commitment mechanism

- Separating equilibria
  - Observe outcome, infer CB type
  - Counter to p. 8, fn. 6, not enough to observe action (instrument setting)
  - Observing action not enough to infer intention
  - In the real world, CB type not precisely known
  - Increased transparency implies increased observability of CB intentions

\[ L_t = \frac{1}{2}(\pi_t - \pi^*)^2 + \epsilon_t \]

- Lack of “credibility” \( \equiv |\pi_{t-1} - \pi^*| \)
- CB “type” \( \equiv z_t \)
- “Reputation” \( \equiv z_{t-1} \)
- “Signalling”
- Estimation error \( \equiv z_t - z_{t-1} \)
- Imperfect control: \( \pi_t = CB \) intention + control error
- “Transparency”: Fraction of control error observable by private sector, observability of CB intention, inference of type
- Commitment mechanism: Increased transparency makes reputation more sensitive to actions