

Lessons from Other Central Banks?

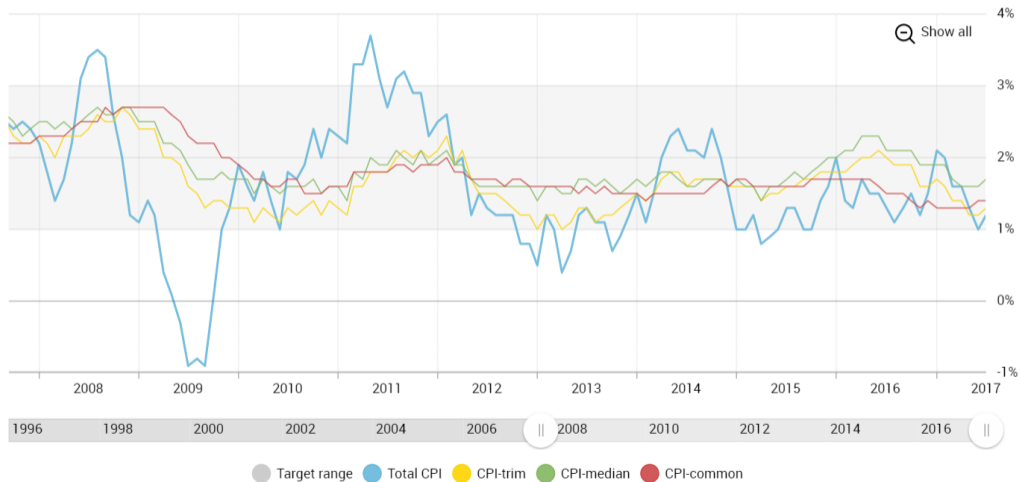
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Monetary Policy Framework Issues:
Towards the 2021 Inflation Target Renewal
Bank of Canada, 14 September 2017



Bank of Canada: Key Inflation Indicators and the Target Range

Total CPI, CPI-trim, CPI-median, CPI-common and Target Range



Source: Bank of Canada

Inflation Targeting: Best practice monetary policy

“The primary objective of Canada’s monetary policy is to promote the economic and financial welfare of Canadians by contributing to sustained economic growth, rising levels of employment and improved living standards. Experience has clearly shown that **the best way monetary policy can achieve this goal is by maintaining a low and stable inflation environment**, which preserves confidence in the value of money.”

Joint Statement of the Government of Canada and the Bank of Canada on the Renewal of the Inflation-Control Target, 24 October 2016.



Some specific elements of best practice

- ▶ A clear, symmetric inflation objective.
- ▶ A systematic, forward looking policy framework.
- ▶ Close attention to maintaining well-anchored inflation expectations.
- ▶ A predictable response to positive and negative shocks.
- ▶ Transparent communications.



Comparison with other central banks?

- ▶ Brief look at ECB.
- ▶ Some similarities:
 - ▶ Monetary union—provinces in Canada, member states in euro area.
 - ▶ Primary operational goal of price stability.
- ▶ Some differences:
 - ▶ Federation vs loose confederation: ECB facing an immensely more complex political environment.
 - ▶ ECB more independent and less accountable.



Bank of Canada:

Government has explicit say in defining Bank's objectives. Bank maintains instrument independence.

ECB:

EU Treaty declares "price stability" to be the primary mandate of the ECB but ECB has the discretionary authority to define and interpret precise meaning.



Clarity in the objective

Bank of Canada: $\pi^* = 2$

“The inflation target will continue to be the 2 per cent mid-point of the 1 to 3 per cent inflation-control range.”

ECB: $\pi^* = ?$

“The Governing Council clarified in 2003 that in the pursuit of price stability it aims to maintain inflation rates below, but close to, 2% over the medium term.”



Symmetry of target

Bank of Canada:

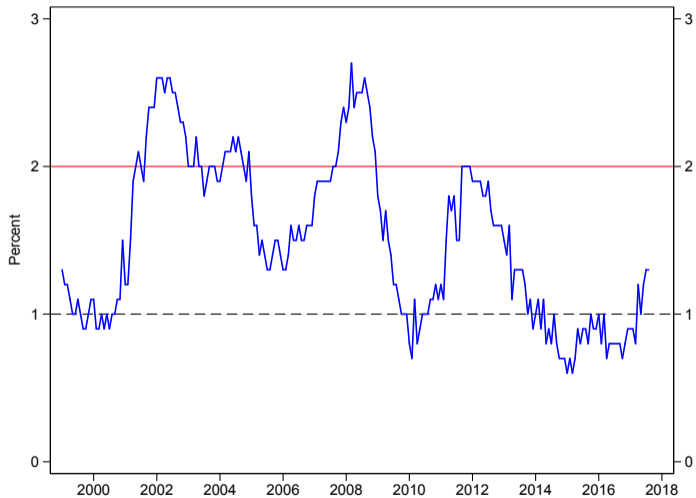
“Canada’s inflation-targeting approach is symmetric, which means that the Bank is equally concerned about inflation rising above or falling below the 2 per cent target.”

ECB:

“By referring to ‘inflation rates below, but close to, 2%’ the definition makes clear that not only inflation above 2% but also deflation (i.e. price level declines) is inconsistent with price stability.”



ECB: Core Inflation in Euro Area



Notably below and **not** close to 2% for several years.



Inflation projections: Bank of Canada vs ECB

	Inflation projections			
	2016	2017	2018	2019
Bank of Canada (July 2017)	1.4	1.6	2.0	2.1
ECB (Sept. 2017)	0.2	1.5	1.2	1.5

Source: Bank of Canada and ECB. Projection of CPI inflation for Canada, HICP inflation for euro area.



Transparent communications

- ▶ What are the limits of constructive communication?
 - ▶ Policy strategy
 - ▶ Inflation forecasts
 - ▶ Interest rate forecasts?
- ▶ Forward guidance vs a systematic response to economic developments?
 - ▶ Forward guidance a useful policy easing tool at the effective lower bound.
 - ▶ Outside effective lower bound, key to success is a systematic and predictable response to economic developments—an explicit or implicit policy rule.
 - ▶ Need to respect lack of knowledge regarding the natural rate of interest.



A Wicksellian Rule for Inflation Targeting

$$\Delta i = a(\pi - \pi^*)$$

π^* , inflation target.

π , short-term inflation forecast.

Δi , change in policy rate.



Inflation Targeting in Canada

- ▶ The adoption of Inflation Targeting in Canada has been a success.
- ▶ Governance of objective respects democratic legitimacy and protects against politicization.
- ▶ Periodic reevaluation and public discussion important for maintaining best practices.
- ▶ Other central banks could benefit by converging towards key elements of the Bank of Canada's Inflation Targeting framework.

