

Monetary policy at the Riksbank and the Phillips curve

Lars E.O. Svensson
Sveriges Riksbank

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Flexible inflation targeting

- Stabilize inflation around the inflation target (2%)
- Stabilize the real economy
(resource utilization, output gap)
- Minimize loss function ($\lambda > 0$)

$$L_t = (\pi_t - \pi^*)^2 + \lambda(y_t - \bar{y}_t)^2$$

Flexible inflation targeting

- “Forecast targeting:” Choose an instrument-rate path such that the forecast of inflation and resource utilization “looks good”
- “Looks good:” Inflation goes to target and resource utilization goes to normal at appropriate pace
- Publish and motivate instrument-rate path and forecast of inflation and real economy
- “Management of expectations”

Decision process

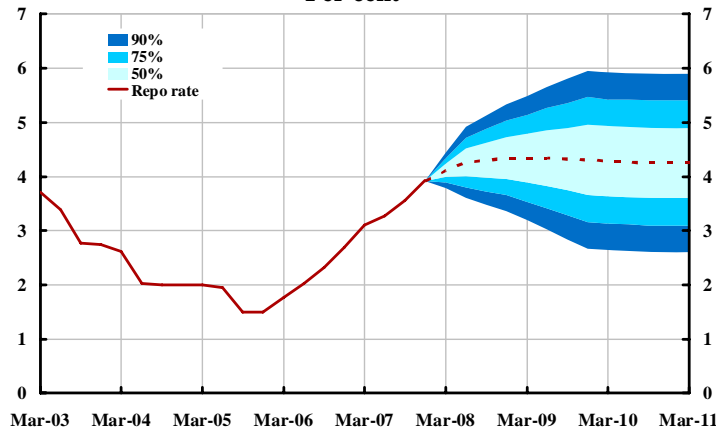
- 6-member Executive Board
- 6 policy decisions per year (3 reports, 3 updates)
- Interaction between staff and EB results in main and alternative combinations of forecasts of repo rate, inflation, and real economy
- At final policy meeting EB discusses and votes on decision and report/update
- Majority decision published day after policy decision
- Named minutes including any dissenting views published 2 weeks after policy decision

Forecasts

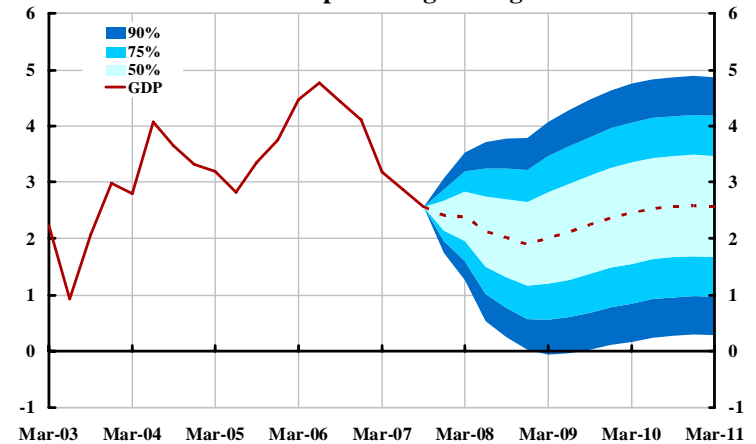
- Forecasts and simulations produced with
 - DSGE model (Ramses, since 2005)
 - Bayesian VAR
 - Other models (indicator, single-equation)
 - Judgment
- Mean forecasts, not mode
- Uncertainty intervals

Mean forecasts, uncertainty intervals

Repo rate
Per cent

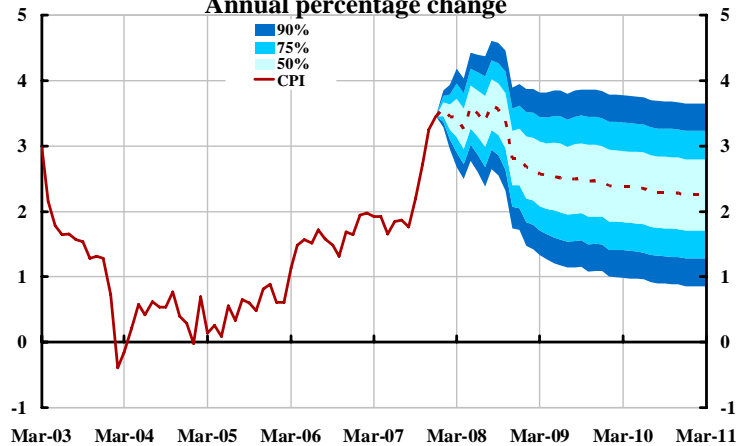


GDP
Annual percentage change



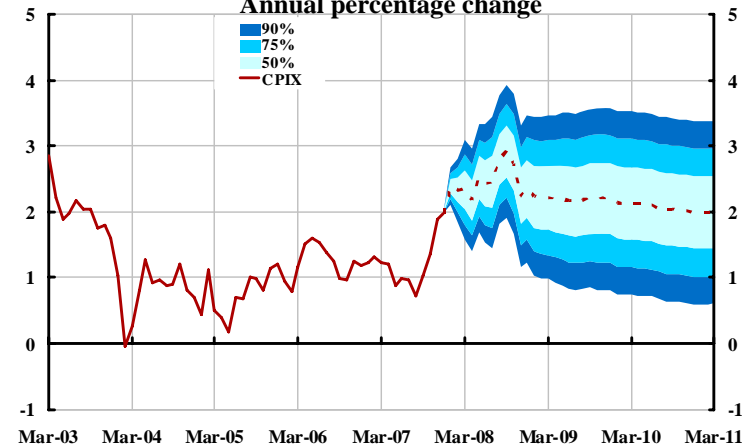
CPI

Annual percentage change



CPIX

Annual percentage change



Ramses, Phillips curves

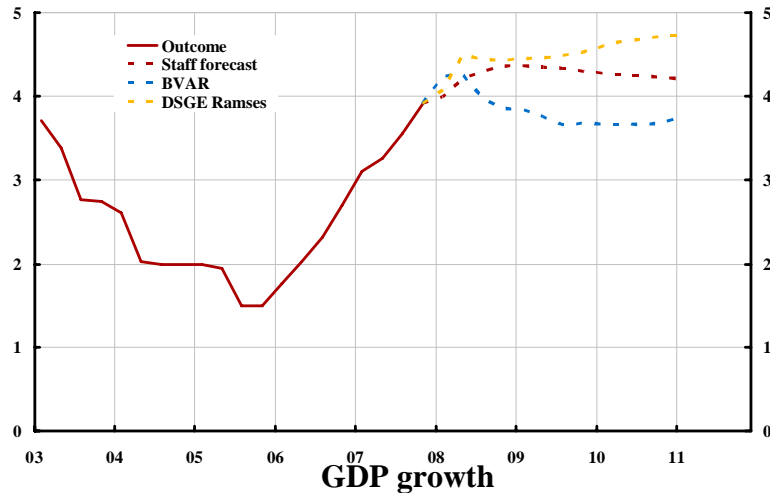
- Open-economy DSGE model (Adolfson, Laséen, Lindé, Villani)
- Estimated with Bayesian methods
- AS block: New-Keynesian Phillips curves (domestic, consumer-goods import, investment-goods import, export)
- Estimated instrument rule
- Optimal policy (to be implemented)

Implications for policy

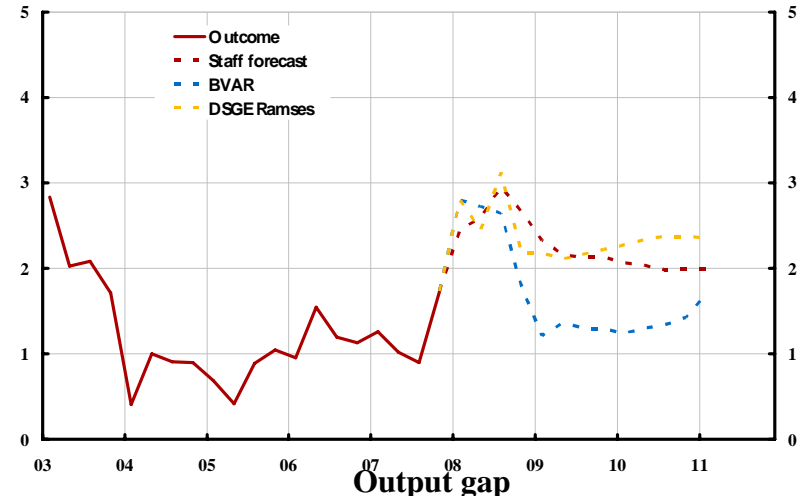
- Discussion about alternative paths of repo rate, inflation, and real economy
- Discussion more about future repo-rate paths than current repo-rate level
- More medium and longer-term perspective
- More general-equilibrium perspective
- More systematic treatment of alternative assumptions about (scenarios of) of exogenous variables, transmission mechanism, inflation expectations, etc.

Model and staff forecasts

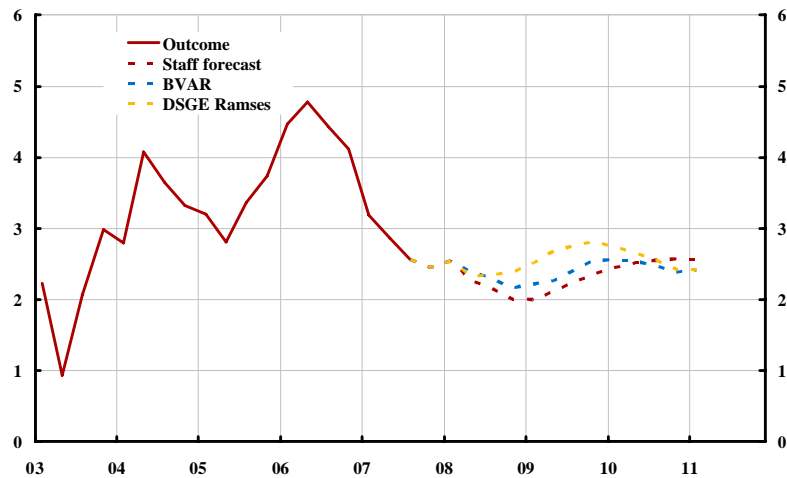
Repo rate
Per cent



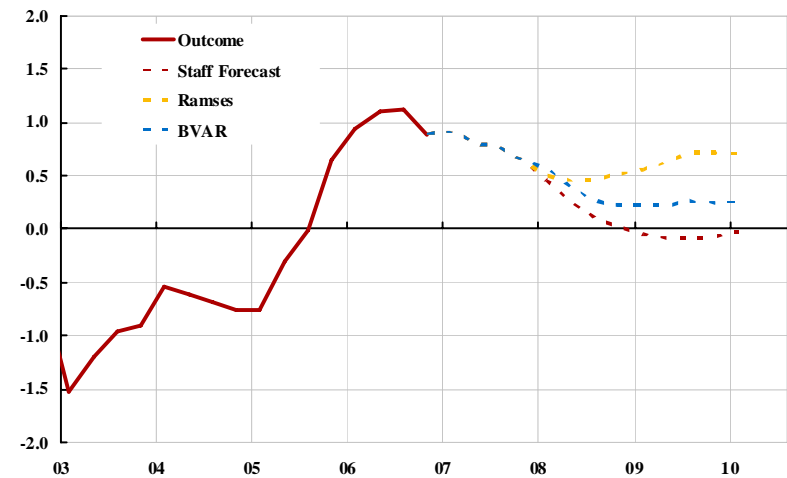
CPIX
Annual percentage change



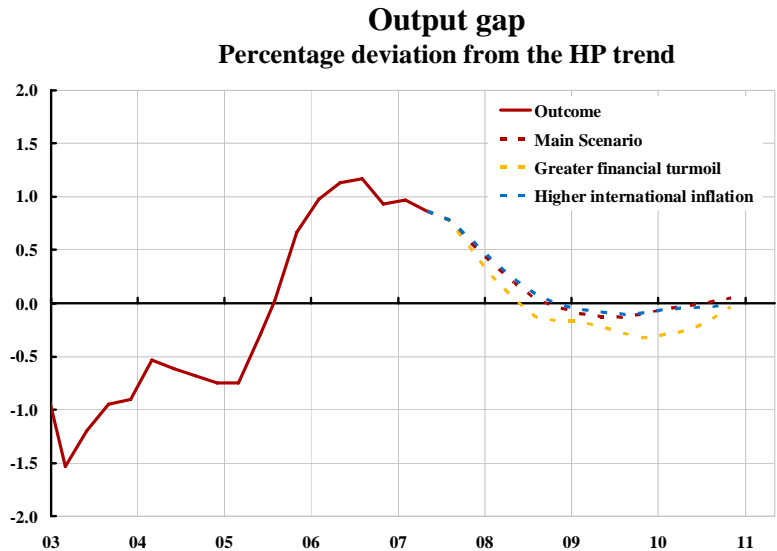
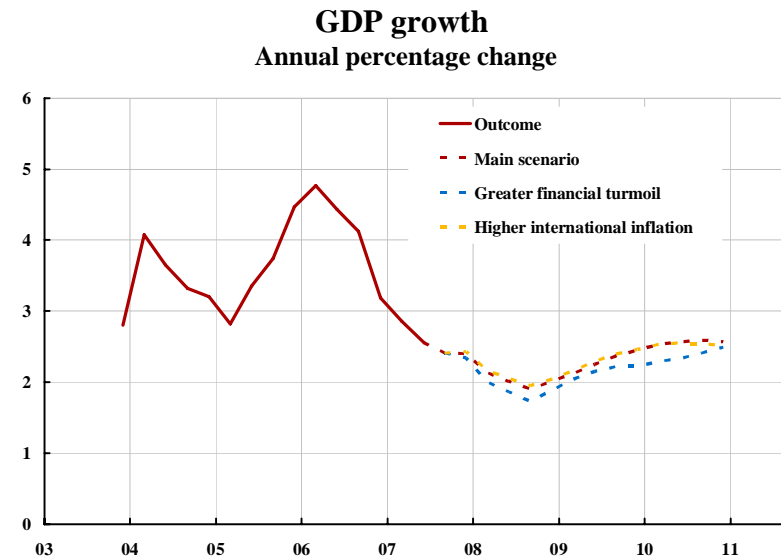
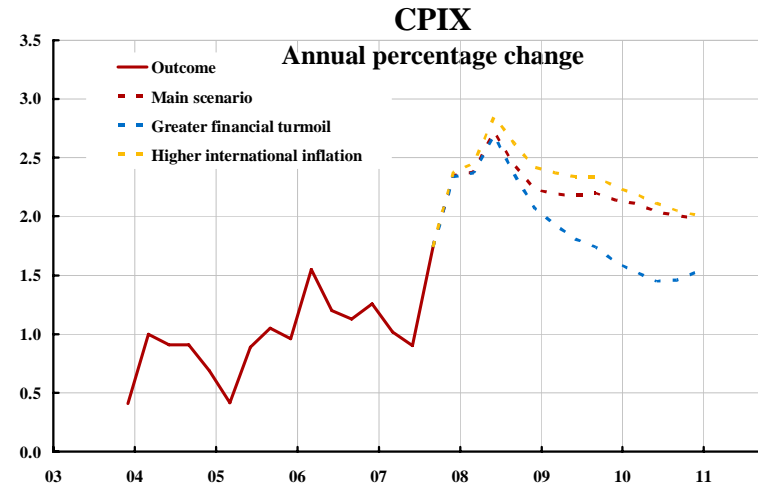
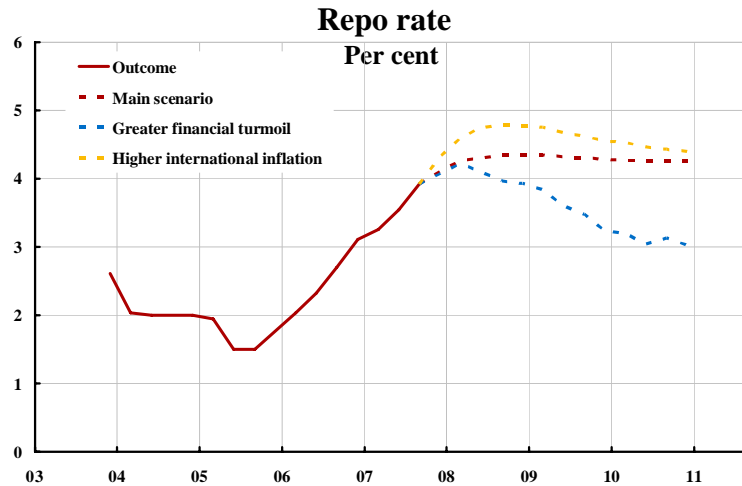
GDP growth
Annual percentage change



Output gap
Percentage deviation from the HP trend

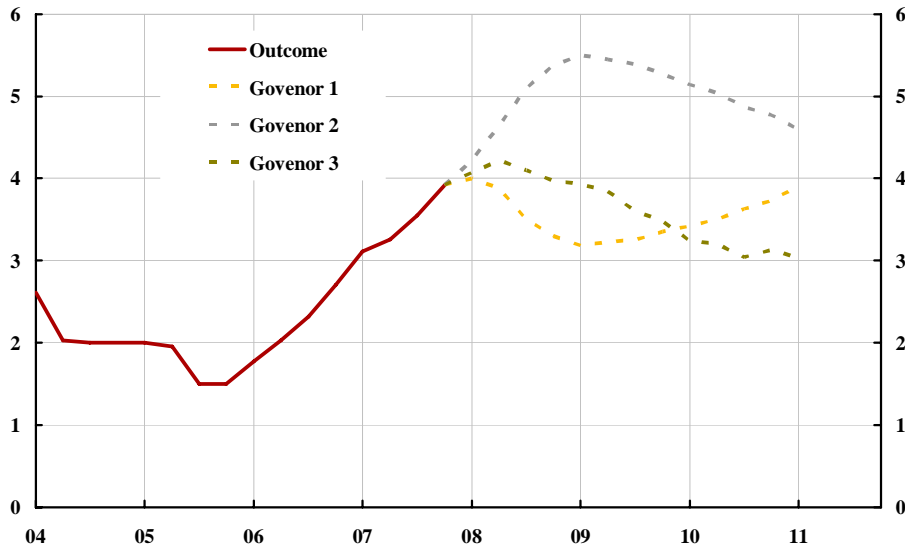


Alternative scenarios

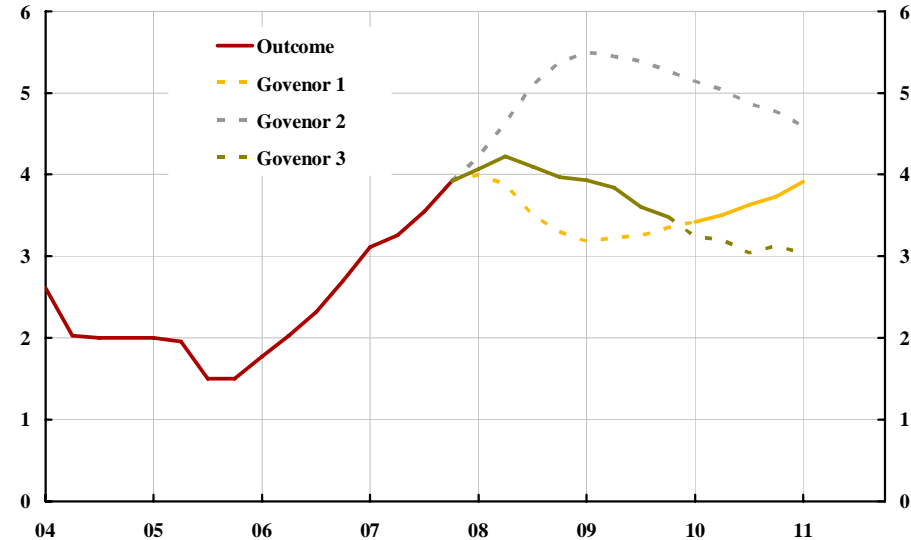


Deciding on a repo-rate path: Median path?

Repo rate Percent

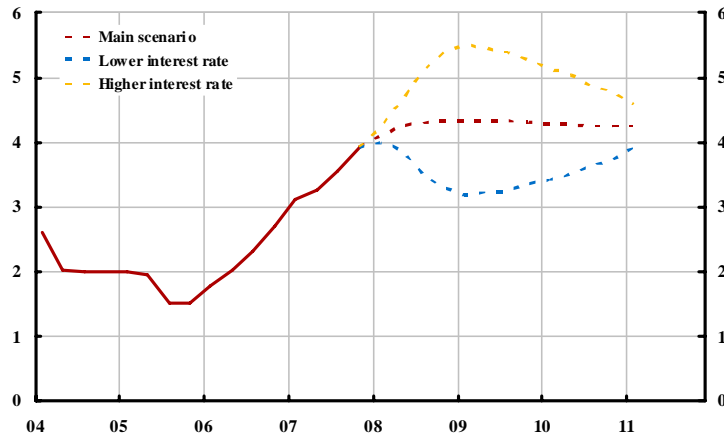


Repo rate Percent



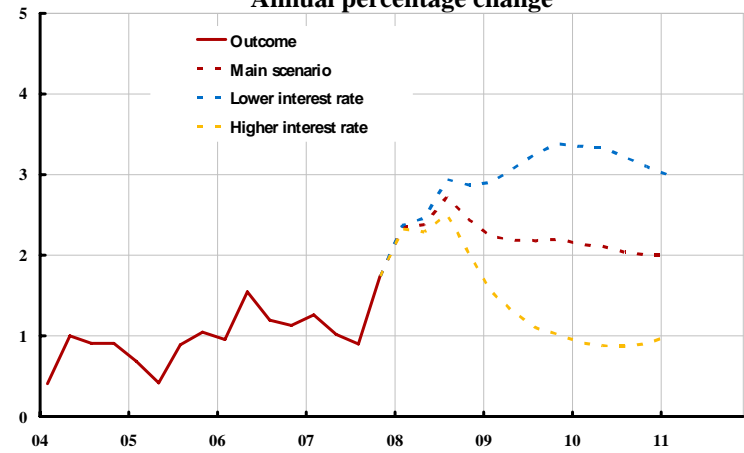
Deciding on a repo-rate path: Just vote among a few alternatives

Repo rate
Per cent

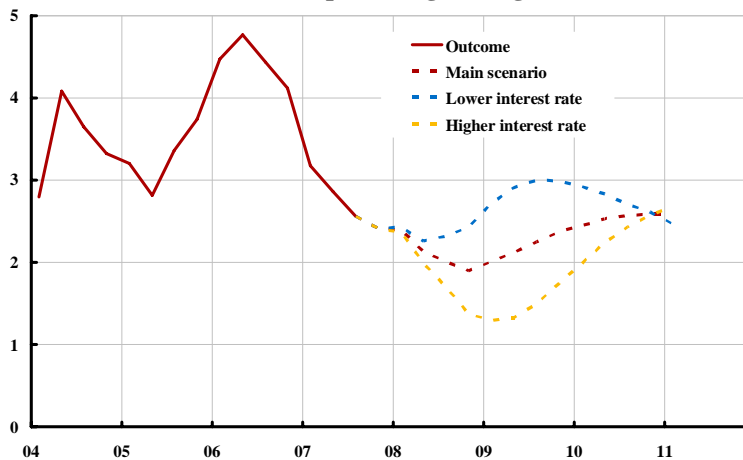


CPIX

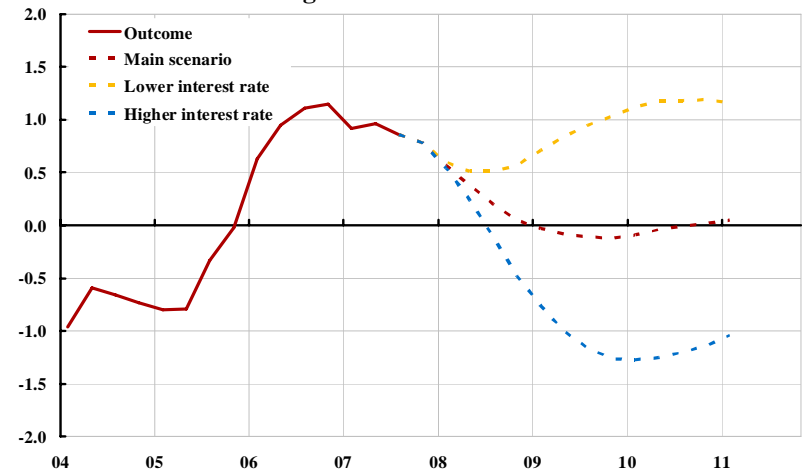
Annual percentage change



GDP growth
Annual percentage change



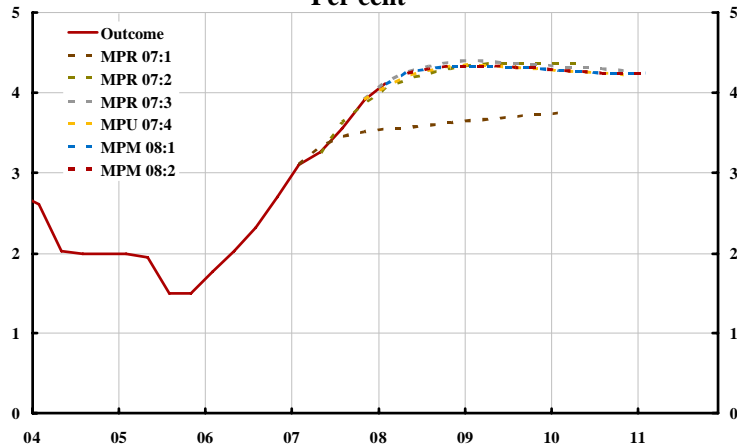
Output gap
Percentage deviation from the HP trend



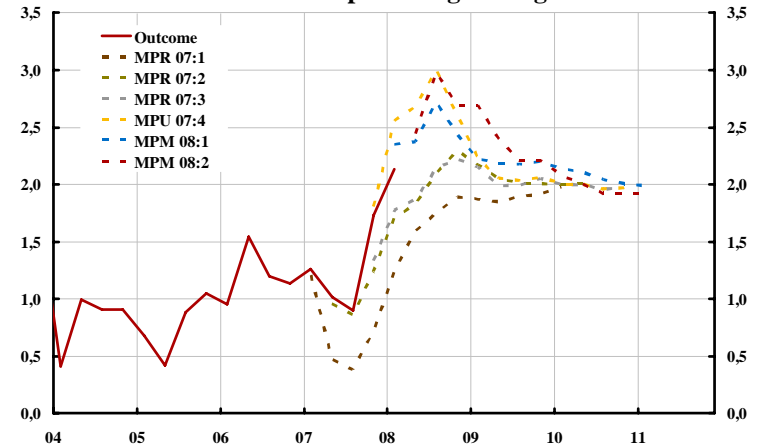
Decisions

January 2007-April 2008

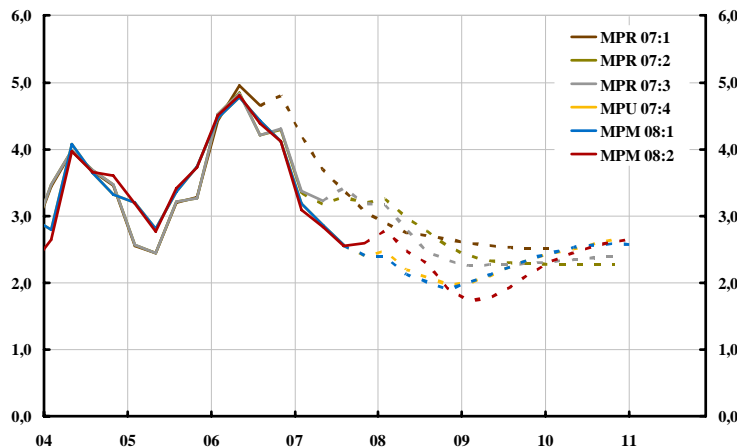
Repo rate
Per cent



CPIX
Annual percentage change



GDP growth
Annual percentage change



Output gap
Percentage deviation from the HP trend

