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The CNB Experience with Inflation Targeting

Jiří Rusnok

Inflation: Dynamics, Expectations, and Targeting

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General assessment of CNB inflation targeting framework

- IT (adopted in 1998) has worked well for us over last almost quarter of a century, including in critical situations such as financial crisis and corona crisis
- IT framework has proven flexible enough to allow us to use unconventional tools without compromising its consistency and comprehensibility
- IT framework has never become irrelevant, has never been seriously questioned
- 1998–2009: IT directed at achieving disinflation; from 2010 on: used to deliver stable inflation at 2% (for CPI)
- CNB has never considered raising inflation target – no need to do so
- IT framework has been refined technically and communication-wise over long period; today one of the most transparent in the world

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CNB inflation targeting during two crises

- Financial (and debt) crisis:
  - Czech economy faced very low inflation between 2013 and 2016
  - In September 2012 CNB lowered 2W repo rate to 0.05% (ZLB); in November 2013 it adopted "exchange rate commitment" (not to let koruna strengthen below CZK 27 to euro) – an unconventional tool intended to foster quicker recovery and earlier fulfilment of inflation target
- Corona crisis:
  - After outbreak of corona crisis (spring 2020), CNB cut 2W repo rate to 0.25% and eased some macroprudential supervisory tools
  - During 2020–2021 inflation fluctuated above inflation target (overheated economy)
  - CNB was not forced to use any unconventional tools
  - In late June CNB raised interest rates for first time and started to return them to normal

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CNB inflation targeting: guiding questions 1/3

- CNB has been struggling with elevated inflation recently (unlike advanced economies):
  - ⇨ “Earlier” attainment of interest rate normalisation
  - Likely to face overheated economy again in foreseeable future
- Target band *versus* point target:
  - Target band: somewhat vague interpretation of inflation at margins (is 3% price stability?) but easier “fulfilment” of inflation target
  - Point target: better anchors inflation expectations, but target is almost never (strictly speaking) met
- Symmetric reactions: we advise following basically symmetric reactions, because credibility of inflation target (and central bank) is at stake in both directions of deviation of inflation from target (but approach should not be applied “mechanistically”)

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CNB inflation targeting: guiding questions 2/3

- Synchronisation of inflation target with major trading partners:
  - Not an issue (CNB used to have higher inflation targets than ECB during 1998 – 2009)
  - Real appreciation is given exogenously (by government policies); specification of inflation target implies split of real appreciation between nominal appreciation and inflation differential
  - Unsynchronised inflation targets inhibit neither real appreciation nor real convergence
- Inflation target in terms of core inflation:
  - CNB used to target “net inflation” (CPI *minus* regulated prices) until 2005 → switch to CPI targets
  - Difficulties:
    - explaining concept to public
    - anchoring inflation expectations
  - Possible advantage: less frequent use of escape clauses

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CNB inflation targeting: guiding questions 3/3

- Fed's recent shift to more flexible/tolerant inflation target corresponds to its traditional dual mandate (inflation, unemployment)
- Czech Phillips curve:
  - We do not have convincing evidence that our Phillips curve became flatter
  - ⇨ prices are not less sensitive to changes in production
  - ⇨ monetary policy still preserves its ability to affect price dynamics
- Price implications of technological developments → ambiguous impacts:
  - Some technologies (e.g. telecoms + IT) tend to slow down price movements
  - Others (e.g. higher environmental standards) tend to accelerate prices

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Thank you