

Inflation Targeting: Czech Experience

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Paris, February 2007

***) The views expressed are those of the author, and do not necessary represent those of the CNB.**

1998-2007

**After nearly ten years of targeting
inflation in the CNB,
there are certainly lessons to
share**

**What to Learn from the Czech
Experience?**

- **One should think about IT in three steps**
 - certain **preconditions** should be met to introduce IT successfully (but it is important to note that one learns swimming only by jumping into water)
 - several **components** should be designed with care (do not focus only on target or forecasting model)
 - certain **outcomes** should be observed relatively soon (others in medium term)
- **One should view IT as a strategy in motion**
 - IT needs modifications to reflect **new theoretical views** and concepts that develop every 3-5 years (think SDGE models)
 - IT needs modifications to reflect **new views on best practices** (think transparency)
 - IT needs modifications to reflect **new external challenges** (think global low inflation)

IT in Three Steps: Preconditions

- **important to have prior to IT**
 - **externally:**
 - institutional set-up (independence accountability)
 - well-developed financial markets
 - **internally**
 - support of the Board
 - core team of educated experts
- **not so important to have**
 - **externally:**
 - perfect set-up (who owns target may be clarified in the introductory period)
 - deep financial markets (some will develop under IT only)
 - **internally**
 - large team of experts (they will come)
 - fashionable complicated forecasting model (it will be developed later)

IT in Three Steps: Components

- **Target specification**
 - time horizon (CNB: 1Y, 3Y, infinite)
 - interval versus point (CNB: points in time, continuous interval, point with bands)
 - which price index (CNB: net inflation, CPI)
- **Caveats**
 - initially no caveats (net inflation)
 - now ex ante caveats
 - no formal explanatory letter
- **Decision-Making Framework**
 - framework for discussion (model forecast by staff)
 - analysis of risks (staff and Board) e.g. alternative scenarios
 - actual decision (Board votes, often different views)
- **Communication (transparency)**
 - decision (press conference)
 - reasons (minutes)
 - details about forecast (Inflation report)
 - details about decision (internal protocol)

Target specification



December 1997

November 1998

April 2001

December 2005

April 2000

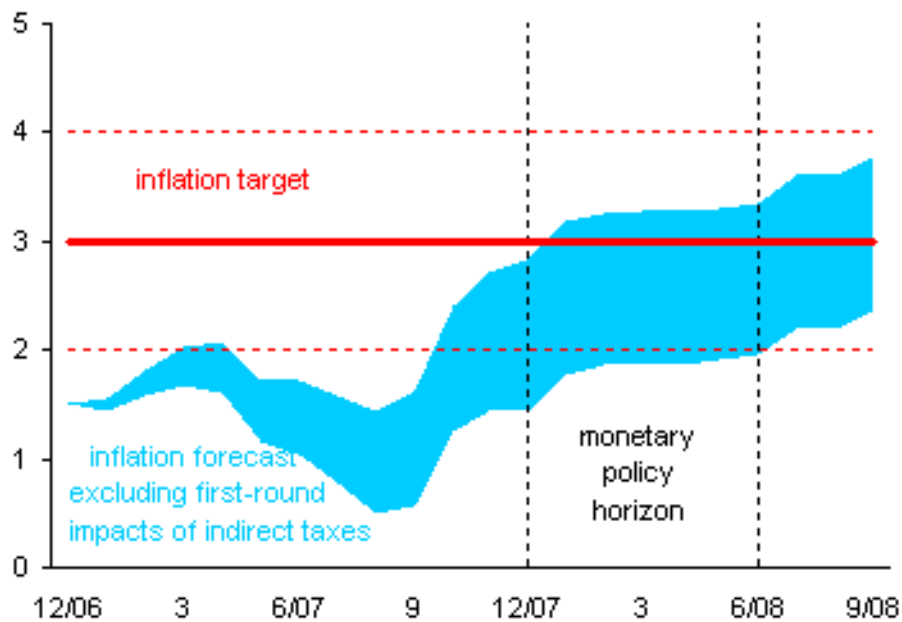
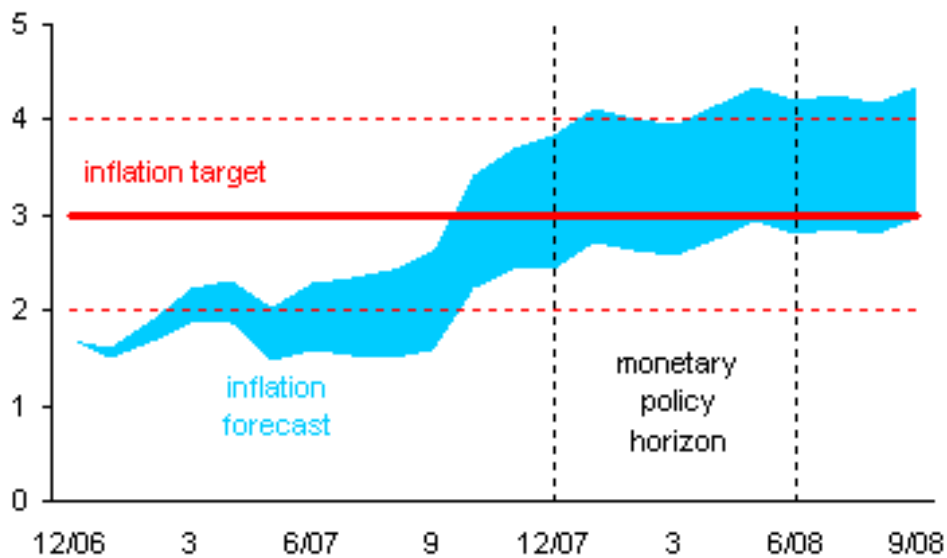
Caveats

The following exceptions ex ante (caveats/escape clauses) from achieving the inflation target are used by the CNB:

- major deviations in world **prices of energy**
- major deviations in **agricultural prices**
- major changes in **indirect taxes**
- major changes in **regulated prices**

In these cases, the CNB does not respond to the primary impacts of the shock.

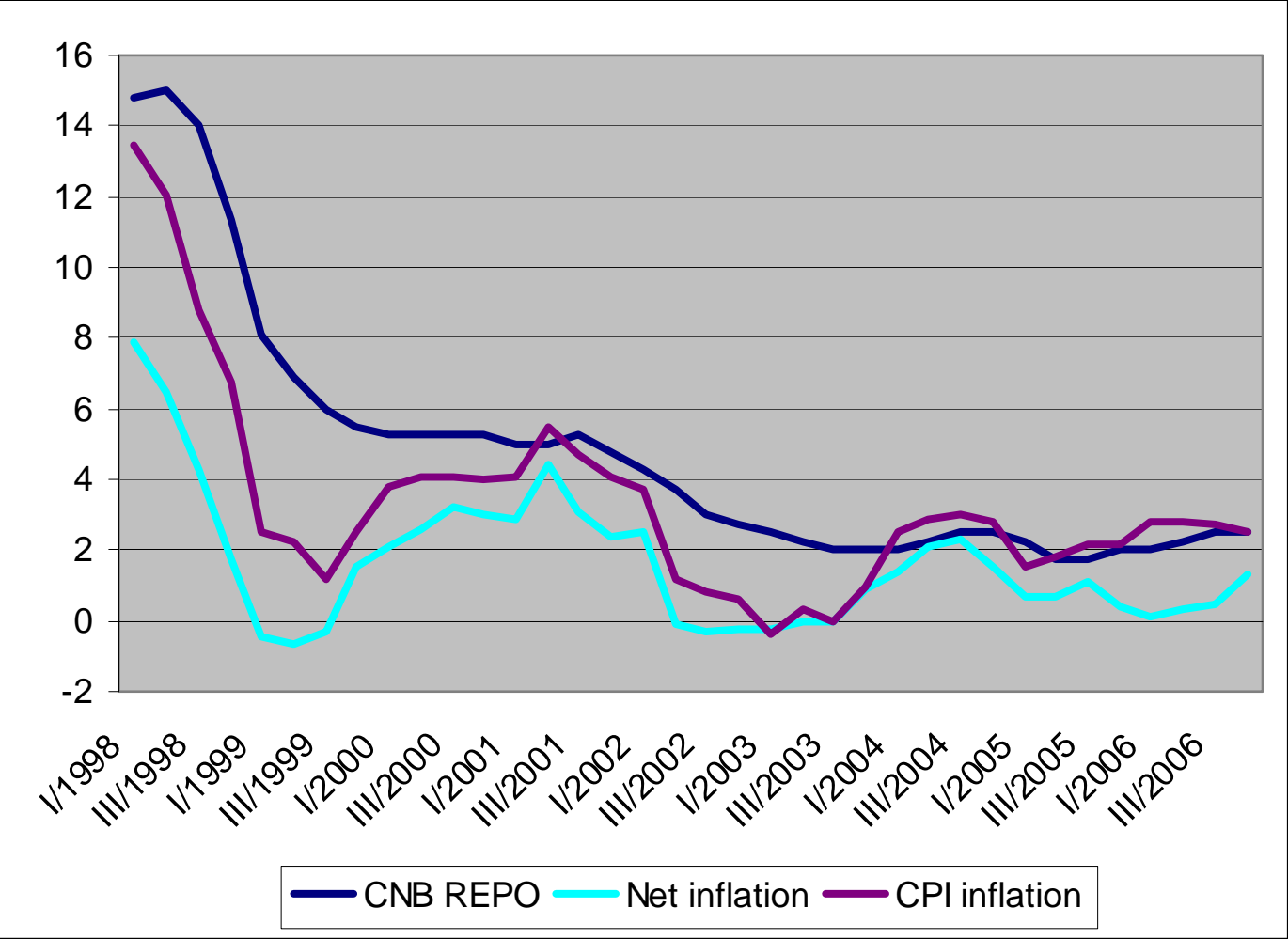
Decision-making Framework



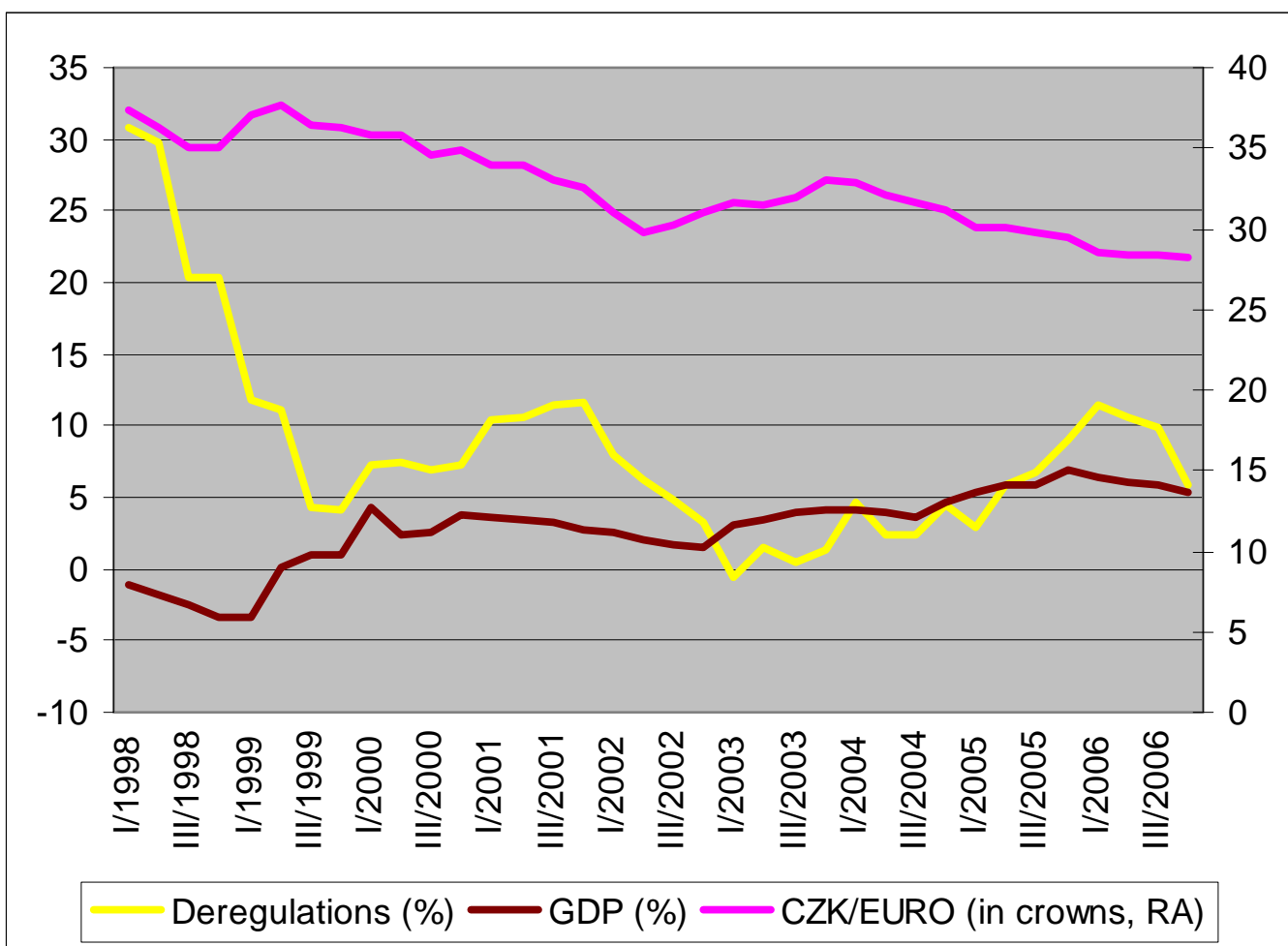
IT in Three Steps: Outcomes

- **primary external outcome: low inflation** (low volatility could be aimed at) and stable expectations
- **secondary external outcome: good economic performance**
- **primary internal outcome: institution changes** (staff improves their modeling know-how, Board focuses more on price stability)
- **secondary internal outcome: various processes can change** (pressure on well-maintained web to comply with transparency)

Primary Outcome



Secondary Outcome



IT in Motion: Current Challenges

- CNB is **improving the forecasting model** (from QPM, used since 2002, to SDGE model)
- CNB is **improving transparency** over time (faster publishing of minutes, new publishing of description of interest rate path)
- CNB considers **level of the target** (global low inflation, and also due to the expected euro adoption after 2010)