Inflation targeting and the new global crisis context; lessons and challenges

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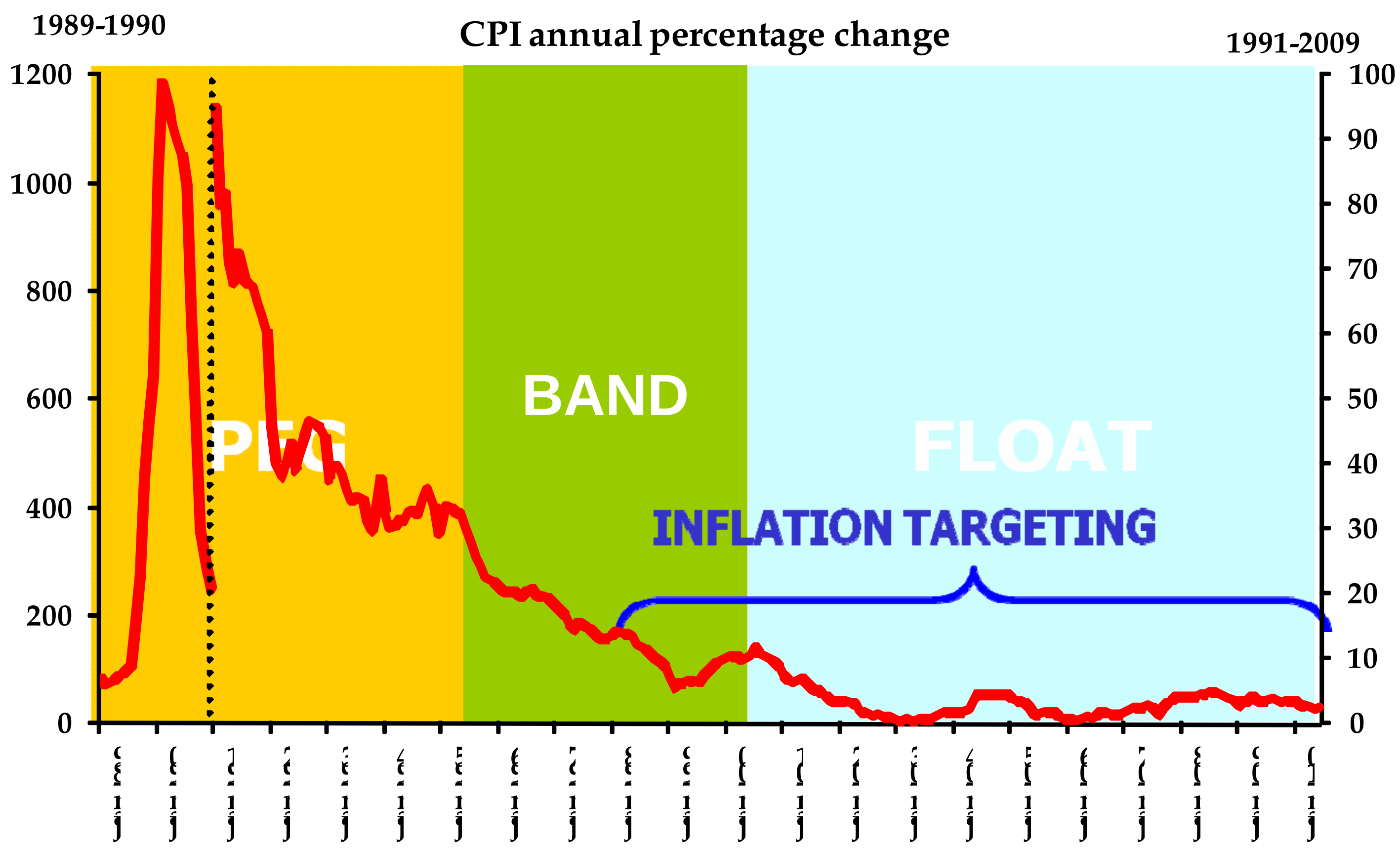
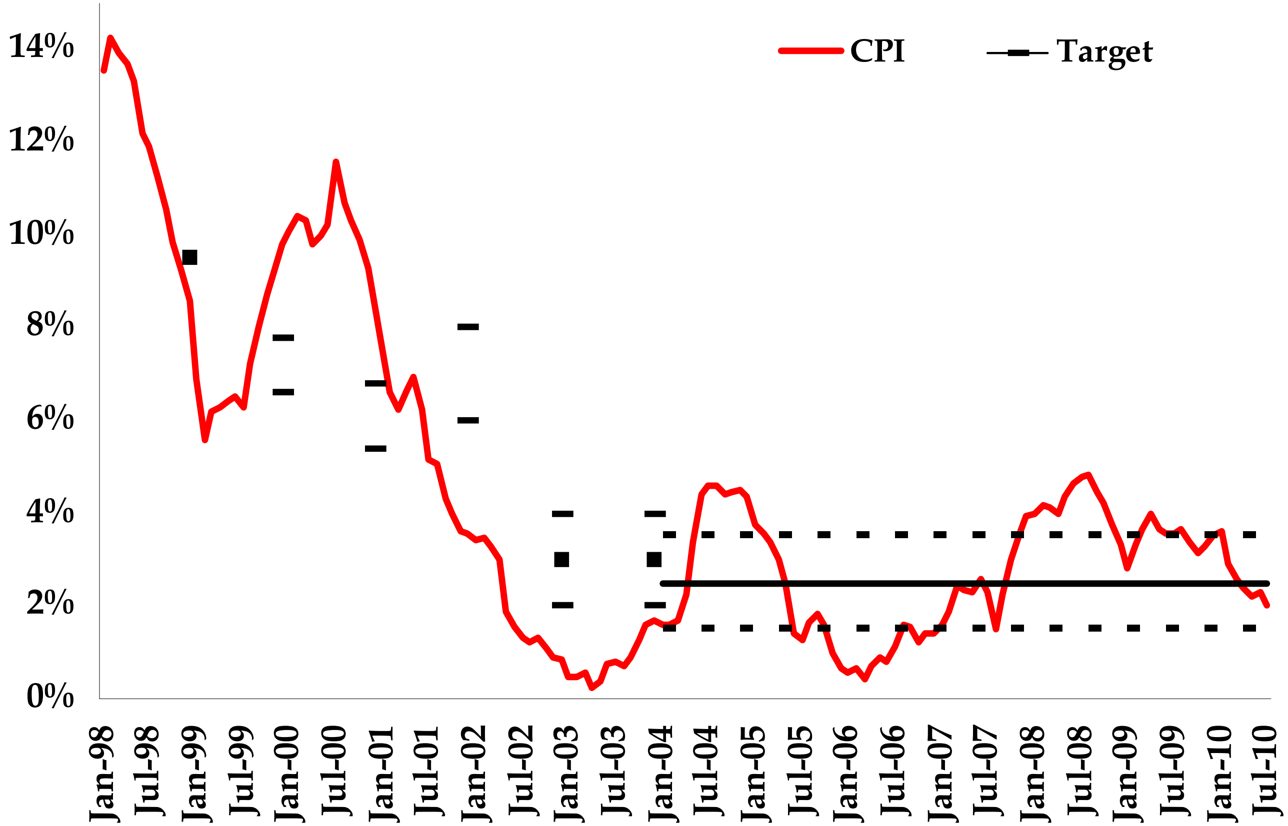
Transition in Poland started with hyperinflation, hence disinflation was one of the most important policy challenges



Source: NBP, CSO

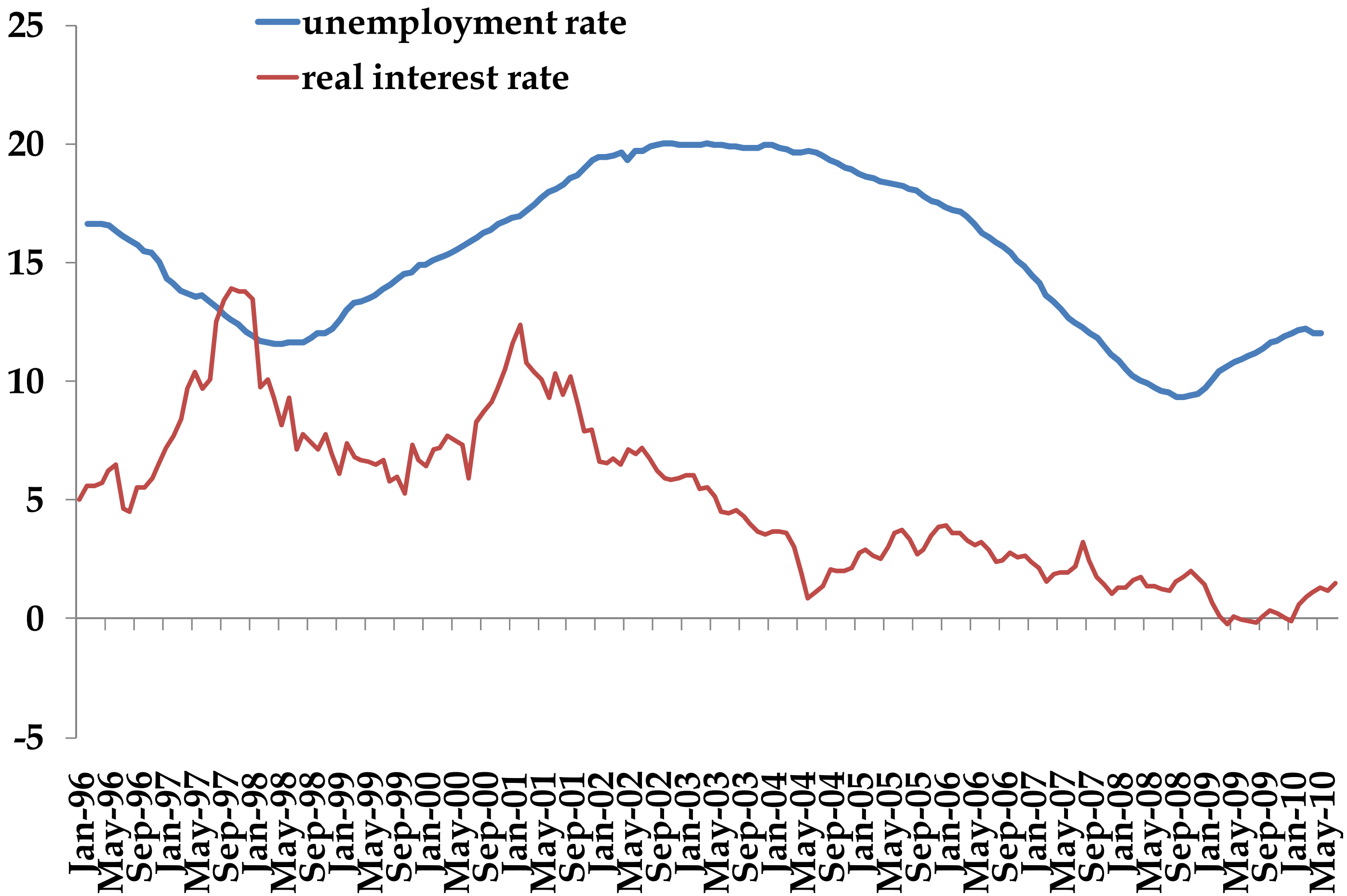
In 1998 Poland was one of the first developing countries to introduce inflation targeting

- When completing disinflation (1998-2003) annual target were missed, yet medium term target (CPI below 4% in 2003) was achieved
- Since 2004 permanent target of 2.5% +/- 1 pp. was introduced



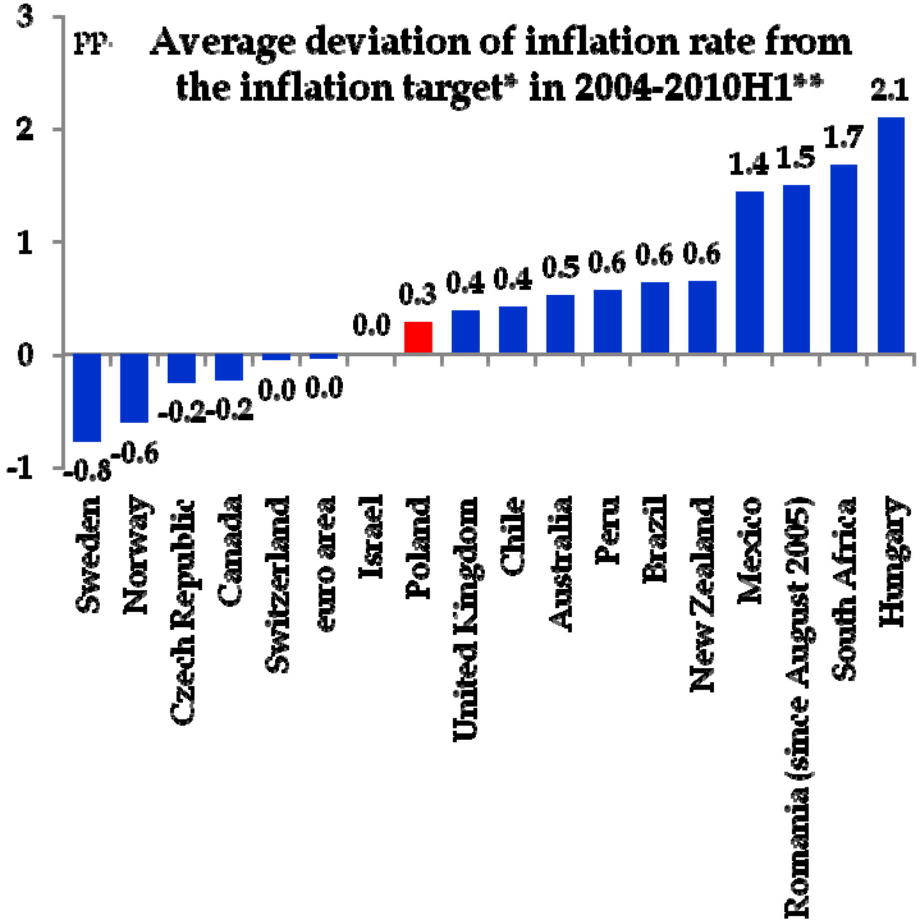
Source: NBP, CSO

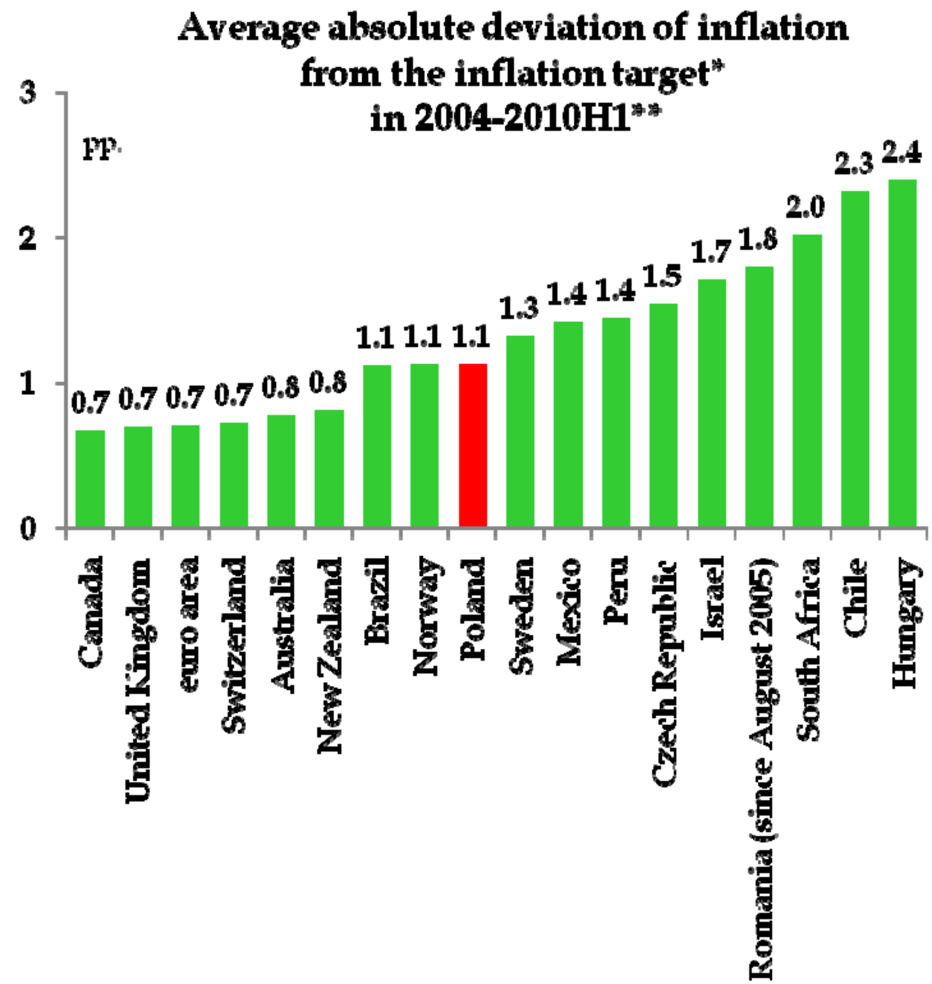
Completing disinflation and building credibility required restrictive monetary policy and entailed macroeconomic costs (increased unemployment)



Source: NBP, CSO

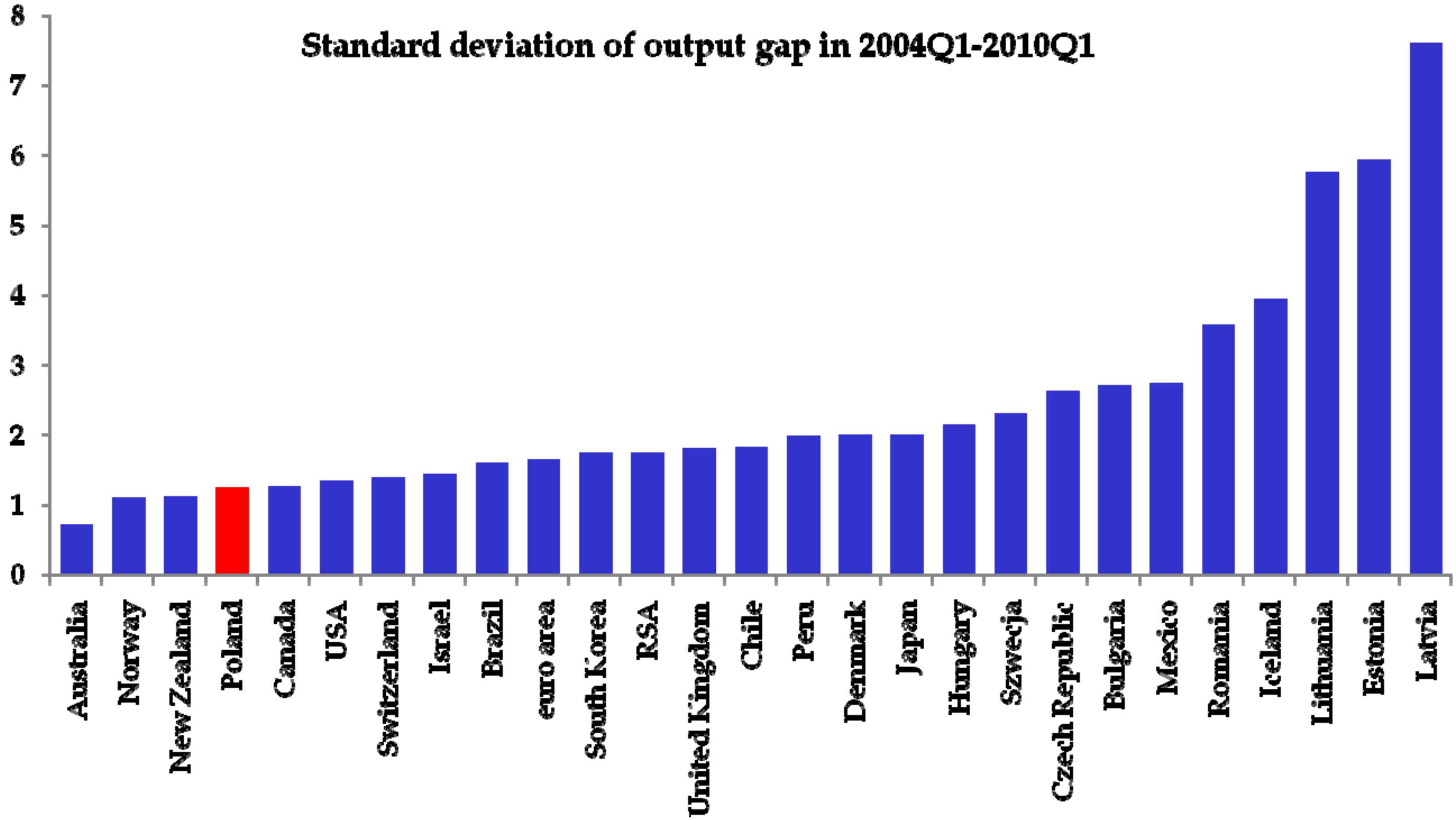
Since 2004 inflation in Poland was close to medium-term target





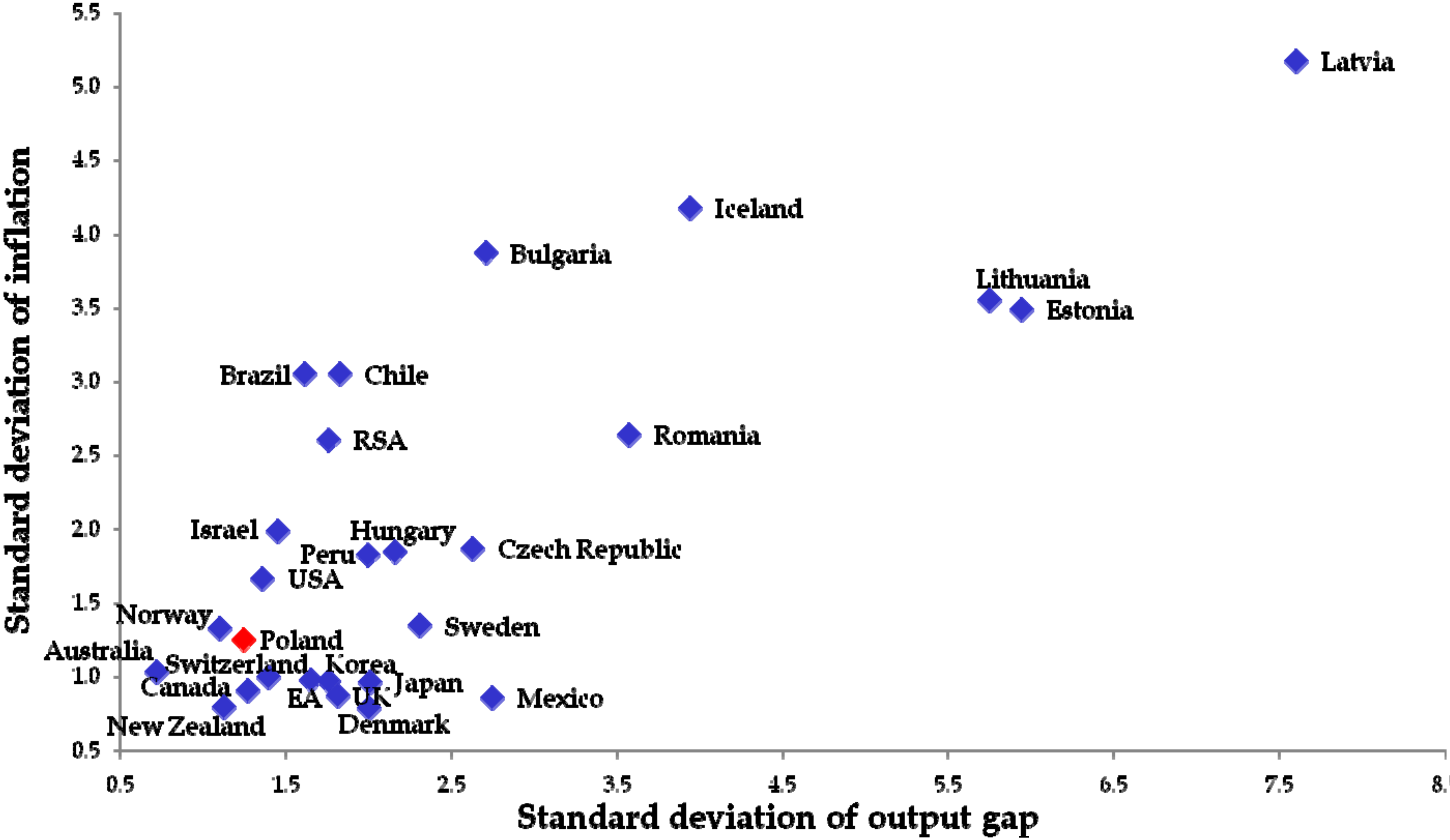
*For countries with a band inflation target its mid-point was chosen as a reference value.
**For all countries - monthly data; except for Australia and New Zealand - quaterly data.
Source: Eurostat, OECD data, NBP calculations.

Maintaining inflation close to target was achieved with limited economic growth volatility



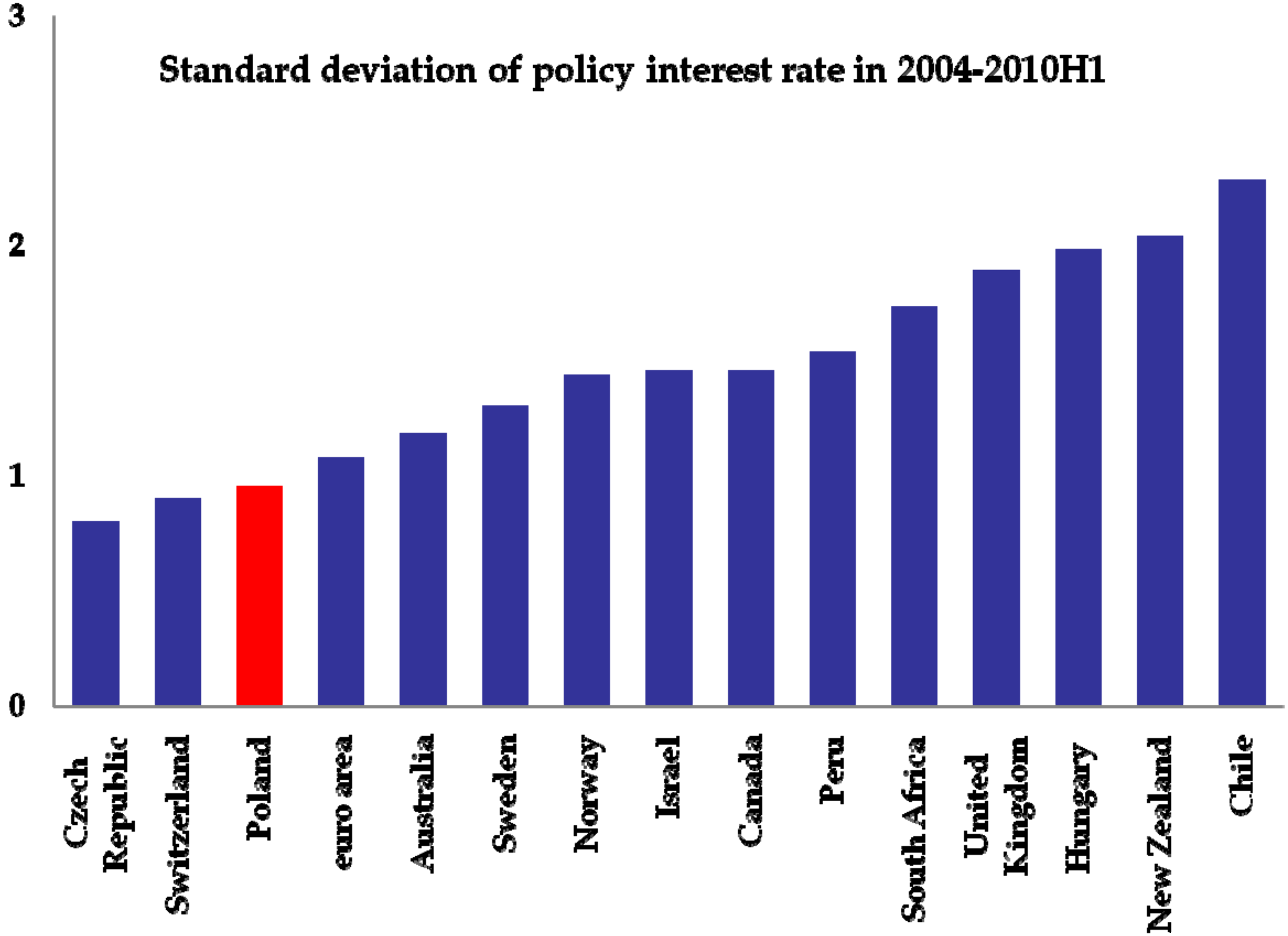
Source: Eurostat, OECD data, NBP calculations.

Combination of inflation and output gap volatility was as good as in the best performing countries



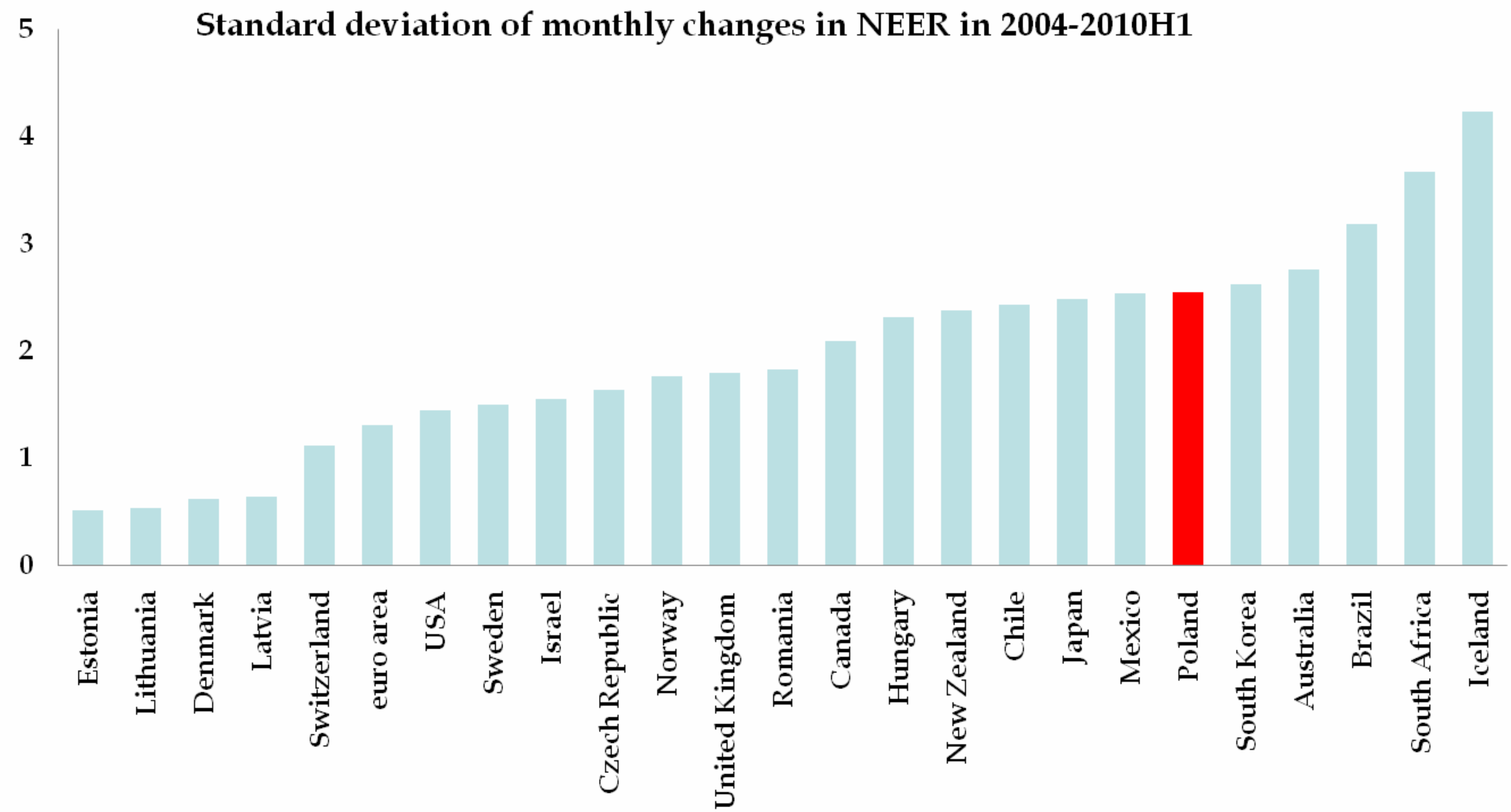
Source: Eurostat, OECD data, NBP calculations.
Ouitput gap calculated using HP filter

Volatility of policy interests rates was also limited



Source: Eurostat, National central banks, NBP calculations.

However, limited inflation, growth and interest rate volatility were traded-off for relatively large exchange rate volatility



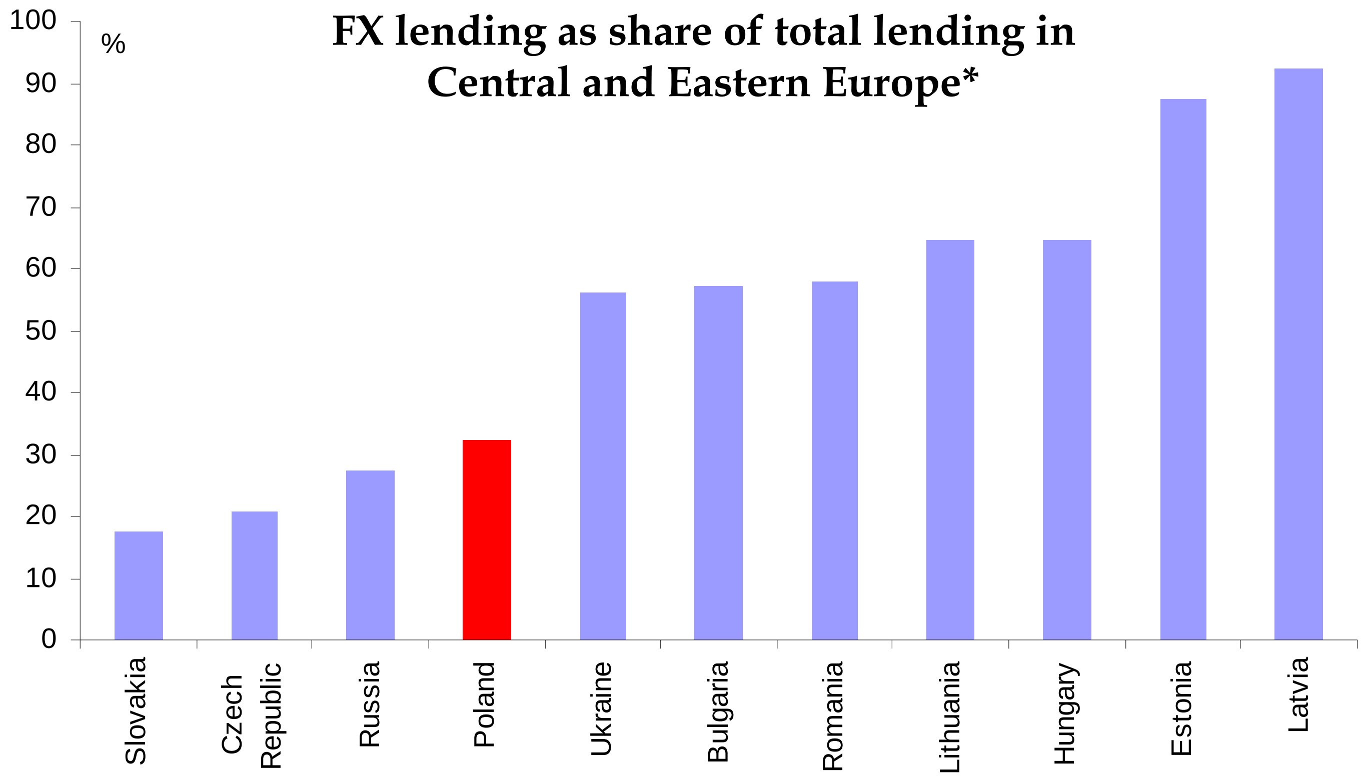
Source: BIS data, NBP calculations.

Inflation targeting in Poland - lessons from the crisis

Volatile exchange rate may be conducive to more stability of other macro-variables (inflation, output gap, interest rates)

Source: NBP

Together with conservative financial supervision it may hinder excessive foreign currency lending



*2009 data for the Czech Republic, Estonia, Hungary,Latvia, and Poland, 2008 data for Bulgaria, Romania and Slovakia, Q4 2008 for Lithuania, H1 2009 for Russia and Q1-Q3 2009 for Ukraine.
Source: IMF Financial Stability Indicators, National Bank of Poland and National Bank of Hungary.

Lessons from the crisis – continued

- Inflation targeting, as practiced in Poland, appeared to be effective both for maintaining macroeconomic stability in the good times, as well as for neutralizing economic shocks in the bad times.
- IT facilitated anchoring of inflation expectations at times of price shocks and increased uncertainty.
- IT alone is insufficient to prevent credit and asset prices booms, especially when these are driven by foreign capital inflow.
- Hence role for strong financial supervision (limiting foreign currency lending).