



Choosing Inflation Targeting as a Flexible Monetary Policy Framework

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Main Themes

- Debate on IT pre-conditions unnecessarily dogmatic
- Only some real important issues
 - Determination, operational independence and clear mandate
 - Technical prerequisites in terms of monetary and foreign exchange operations
- Necessary technical capacities can be built very fast
- Other conditions and capacities can come over time
- Good to be well prepared
 - Transitions can be hard, if not prepared
 - Large investments needed
- Good to take transition at an opportune moment

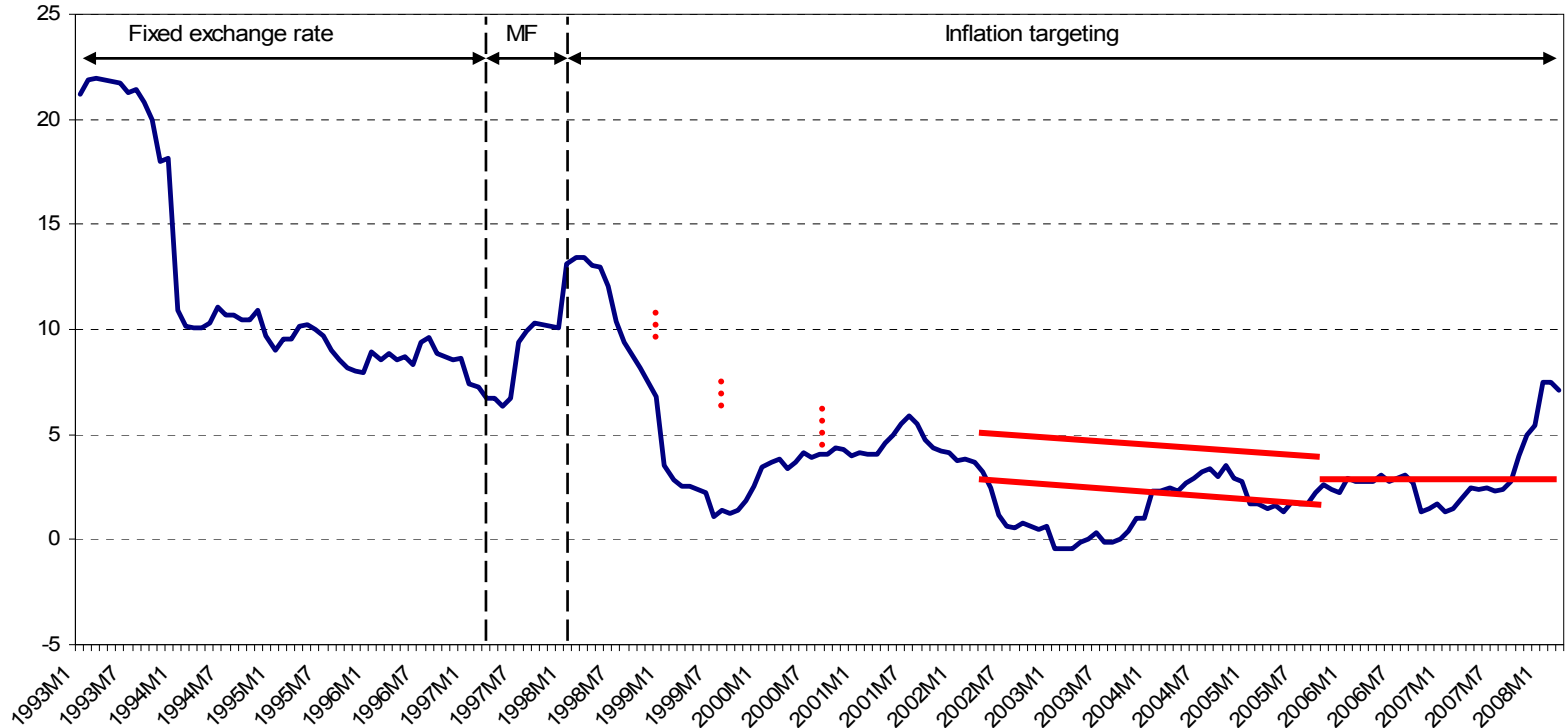


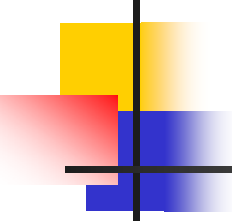
Czech Experience in Brief

- Forced shift to a new nominal anchor without an explicit exit strategy
- IT chosen as the only available option despite many preconditions not met
- Transition hard for the bank and the economy
 - Lacking conditions adding to macroeconomic costs
 - Large reallocation of resources inside the CB
 - Slow building of internal capacities
- Large benefits in terms of stability of inflation expectations vis-à-vis volatility of inflation
 - despite poor target performance

Inflation before IT unanchored

CPI y-o-y Czech Republic





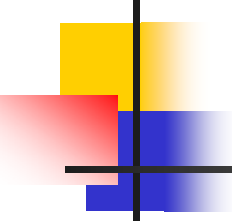
CR 1997: External IT preconditions largely satisfied

■ Satisfied

- Instrument independence
- Institutional independence
- No fiscal dominance
- Reasonably developed financial markets
- Reasonably good monetary policy transmission

■ Not satisfied

- No price stability mandate
- Fragile, state owned banking system
- Little credibility
- Little political support
- Large external imbalance and weak growth



CR 1997: Internal IT capacities only at a basic level

- Satisfied

- Effective MP implementation, key interest rate
- Effective exchange rate intervention strategy

- Not satisfied

- Inadequate organizational structure
- No experience in forecasting inflation
- Little accountability and transparency

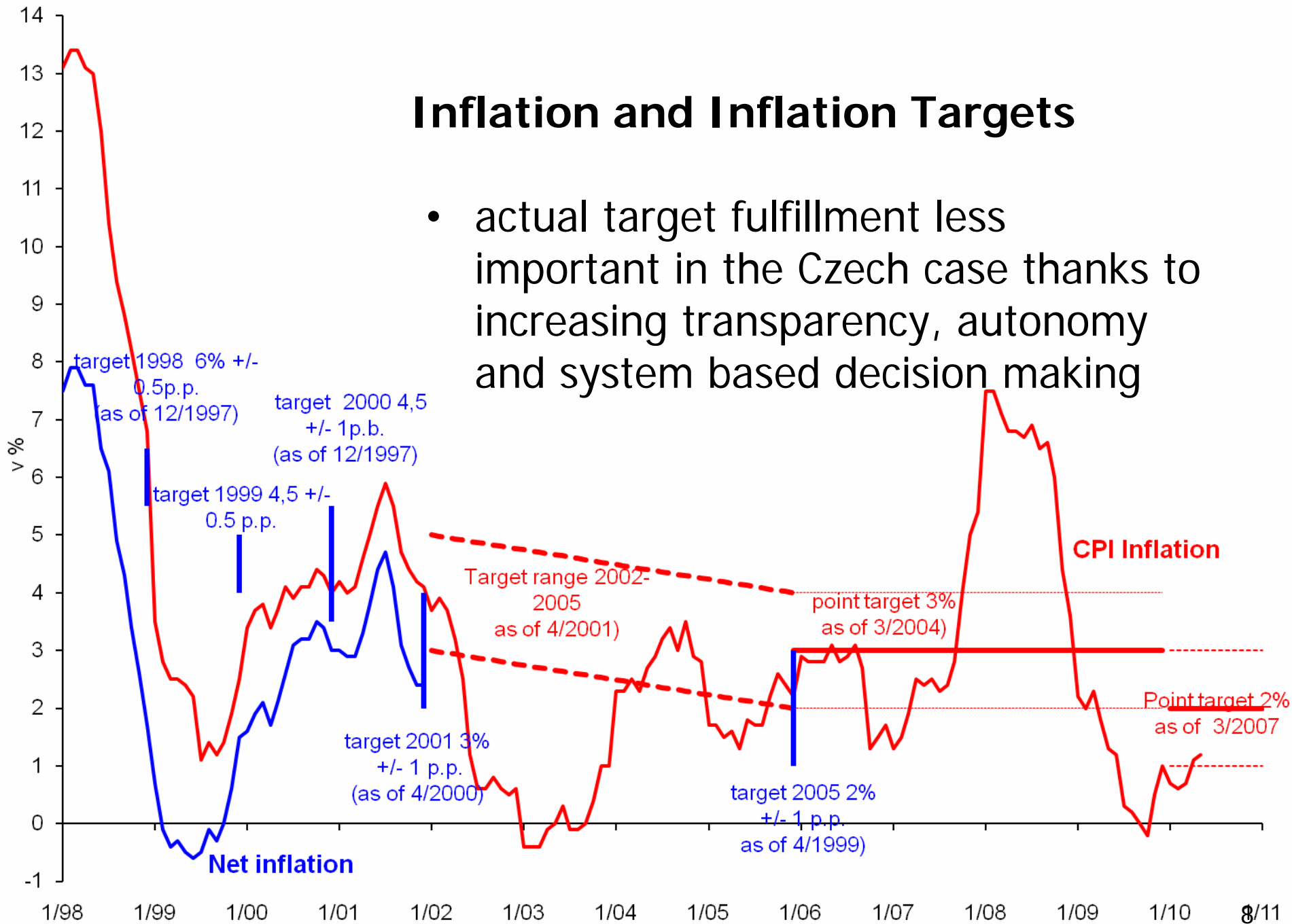


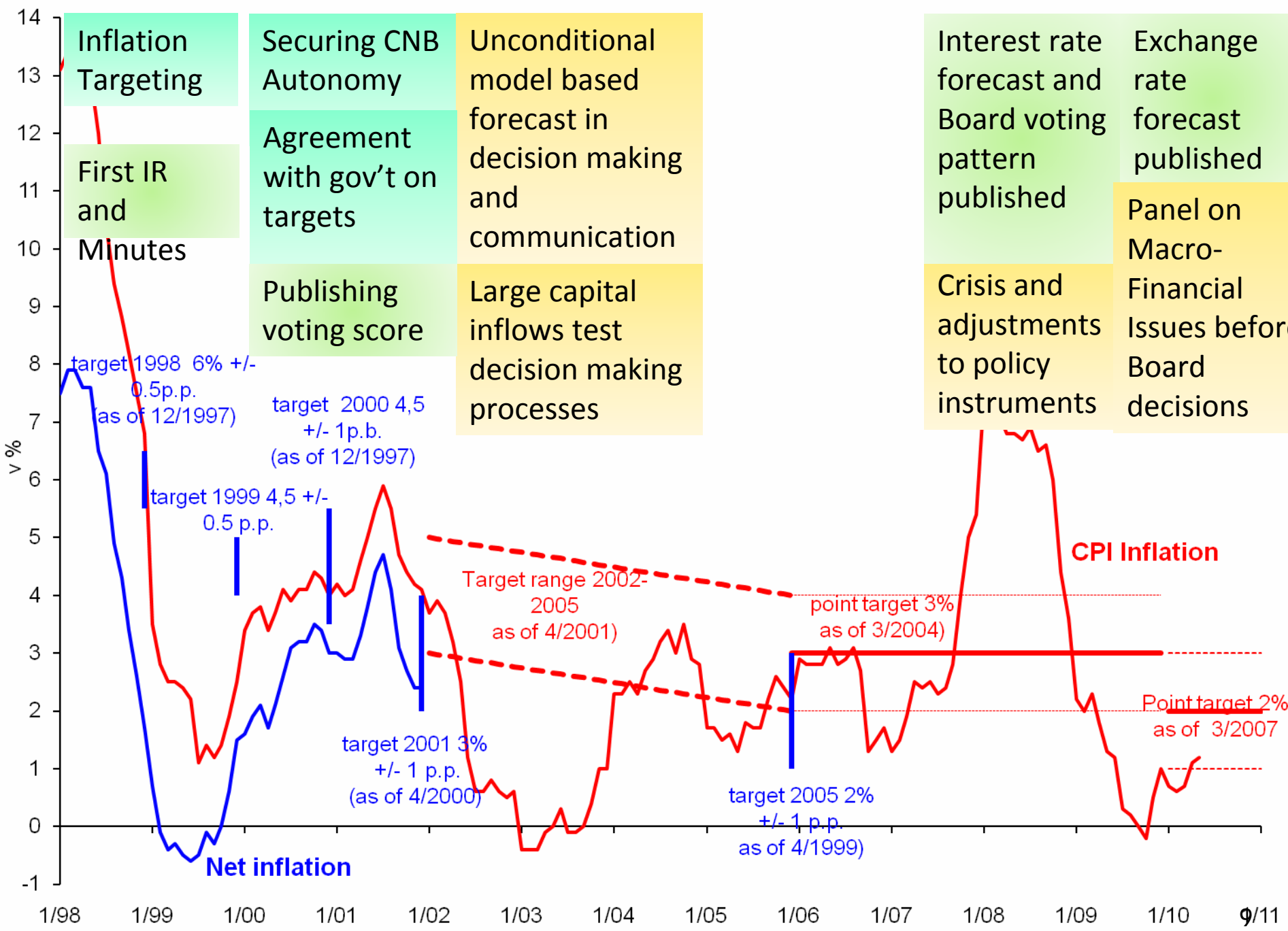
Honoring Basic IT Principles

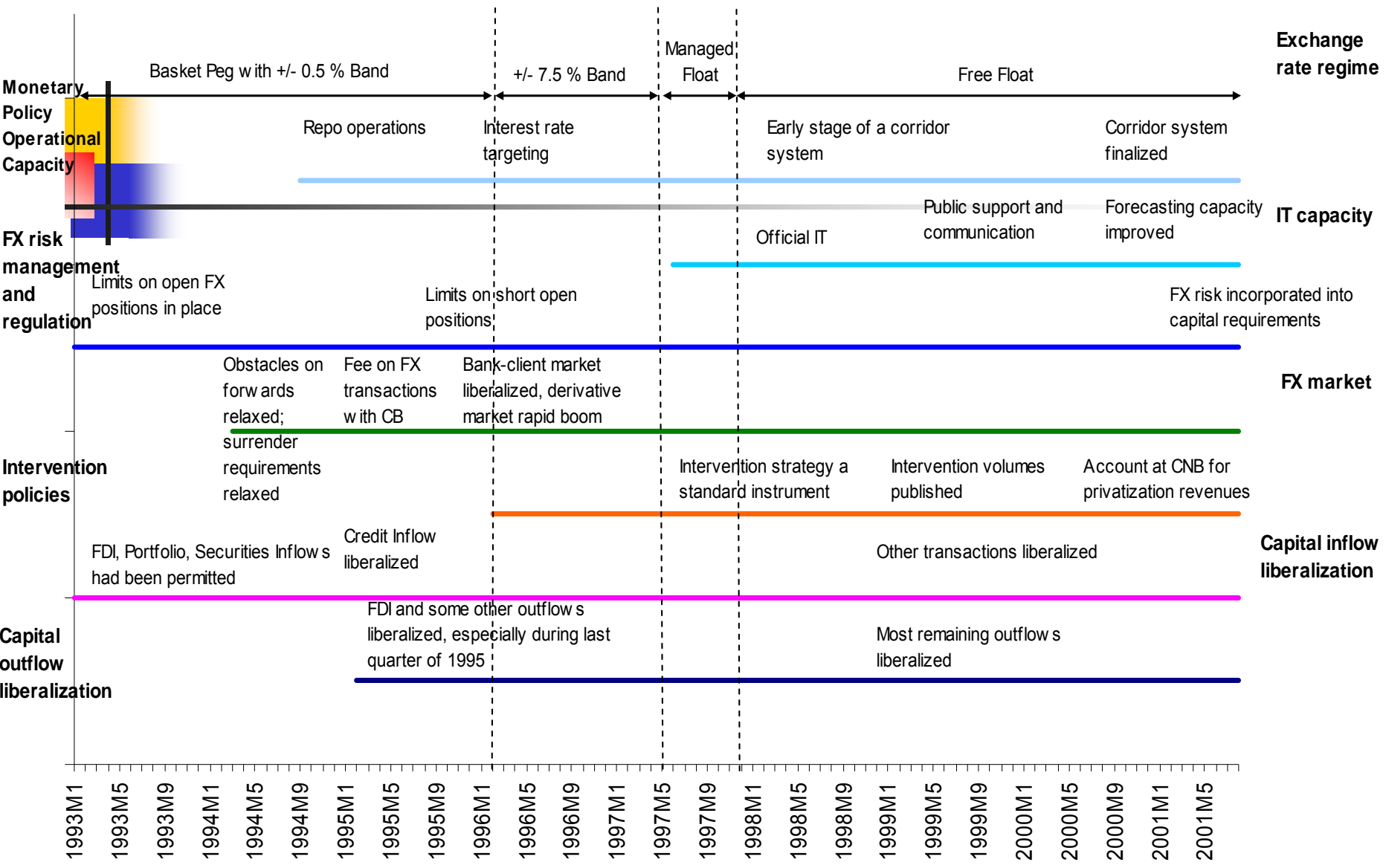
- Only one numeric target in terms of inflation of consumer goods
- Strong mandate and operational independence in achieving it
- Systematic simple rules based policy despite a complex transmission mechanism
- A good example of how transparency helps in making the regime credible
 - Unlike a peg, the performance in achieving the targets is often far from perfect, yet it is credible

Inflation and Inflation Targets

- actual target fulfillment less important in the Czech case thanks to increasing transparency, autonomy and system based decision making







The Czech Republic