General Discussion

The presentation of the experiences of the three countries back to back made it clear that, while the inflation-targeting frameworks each country operated were broadly similar, the political and economic contexts in which they developed had important differences. These differences have had, in turn, important effects on the way the regimes have evolved over the past 25 or so years. The general discussion considered a number of the most notable differences between the regimes, which are summarised in turn below.

Discussion began on whether the inflation-targeting regime should use a range or a target. One participant asked if the introduction of a range in Australia, Canada and New Zealand had provided a better anchor for inflation expectations than might have been the case with a point target. Participants broadly agreed that a range was chosen initially because they believed that central banks only had so much control over inflation. Inflation wasn't expected to remain within the target ranges nearly as much as it actually did and central banks were concerned that a point target would imply a higher degree of control than they had, which would lead to a loss of credibility. Many participants stated that a point target may help focus expectations, but with the benefit of experience, they did not see much practical difference between a point or a range target.

Participants then considered whether small differences in the level of the target were important. One participant raised the concern that if the Phillips curve is very flat, a 0.5 per cent difference in inflation can have a large effect on the economy. Another participant agreed; they stated that 25 years ago central banks were working out whether they could get 2 per cent rather than 10 per cent inflation, but small distinctions may matter now. This prompted a discussion of the optimal degree of flexibility for monetary policy. One participant stated that there was a tension between revealing the central bank's reaction function and discretion for flexible inflation targeting. Another participant responded, saying that it's impossible to pin down exact policy responses, but central banks need to explain deviations.

The discussion also highlighted that the degree of public understanding plays an important role. Many participants noted that the public often doesn't know details about the inflation target or the current level of inflation. This is apparent even after 25 years of increased communication, transparent policies and repeated statements. Some participants suggested that this may be because of rational inattention: inflation has been low and stable for a long time so the public doesn't need to pay attention to the actions of the central bank. However, one participant stressed the need for communication with the public if there were any changes to the framework.

Participants also discussed the risks from changing the inflation target. One participant noted that many central banks were reviewing whether inflation targets were too low. Another participant said they were surprised at how little change in targets had taken place over the past 25 years. There was agreement that this was likely because of the large fixed costs to changing the regime. One participant stated that these costs arose because expectations were so strongly anchored and this had been embedded into asset prices. Any changes to the target could cause significant redistributions of wealth. Another participant likened the situation to a fixed exchange rate regime and quoted Rudi Dornbusch: 'the frequency of change is an imminent predictor of a regime's demise'. However, that participant also acknowledged the apparent low costs of the incremental changes that have been made to New Zealand's regime since its inception.

A number of participants discussed the process of evolution among inflation-targeting regimes. One participant suggested that the smaller central banks that pioneered inflation targeting (Australia, Canada and New Zealand) were more likely to pursue modifications than large central banks who had only recently adopted inflation targeting. Another participant pointed out that this appeared to be part of a convergence process over the past 25 years. Another participant posed the question: should the force for change be internal, through central bank renewals and reviews, or external, through a push by politicians?

The lack of public engagement with inflation targeting was a concern of participants. One participant wondered whether we needed more public debate about inflation targeting. Public consultations and reviews are important for building and maintaining the credibility of the framework with the public. But many participants were troubled by the lack of political concern in recent years as the public viewed the issues as 'settled'. They thought that renewed engagement with politicians and informed debates about the monetary policy framework would be beneficial. However, participants were cautious of politicising the framework, especially around election cycles.

Another participant wondered whether the process of regular research and 'renewals' of inflation-targeting regimes could have unintended costs. A potential pitfall to the consultation and renewal process is that the central bank may not change their framework and this may make the process look like a formality. A second pitfall is that constant discussion about changes to the target may weaken the anchoring of inflation expectations and the credibility of the framework. Participants suggested that small, incremental changes within existing frameworks may be a way to address these concerns.

A range of questions focused on central banks having multiple mandates, such as price stability and unemployment. Some participants questioned whether each mandate should be given equal weight, or whether price stability should be a primary objective. One participant asked how employment mandates should be interpreted: one suggestion was that it should mean avoiding long-lasting downturns and the resulting hysteresis. Another participant noted that increasing the number of goals of a central bank required careful communication to ensure credibility is maintained. Participants also discussed how central banks in small open economies should respond to the exchange rate. One participant noted that the volatility of the exchange rate should be a secondary concern as smaller economies have less control over the level of the exchange rate.

A number of participants asked questions about the role of financial stability considerations in an inflation-targeting framework. Some participants thought that the potential trade-offs, such as the effects of unconventional monetary policy, were not discussed enough. The focus on financial stability by many central banks has tended to be on the housing sector and household debt, because that's where the vulnerabilities are.

One participant asked whether central banks' approaches to financial stability had changed since the early 2000s, when there were also asset booms in many countries. Participants noted that macroprudential actions had been taken in recent years. Participants concluded that it was unclear whether the monetary policy reaction functions had changed over the period in question or whether the economic and financial circumstances, including the structure of balance sheets, were different. One participant noted that the global financial crisis had also raised general awareness of financial stability concerns.

Some participants discussed monetary policy committee arrangements. One participant stated that committees do not imply better decisions, but it is important to ensure that diverse views are considered and committees can enable this. Another participant agreed, saying that while committees may increase the quality of the decision-making process, it is not obvious that they would result in material changes in decisions. One participant suggested moving towards individual accountability of members of monetary policy committees, as this can play an important part of the public process that sustains public confidence in those institutions.

Overall, participants thought that inflation targeting had performed better than they had expected when it was introduced. However, central banks should engage more with their governments and the broader public about the future evolution of their monetary policy frameworks.