ABSTRACTS OF THE ARTICLES

The system for targeting inflation goals in Hungary

Ágnes Csermely

The article sums up the economic thinking behind the system for targeting inflation in Hungary and the main economic-policy experiences with this. It presents briefly a framework model that the author sees as best reflecting present central-bank thinking about the functioning of the economy. It summarizes what normative conclusions can be drawn with the model about optimal monetary policy, and how these theoretical issues are reflected in the monetary systems for targeting inflation. The article then turns to international experience with the effectiveness and success of the regime. Finally, the author looks back over five years at the conditions that accompanied the targeting of inflation, at subsequent experiences with the economic-policy issues of that period, and at operation of the system so far.

What are we studying? The role of central-bank forecasts in Hungarian inflation targeting in the first five years

Zoltán M. Jakab, Gergely Kiss and Mihály András Kovács

This paper marks the fifth anniversary of the inflation targeting regime in Hungary by reviewing the role of forecasting in inflation-targeting regimes and evaluating the experiences of the National Bank of Hungary. A brief historical review is followed by a forecast assessment. Based on theoretically justi-fied assessment of conditional forecasts, the following conclusions can be drawn. In most cases, the turning points in inflation were projected correctly, i. e. the monetary-policy signals were adequate. The statistical analysis of key forecast errors revealed that projection errors were unbiased. There were, however, projection errors as well, in wage adjustment, household consumption growth, and external activity of the corporate sector. Comprehensive analysis of the structure of the forecasting errors indicates that ex post forecasts have not utilized all information to an optimal extent. There was overreaction to the latest-quarter CPI figure, while the effect of nominal wages, exchange rates and oil prices might be weaker in the short run and stronger in the long run, compared with the National Bank forecasting methods.

The role of transparency in central-bank strategy

Máté Barnabás Tóth

During the past five years – in line with the logic of inflation targeting and following international best practice – the National Bank of Hungary has been moving towards a greater degree of transparency. The evolution of the international best practice can be explained by the fact that in the past decade, views on the desirability of central-bank transparency have changed to a great extent. In the past, several central banks explicitly aimed to operate discreetly, but a general tendency towards increased transparency can be seen since the beginning of the 1990s. Calls for increased transparency may come from two directions. On the one hand, a democratic political setup requires public accountability of decision-makers at independent central banks, while on the other, economic thinking in the last decade has robustly inferred that central-bank transparency can preclude the emergence of inflation bias, increase the effectiveness of monetary policy, and under some conditions, have a welfare-enhancing

effect. The study examines the validity of the latter assertions with two simple models often applied in transparency literature. It illustrates that the right degree of transparency can be subject to debate in theoretical and in practical terms. Finally it shows how transparency practice has evolved at the National Bank of Hungary since inflation targeting was introduced.

The optimal horizon for inflation targeting in Hungary

Viktor Várpalotai

The paper presents calculations of the optimal horizons for inflation targeting in Hungary, using small-scale macro and vector auto-regressive models, relying on the theoretical framework of Batini and Nelson (2000). Given the assumed parameter values of central-bank preference, it was found that current National Bank practice, i. e. putting the inflation forecast for the next one to one-and-a-half years into the policy rule and using this horizon in its communication, can be regarded as optimal with respect to welfare analysis. In most cases of potential future shocks, this horizon also proved long enough to bring inflation back on target following an optimal monetary policy. However, there is no precluding the probability of future shocks that divert inflation from its target for longer than one to one-and-a-half years, when MNB follows an optimal monetary policy.

The main features of Hungary's monetary transmission mechanism

Balázs Vonnák

This paper attempts to aggregate and summarize fresh findings on the monetary transmission mechanism in Hungary. Within a research project at the National Bank of Hungary, nine studies have appeared that investigate the channels through which Hungarian monetary policy affects the economy. This paper creates a framework for synthesizing particular results, based on Mishkin's (1996) classification, and analyses how aggregate demand is affected through these channels. The conclusion is that in the last ten years, monetary policy has exerted measurable influence on real activity and prices. The dominance of the exchange-rate channel explains why prices respond faster and output responds more mildly than in closed developed economies like the United States or the Euro Zone. We expect that after Hungary's adoption of the euro, the absence of an exchange rate will be compensated by the fact that the interest-rate channel will work through foreign demand as well, so that no significant monetary-transmission asymmetries can be expected when the country is inside the Euro Zone.

Estimating the reaction function for Hungarian monetary policy

János Hidi

Analysis based on reaction functions, a popular tool in monetary policy, can be used for two purposes: on the one hand, they can provide a reference value for the actual interest-rate level, and on the other, they allow characterization of the relationship between interest rates and other macro variables. This study discusses both issues for Hungary in the recent period of inflation targeting. Overall it can be concluded that the Taylor rule fits the Hungarian interest rate series well, although taking into account the openness of the economy, this fit can be improved further by using other reaction functions. Significant deviations of the actual interest rate from the levels implied by reaction functions can be explained by the presence of the exchange-rate band or by swings of the risk premium. With the relationship between interest rates and other macro variables, the role of the output gap in determining interest rates seems insignificant. The effect of inflationary expectations and the exchange rate turns out to be significant, and their relationship with interest rates is similar to those found in other countries. When inflation expectations are higher, interest rates increase more. The role of the exchange rate depends on the time horizon: at monthly frequency, interest rates are sensitive to exchange-rate changes. But at quarterly frequency, which is closer to the central bank's policy horizon, the exchange rate only has an indirect effect on interest rates through its effect on inflationary expectations.