

SEÐLABANKI ÍSLANDS

Post-crisis monetary policy reform: Learning the hard way



The 2008 Global Financial Crisis in Retrospect
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Thórarinn G. Pétursson
Chief Economist Central Bank of Iceland

The views expressed do not necessarily reflect those of the Central Bank of Iceland or the Bank's Monetary Policy Committee.

Post-crisis period has seen comprehensive changes to monetary policy framework

Governance and decision-making structure

Governing structure of Central Bank

Five-member MPC with two external members

Individual responsibility, majority voting, minutes, parliamentary hearings

Inflation Targeting Plus

More flexible IT

Managed rather than freely floating ISK

Greater focus on financial system, capital flows, and BoP vulnerabilities

Expansion of toolkit

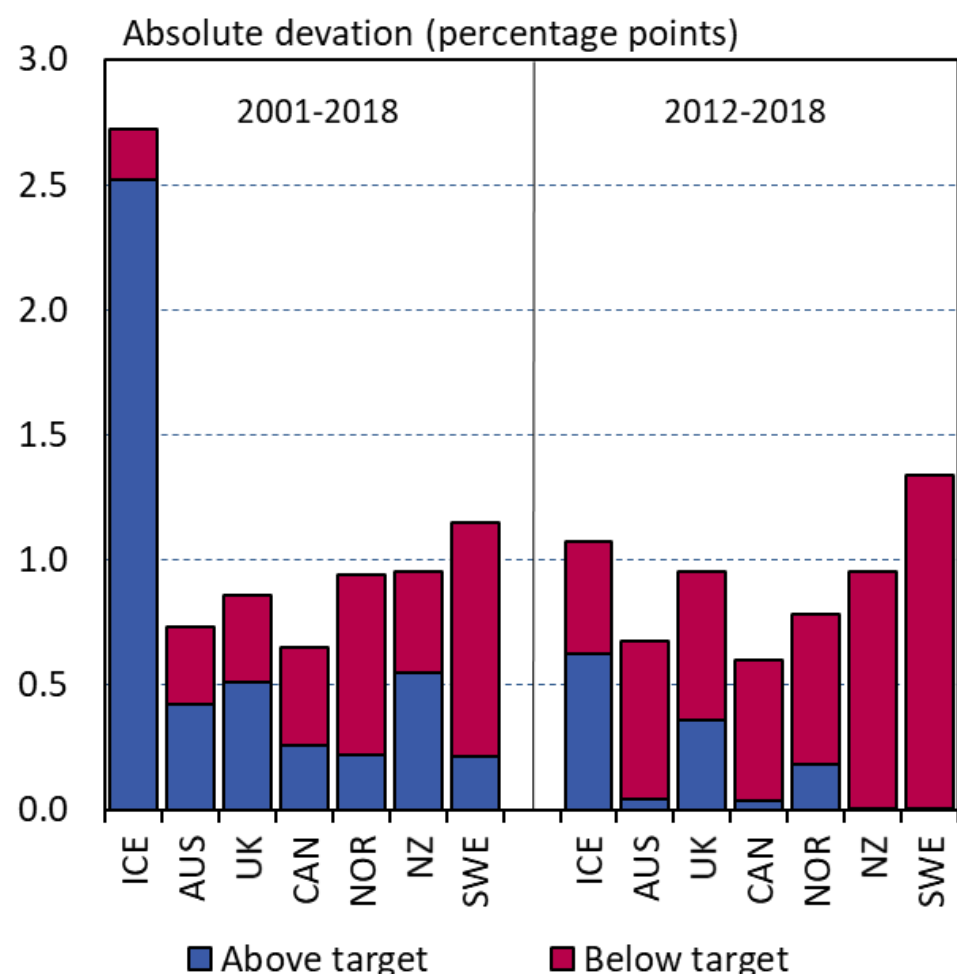
Macroprudential tools

FX interventions

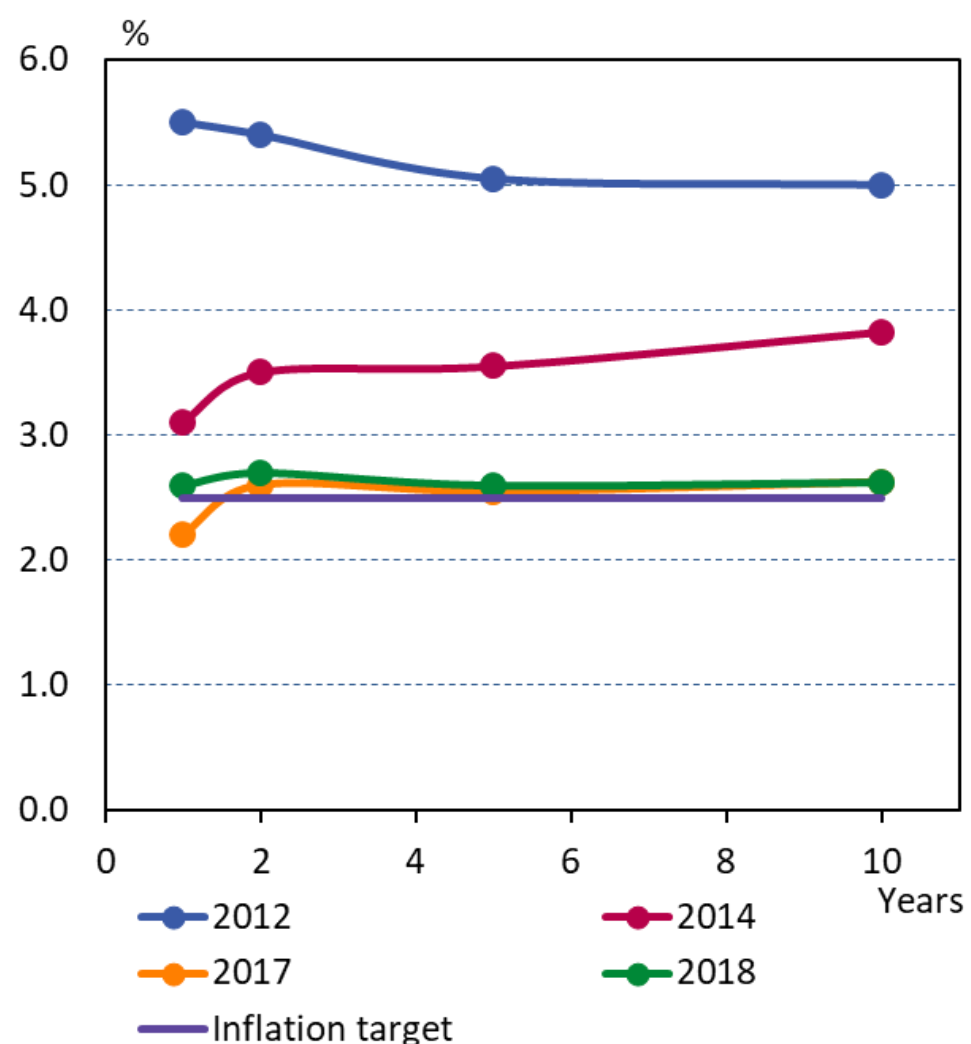
Capital flows management

Less frequent target misses, better anchored inflation expectations, and improved credibility

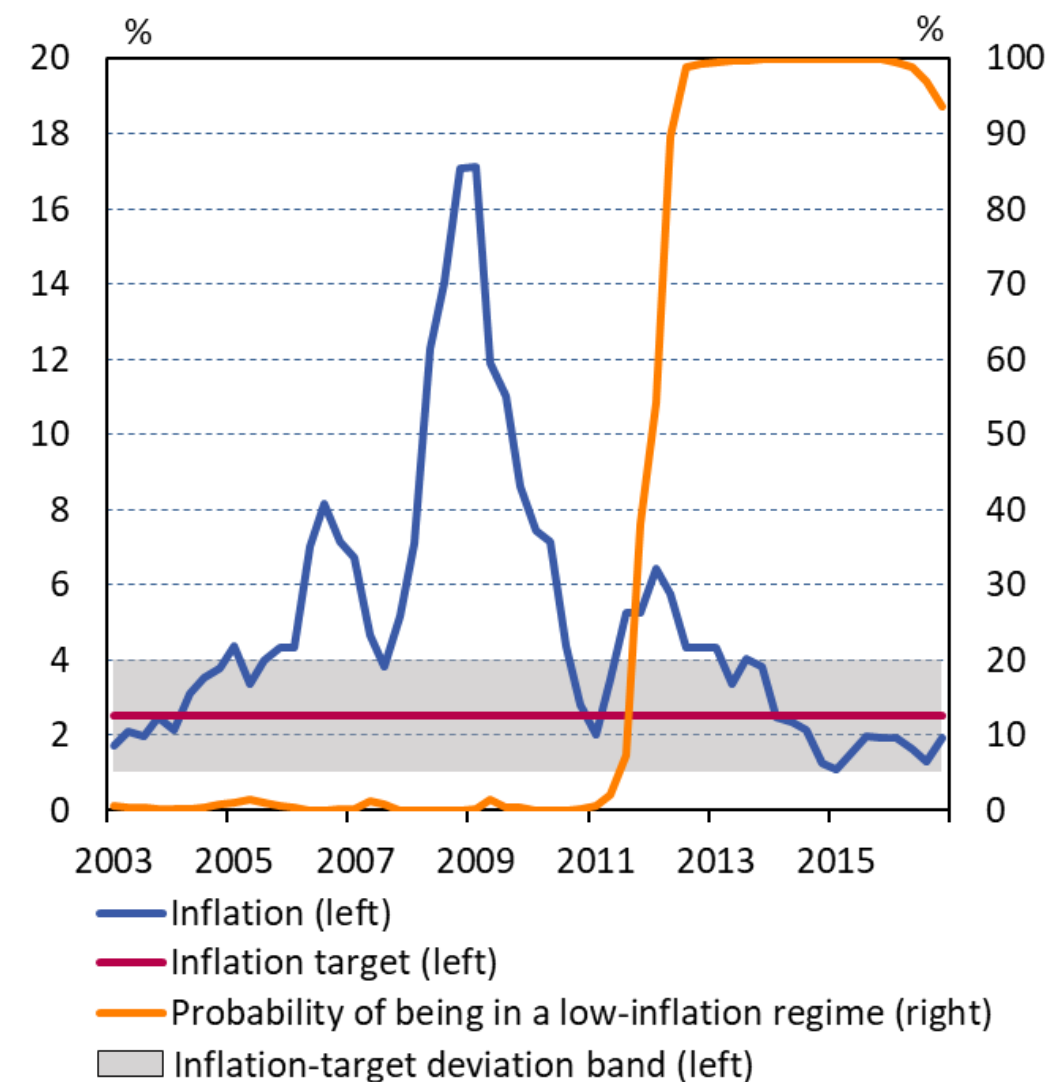
Average deviation from inflation target¹
Q1/2001 - Q2/2018



One- to ten-year inflation expectations²
Observations for Q2 in 2012, 2014, 2017, and 2018



Probability of being in low-inflation regime³

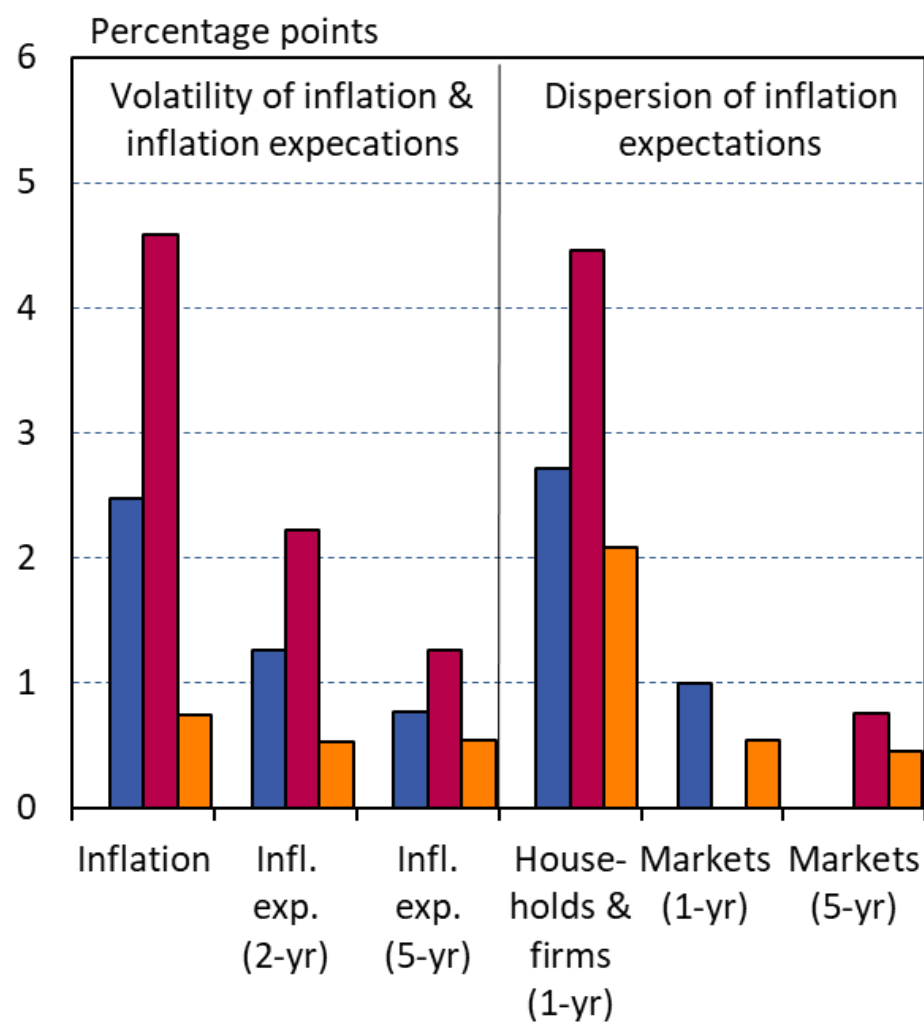


1. Average absolute deviation from inflation target (based on inflation target measure used by each country) and relative contribution of above- and below-target deviations. 2. 1-10 year inflation expectations from surveys among financial market participants. 3. Smoothed probability of being in a low-inflation regime based on an open economy, forward-looking Phillips curve, estimated with a two-regime Markov switching model.

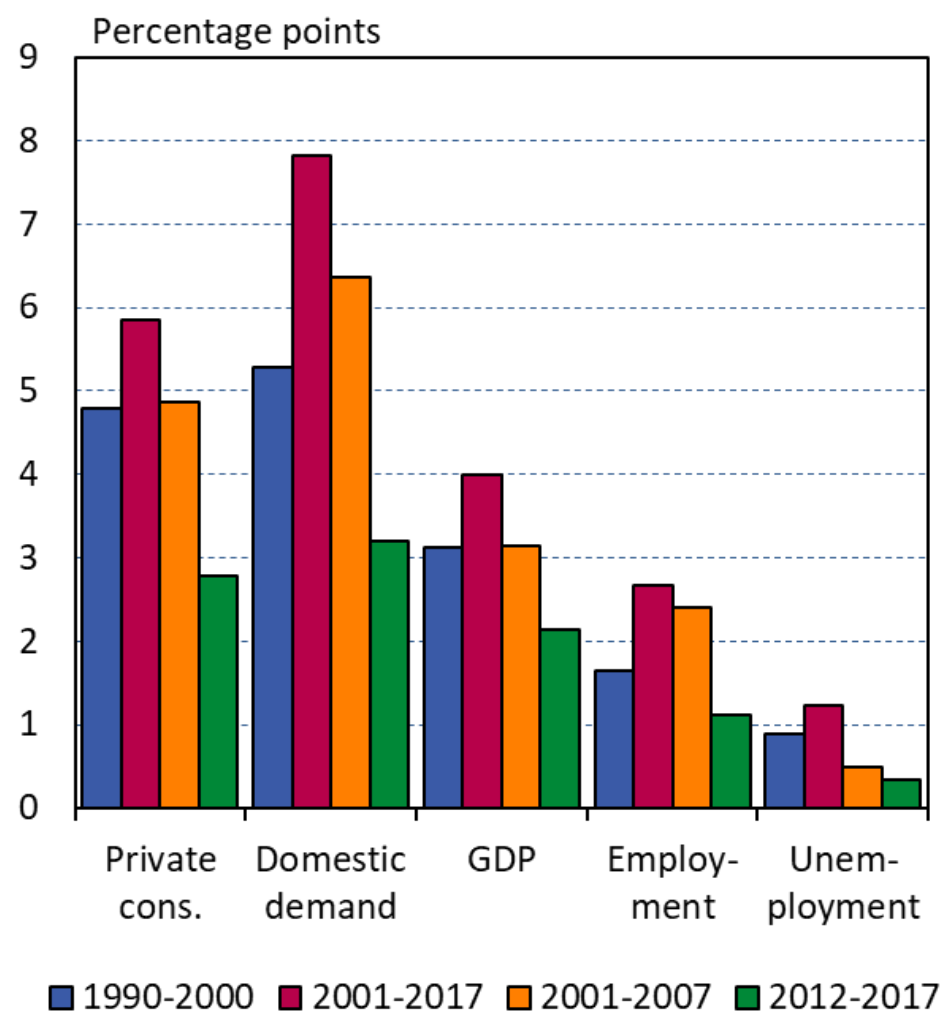
Sources: Central bank websites, OECD, Statistics Iceland, Central Bank of Iceland, Thórarinn G. Pétursson (2018), "Disinflation and improved anchoring of long-term inflation expectations: The Icelandic experience", Central Bank of Iceland Working Paper no. 77.

Increased nominal and real stability, and more effective monetary policy

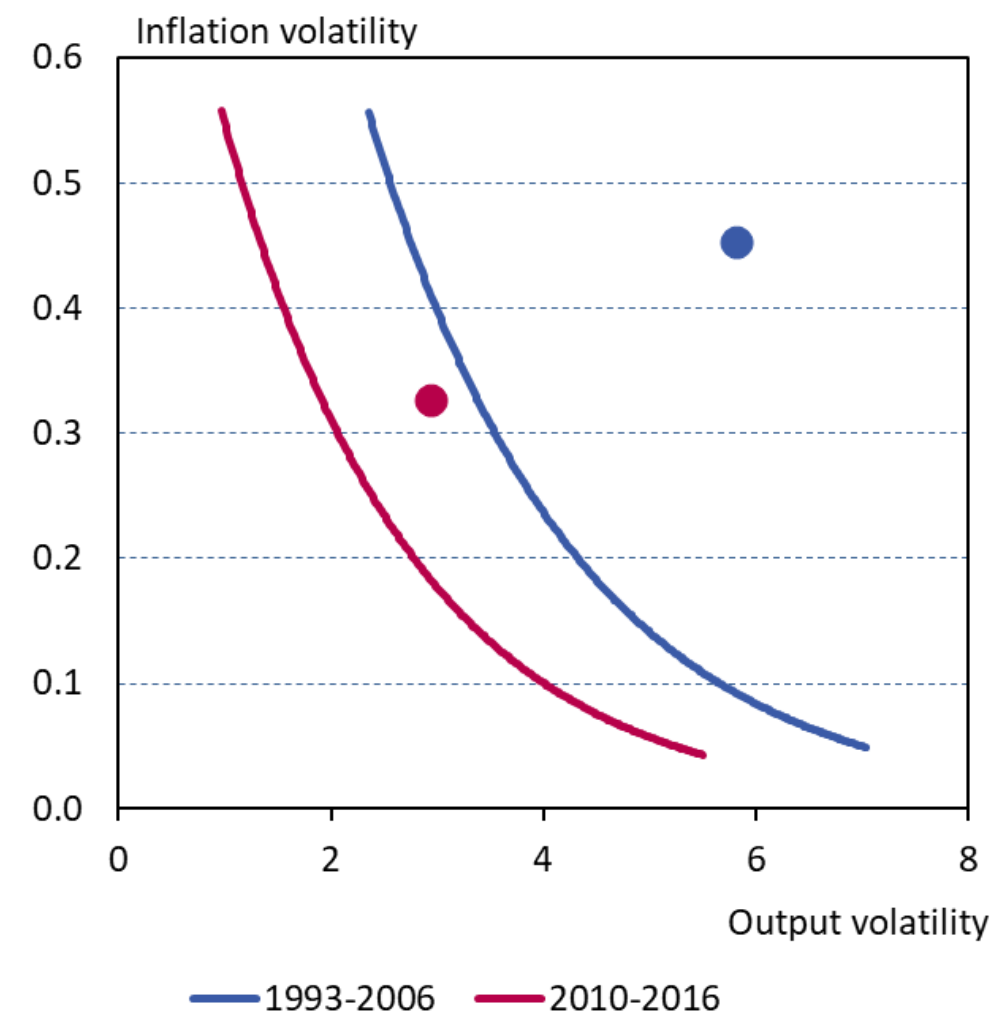
Inflation volatility and dispersion for three 5-year periods¹



Volatility of key macro variables in different periods²



Monetary policy frontier³



■ 2003Q3-'08Q2 ■ 2008Q3-'13Q2 ■ 2013Q3-'18Q2

1. Standard deviation of quarterly year-on-year CPI inflation and 2- and 5-year breakeven inflation expectations (from Q1/2003) and dispersion of survey-based inflation expectations of households and firms (simple average) and financial market participants. 2. Standard deviation of annual changes in various macro variables. 3. The efficient frontier shows pairs of standard deviations of inflation (deviations of annualised quarterly inflation from trend, π_t) and output (annualised quarterly GDP growth, y_t) which minimises the loss function $L = \sum_{t=0}^{\infty} (\lambda \pi_t^2 + (1 - \lambda) y_t^2)$ for different values of λ . The dots show pairs of actual standard deviations of inflation and output. The data is seasonally adjusted, de-trended and Kalman filtered using the Central Bank of Iceland's DSGE model.

Sources: Gallup, Statistics Iceland, Central Bank of Iceland, Central Bank of Iceland (2017), "Monetary policy based on inflation targeting: Iceland's experience since 2001 and post-crisis changes", *Special Publication* no. 11.