

Monetary policy tightening was the main trait of the last three months. Of the eight central banks monitored, only those of Poland and New Zealand left their rates unchanged. The Hungarian central bank took the record, raising its rates in three steps by a total of 1.25 percentage points. Rate increases of 0.5 percentage point were also recorded in Sweden and Slovakia. In Spotlight we take a look at likely monetary policy developments in the USA. Our selected speech is Kenneth Rogoff's address on globalisation and monetary policy.

1. Developments since the last issue of Monitoring (June 2006) and expected future information

	Inflation target ¹	Latest inflation	Current basic rate	MP meeting date/rate change/expectation ²	Next MP meeting/expectation ³	Other expected events
Euro area (European Central Bank, ECB)	< 2.0%	2.3% (Aug 2006) ⁴	3.00%	6 Jul/0.00 3 Aug/+0.25 31 Aug/0.00 ↗	5 Oct 2 Nov 7 Dec ↗	7 December: publication of new forecast
Sweden (Sveriges Riksbank)	2.0%	1.7% (Jul 2006)	2.50%	19 Jun/+0.25 29 Aug/+0.25 ↗	25 Oct 14 Dec ↗	26 October: publication of IR ⁵
United Kingdom (Bank of England, BoE)	2.0%	2.4% (Jul 2006)	4.75%	5–6 Jul/0.00 2–3 Aug/+0.25 6–7 Sep/0.00 →	4–5 Oct 8–9 Nov 6–7 Dec →	15 November: publication of IR ⁵
Hungary (Magyar Nemzeti Bank, MNB)	3.5%	3.0% (Jul 2006)	7.25%	19 Jun/+0.25 24 Jul /+0.50 28 Aug/+0.50 ↗	25 Sep 24 Oct 20 Nov →	20 November: publication of IR ⁵
Poland (Narodowy Bank Polski, NBP)	2.5%	1.1% (Jul 2006)	4.00%	27–28 Jun/0.00 25–26 Jul/0.00 29–30 Aug/0.00 →	26–27 Sep 24–25 Oct 28–29 Nov →	30 October: publication of IR ⁵
Slovakia (Národná banka Slovenska, NBS)	< 2.5%	5.0% (Jul 2006)	4.50%	27 Jun/0.00 25 Jul/+0.50 25 Aug/0.00 ↗	26 Sep ⁶ 31 Oct ⁶ 28 Nov ⁶ →	Monetary survey issued on given MP meeting dates
USA (Federal Reserve System, Fed)	n/a	4.1% (Jul 2006)	5.25%	28–29 Jun/+0.25 8 Aug/0.00 ↗	20 Sep 24–25 Oct ↗	12 October and 29 November: publication of Beige Book
New Zealand (Reserve Bank of New Zealand, RBNZ)	2.0%	4.0% (2Q 2006)	7.25%	27 Jul/0.00 →	14 Sep 26 Oct 7 Dec →	

¹ Inflation target valid for the current period (or, in the cases of Hungary and Slovakia, the year-end target).

² The direction of the expected change in rates in the past quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey).

³ Provisional meeting dates. The direction of the expected change in rates in the coming quarter is taken from the Consensus Forecasts survey (or, in the case of New Zealand, from the RBNZ's own survey).

⁴ Preliminary estimate.

⁵ Inflation Report.

⁶ The NBS Bank Board decides on rates once a week; the given dates correspond to the discussion of the Situation Report.

2. News

[ECB grants observer status](#)

The Governing Council of the ECB decided at the beginning of July to grant observer status in the Council to the Governor of the Slovenian central bank. This decision is related to Slovenia's entry into the euro area on 1 January 2007.

[Riksbank to publish book on its history](#)

In June, the Executive Board of the Riksbank decided to issue a book on the Riksbank's history. At present there is no such publication. The book will be published in Swedish and English and is expected to be ready by the end of 2008.

[NBS releases analysis of convergence of Slovak economy](#)

In July, the NBS's Research Department prepared and published an "Analysis of Convergence of the Slovak Economy". The Analysis states that given responsible policy and no negative shocks, Slovakia should be able to fulfil all the Maastricht convergence criteria in 2007 and introduce the euro on the planned date, i.e. 1 January 2009. The Analysis also assesses regional cohesion for the first time.

[Member of Board of Governors leaves Fed...](#)

Mark W. Olsen resigned from the Fed's Board of Governors on 30 June. Mr Olson, who had been member of the Board since 7 December 2001, left to assume the chairmanship of the non-profit Public Company Accounting Oversight Board.

[...and new member is appointed](#)

Well-known economist and long-serving Fed employee Frederic S. Mishkin took the oath of office as a member of the Board of Governors on 5 September. Frederic Mishkin was nominated by President Bush on 30 June and the Senate confirmed him on 26 July. Mr Mishkin replaces Roger W. Ferguson, who resigned on 28 April. Mr Mishkin's term of office expires on 31 January 2014.

[RBNZ issues book on its history...](#)

June saw the publication of "Innovation and Independence: The Reserve Bank of New Zealand 1973–2002", a book written by John Singleton and co-authors Gary Hawke and Arthur Grimes. The authors note that the RBNZ has been at the forefront of thinking in central banking. It was the first central bank to define its autonomy around a contractual relationship between Governor and Government, and was also the first to adopt inflation targeting.

[...and opens museum](#)

The Reserve Bank Museum was officially opened on 6 September by Peter Hillary, on behalf of Sir Edmund Hillary, the only living New Zealander portrayed on New Zealand's bank notes. Situated on the ground floor of the RBNZ's building in Wellington, the museum is the first in New Zealand focusing on the country's economy, the role of central banking and the production of currency. For the first time ever, people can see the Bank's valuable collection of historic notes and coins.

3. Spotlight: Likely monetary policy developments in the USA

At its most recent meeting, on 8 August, the Federal Open Market Committee (FOMC) left interest rates unchanged after a series of 17 increases. This has generated considerable speculation about the future direction of U.S. monetary policy.

Developments to date

Inflation in the USA was 4.1% in July and the Fed's key interest rate stopped rising at 5.25%. According to many analysts, economic growth will become the dominant indicator for the future decision-making of the Fed, which does not employ inflation targeting in its monetary policy management. However, the opposite view has also been expressed that the personnel changes in the Board of Governors – the arrival of Ben S. Bernanke and Frederic S. Mishkin – will conversely mean a greater focus on inflation in monetary policy-making.

Differing opinions on the future

This issue has recently been analysed in detail by the investment banks Goldman Sachs and Lehman Brothers.

Goldman Sachs' economists expect the Fed to start lowering rates from their present level only if economic growth slows more markedly. Inflation would be sidelined as a decision-making factor. The first monetary policy easing may take place as early as the first quarter of 2007. The historical experience with Fed monetary policy shows that the Fed reacts very flexibly to increasing unemployment. The Goldman Sachs analysis states that since mid-1960 the Fed has lowered rates every time unemployment has recorded a quarter-on-quarter increase of more than one-sixth of a percentage point. The analysis concludes that the key monetary policy rate may fall from the present 5.25% to around 4% by the end of 2007.

The conclusions of Lehman Brothers are quite different. They do not rule out a further increase in the key monetary policy rate to 5.75%. It should then be held steady for at least one year, with a potential lowering following in the first quarter of 2007 at the earliest. According to Lehman Brothers, the U.S. economy is not slowing all that much and inflation is still rising. A monetary policy easing can only be expected if annual GDP growth slows by more than one percentage point and inflation stops rising or starts falling. The Taylor rule may then start to play an important role (with monetary policymakers ceasing to work with forecasts and working with current data).

According to the Lehman Brothers analyses, unemployment is a very good indicator of recession. A recession has started to threaten the U.S. economy every time the quarter-on-quarter unemployment rate has risen by more than a third of a percentage point. The conclusion is that the Fed will start to ignore inflation only if annual GDP growth dips below 2% and unemployment simultaneously rises.

The very different conclusions of analysts specialising in the U.S. economy suggest considerable uncertainty regarding the Fed's future behaviour, which to some extent affects the behaviour of other central banks and the future development of the world economy.

4. Kenneth Rogoff at the Jackson Hole Symposium

In this part we summarise the speech given by U.S. economist Kenneth Rogoff entitled “[Impact of Globalization on Monetary Policy](#)” at the traditional symposium of central bankers at Jackson Hole on 24–26 August 2006, sponsored by the Federal Reserve Bank of Kansas City.

Kenneth Rogoff divided his speech into three parts linked by the common thread of globalisation. He discussed the following issues: (i) the impact of globalisation on the international inflationary process, (ii) the connection between globalisation and asset price volatility, and (iii) openness and its consequences for the conduct of monetary policy.

The starting point for the discussion of the first issue was an analysis of the popular view that “China is exporting deflation”, which Rogoff views as quite naive. The author acknowledges that low Chinese wage costs are placing relentless downward pressures on wages and prices in other countries. But he immediately adds that hyper-competitive Chinese exports only affect relative prices. Upward pressures on prices of other goods, particularly oil and other commodities, are a necessary counterpart of the low prices of Chinese goods. From this perspective, Rogoff concludes that, on the contrary, China is exporting inflation.

The second part of the speech is based on the fact that globalisation in the past 25 years has been accompanied by a continuing decline in real output volatility, which has been fostered by more successful monetary policy implementation and deeper financial markets. Nevertheless, the decline in output volatility and inflation has not been accompanied by lower volatility in asset prices, and in particular equity prices and exchange rates. This may be due to heightened asset price sensitivity to risk changes, although not to risk size. Getting the right grip on the link between asset price volatility and monetary policy response was identified by Rogoff as the greatest challenge facing central bankers at present.

The concluding part of the speech was devoted to answering the often raised question of whether the exchange rate or terms of trade should enter directly into the central bank’s monetary policy rule. As regards the exchange rate, Rogoff is against this option. His argument is based on the fact that the exchange rate behaves more like an asset price than a price for trading goods. In contrast to many other economists, he thus does not tie the exchange rate to fundamentals and claims that exchange rates respond to economic developments only in the case of extreme movements. He then generalises the conclusion about excluding the exchange rate from the monetary policy rule to a general exclusion of all other asset prices. However, the case for incorporating the terms of trade into the monetary policy rule seems stronger. The terms of trade are able to capture the behaviour of fundamentals much better than the exchange rate or other asset prices. This contention is supported by data from the past 25 years when the volatility of terms of trade has decreased.

We would also like to draw readers’ attention to the related contribution by [Charles Bean](#) (Bank of England), who presents numerous stimulating arguments regarding this speech.

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