



MAGYAR NEMZETI BANK
THE CENTRAL BANK OF HUNGARY

RESEARCH

BESS at MNB (MNB-CEU)

Optimal Disinflation under Learning

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Time: 15:15 pm, Wednesday, 30rd March 2011

Venue: MNB-Visitor Centre (1054 Budapest, Szabadsag ter 8.)

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<http://www.barcelonagse.eu/Faculty.php?id=385>

Abstract

We model transitional dynamics that emerge after the adoption of a new monetary-policy rule. We assume that private agents learn about the new policy via Bayesian updating, and we study how learning affects the nature of the transition and choice of a new rule. In our model, uncertainty about the long-run inflation target matters only slightly, and the bank can always achieve low average inflation at relatively low cost. Uncertainty about policy-feedback parameters is more problematic. For some priors, the bank's optimal strategy is to adopt an incremental reform that limits the initial disagreement between actual and perceived feedback parameters. More ambitious reforms can succeed when priors permit agents to learn quickly enough. While fast learning is critical for the success of an ambitious reform, full credibility is not.

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