

On the Value of Price Stability

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Budapest, February 2, 2015 Lamfalussy Lectures Conference, Magyar Nemzeti Bank

Annual Inflation in the US

(Percent)



Source: FRED



Annual Inflation in Japan

(Percent)



Source: FRED



Annual Inflation in Turkey

(Percent)



Source: FRED



The Cost of Inflation: A Counterfactual for Turkey*

Per Capita Income with Respect to the US (Percent)



*Average inflation in Turkey between 1973 and 2003 is 54.5 percent. According to growth regressions every 10 percentage points higher inflation leads to a reduction in GDP growth rate by 0.25 percentage points on average.

Source: UN, CBRT.



What's wrong with a deflation?

- Complications in using nominal interest rates.
- Zero lower bound?
- Negative nominal interest rates?
- How negative?
- Will it be enough to raise inflation expectations?
- Channels of transmission?



Requirements for Price Stability





Stable Money Growth





Stable Money Growth



Source: IMF.



Control of Money and Credit Growth

- 1. Macroprudential Measures (especially to tighten)
- 2. Quantitative Easing
- 3. Interest Rates



Stable Output Growth





Stable Velocity





Downward Trend in Velocity of Money

Velocity of M2 Money Stock in Japan





Downward Trend in Velocity of Money

Velocity of M2 Money Stock in the US





Stable Velocity

Velocity Function



Long Term Government Bond Yield (percent)



Requirements for Price Stability

- Stability of long term government bond yields is another condition for the stability of velocity, and hence for price stability.
- Negative nominal deposit rates may have a potential to increase velocity, by sharply reducing the real money demand. But this is unchartered territory.



Interest Rates in US

Annual Change in Long Term Interest Rate* (10 Year Government Bond Yield, Difference of Natural Logarithm)



* Monthly averages of daily interest rate data Last Observation: January 26, 2014.



Source: FRED, Bloomberg.

Interest Rates in Japan

Annual Change in Long Term Interest Rate* (10 Year Government Bond Yield, Difference of Natural Logarithm)



* Monthly averages of daily interest rate data Last Observation: January 26, 2014.

Source: FRED, Bloomberg.



Interest Rates in Germany



* Monthly averages of daily interest rate data Last Observation: January 26, 2014.

Source: FRED, Bloomberg.



The Benefits of Price Stability

- High inflation is costly in terms of allocational efficiency.
- Deflation seems like a disequilibrium phenomenon (i. e. liquidity trap).
- Maintaining low and stable inflation would be the best contribution to growth from a central bank.



Real Pillars of Growth Strategy in Turkey

- i. Human Capital and Labor Market
- ii. Technology and Innovation
- iii. Physical Infrastructure





- Both high inflation and deflation are detrimental to growth.
- The best contribution to growth from a central bank would be to maintain price stability.
- Reforms in human capital, labor market, technology, innovation and physical infrastructure are going to boost the growth potential in Turkey.





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