

Discussion of
Kamenik, Kiem, Klyuev, and Laxton's
Why Is Canada's Price Level So Predictable?

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How to test for targets?

1. Use a DSGE model.
2. Use a term-structure model.
3. Test forecastability directly.

What are the advantages and disadvantages of each method?

Disadvantages of using a NK DSGE model:

(a) identification

(b) power.

But results hold in several different versions of the model.

Advantages:

(a) characterization of policy.

(b) use the same model to evaluate the policy rules.

I use method 3.

Rowe-Yetman Test (update)

No predictable deviations from the target.

Use the monthly, year-on-year inflation rate:

$$\pi_{t+j} \equiv 100 \left(\frac{p_{t+j}}{p_{t+j-12}} - 1 \right)$$

$$\pi_{t+j} - 2.00 = \beta_0 + \beta_1 x_t$$

$$H_0 : \beta_0 = \beta_1 = 0$$

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I allow for a $MA(j - 1)$ error.

(We also could do an interval version.)

Monthly data: 1995:1 – 2008:3

x_t :

inflation

overnight interest rate

2-year bond rate

unemployment rate

core inflation

1-year bill rate

USD/CAD exchange rate

These tests easily reject with headline and core inflation:
 p -values are zero at all horizons.

Differences from Rowe-Yetman:

- (a) post-2001 data
- (b) monthly not quarterly
- (c) non-rolling
- (d) different x_t

Canadian inflation is predictable.

The unemployment rate has a negative coefficient. The price of the USD has a positive coefficient. Other effects vary with the horizon.

One reason for predictability might be PLPT ... which gives negative autocorrelation in inflation.

Next, apply the Rowe-Yetman method to PLPT.

Is Canada's Price Level So Predictable?

$$\ln p_{t+j} - \ln p_t - j \frac{\ln(1.02)}{12} = \beta_0 + \beta_1 x_t$$

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Again tests easily reject.

We can predict deviations from this trend at any horizon, using either CPI or core CPI as the base.

The unemployment rate has a negative coefficient; the exchange rate has a positive coefficient. The 2-year–1-year interest-rate spread has a positive coefficient.

Unlike KKKL I do not have a characterization of policy.

But there is some evidence against either strict IT or PLPT as a model of expectations.

A fact for a model to fit.

What next?

Real-time data ... real-time coefficients.

Forecast survey data ...

Apply to Sweden, UK, ...