

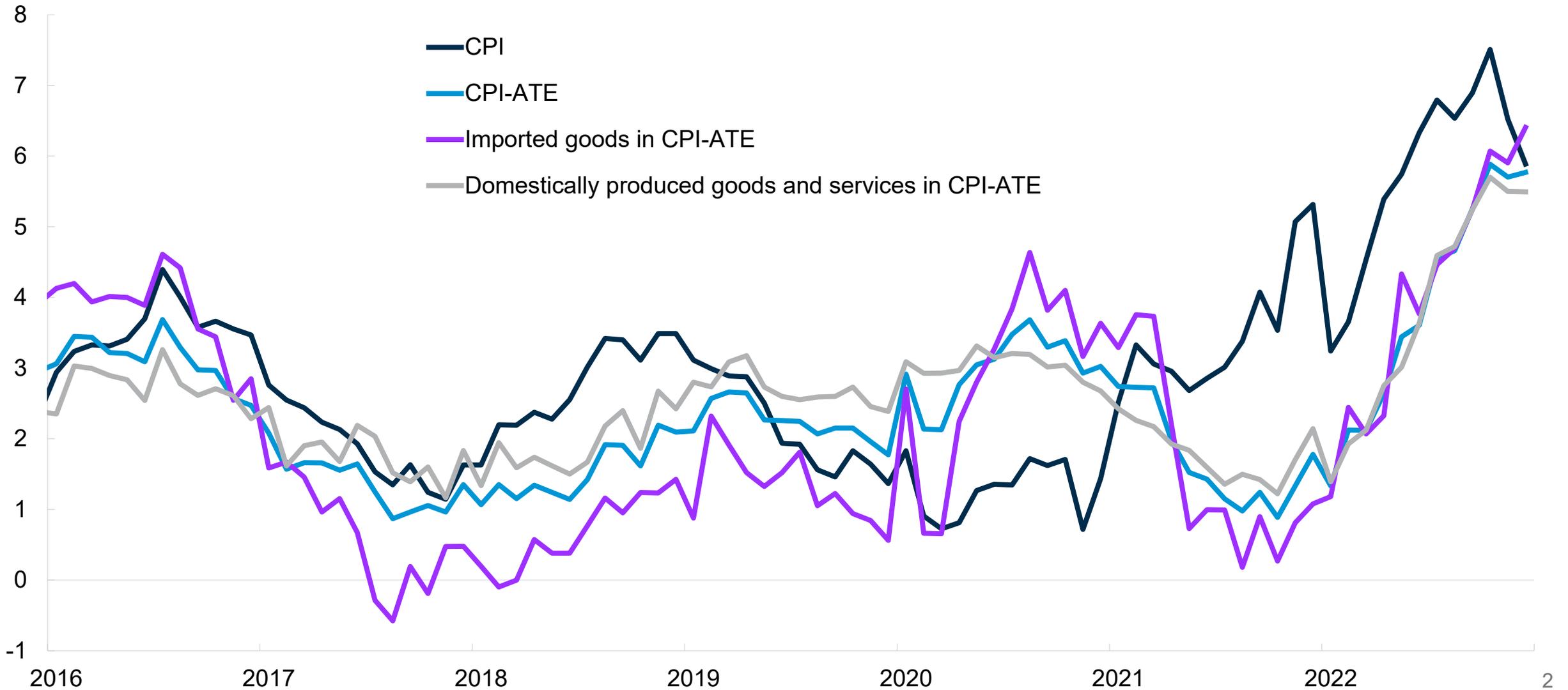
The role of the krone exchange rate under inflation targeting

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Inflation is too high

Sources: Statistics Norway and Norges Bank

Twelve-month change. Percent. January 2016 – March 2023¹⁾



Independent monetary policy

- A choice between a fixed exchange rate and an independent monetary policy.
- A fixed exchange rate implies that wage and price *levels* must adjust to levels in other countries.
- Inflation targeting means that the exchange rate adjusts so that price and wage *inflation rates* are consistent with the target.



Real exchange rate

Short run:

$$q_t = (v_t * p_t^{Abroad}) / p_t^{Home}$$

NOK amount per USD (points to v_t)
Price level abroad in USD (points to p_t^{Abroad})
Price level at home (points to p_t^{Home})

Price level abroad in NOK (bracketed under $v_t * p_t^{Abroad}$)

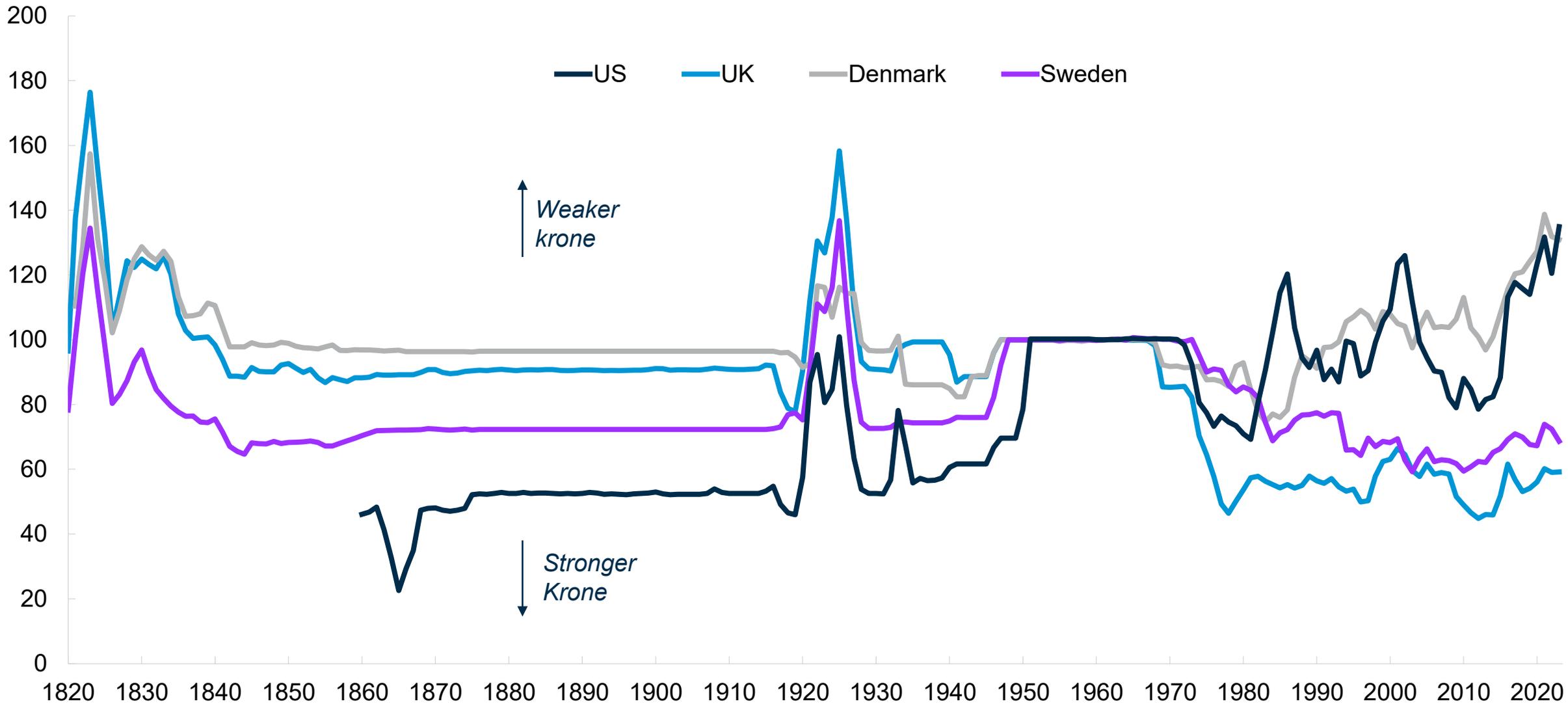
Long run: q^*



Longer periods of time under a fixed exchange rate

Source: Norges Bank HMS

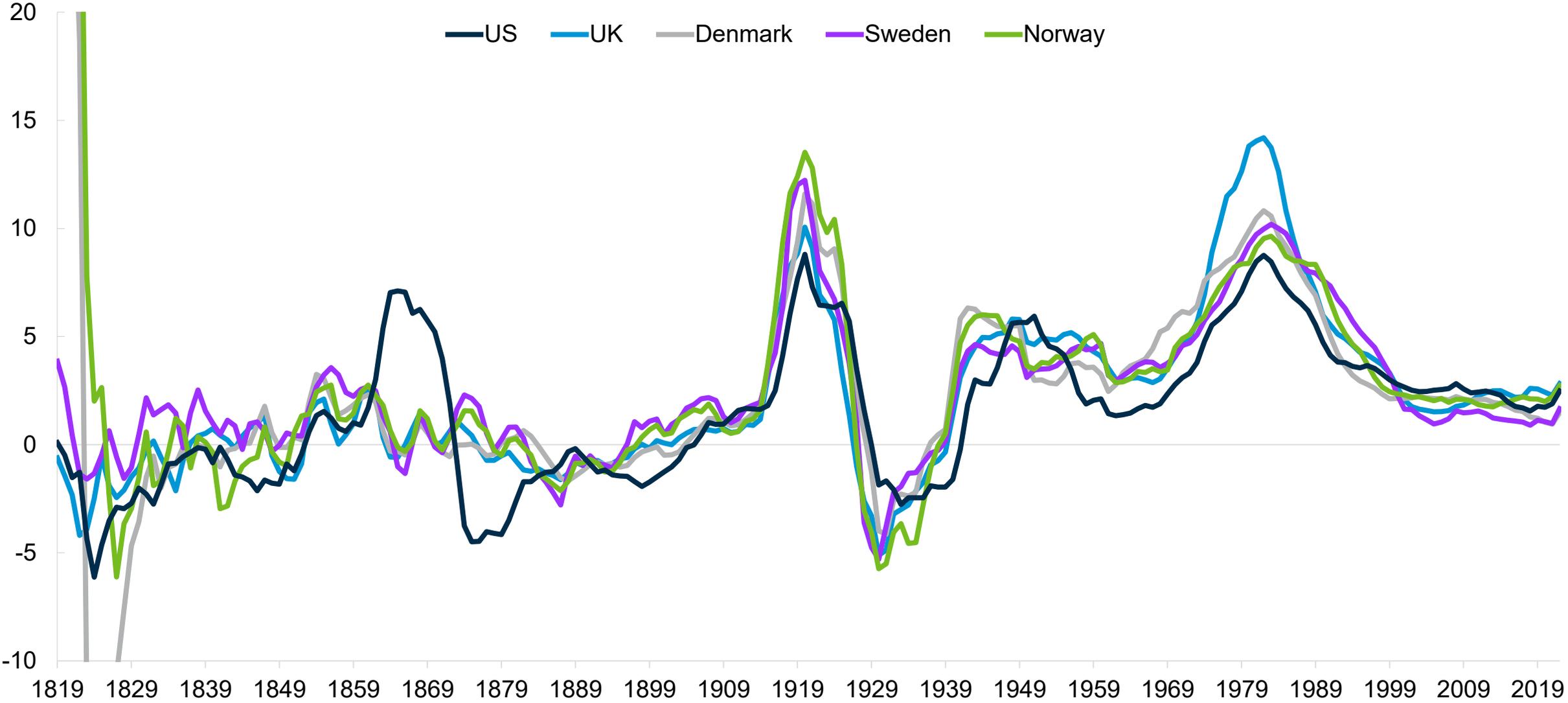
Indexed. 1960=100



Inflation

Ten-year moving average

Source: Norges Bank HMS



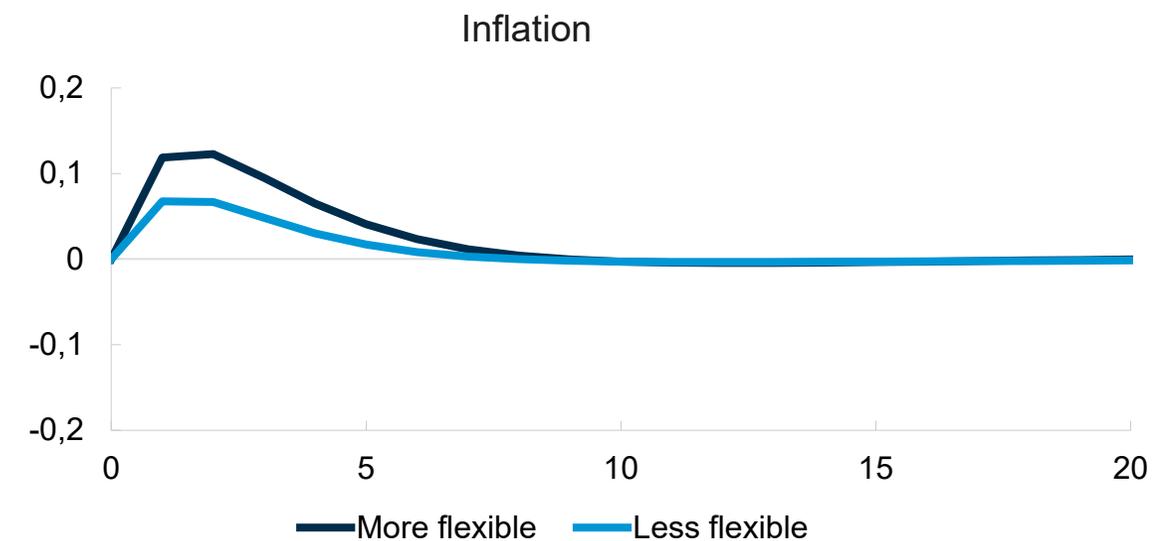
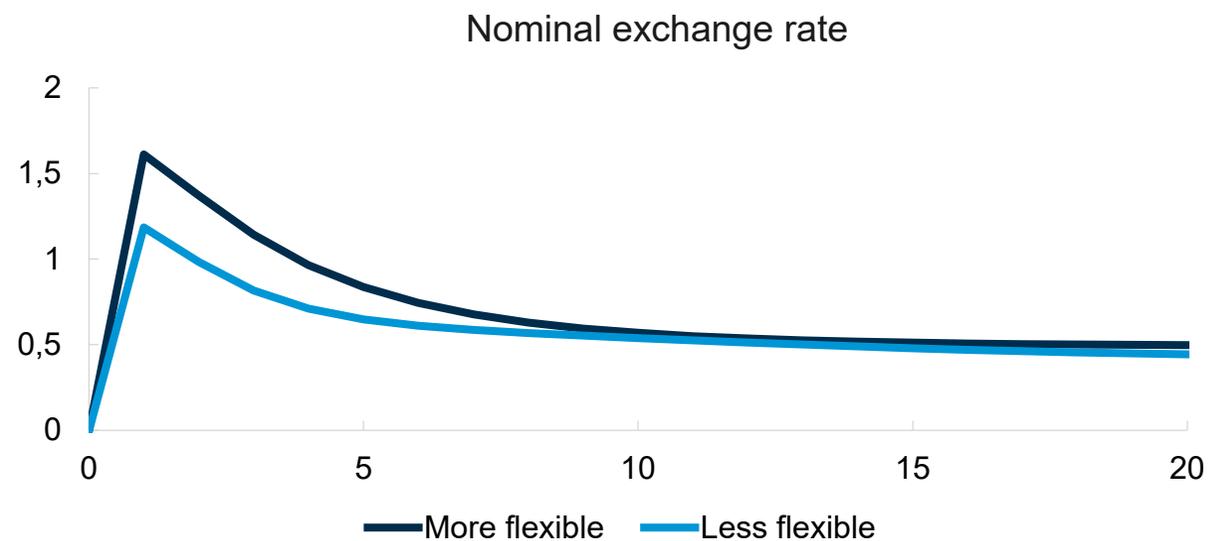
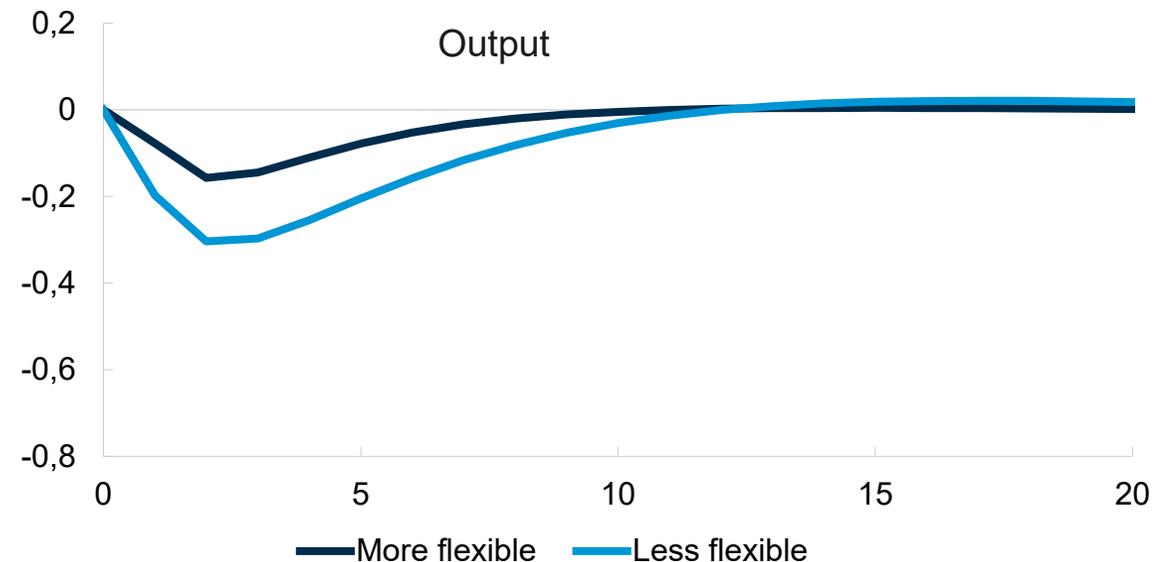
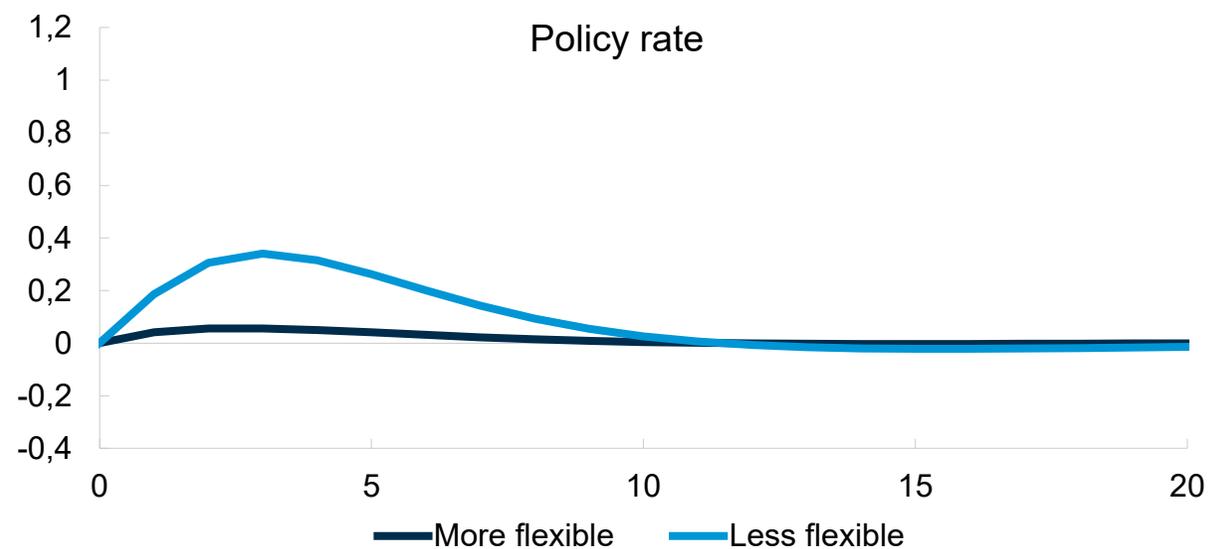
Model exercise

- Structural model for a small open economy
- Long-run real exchange rate
- Uncovered interest rate parity

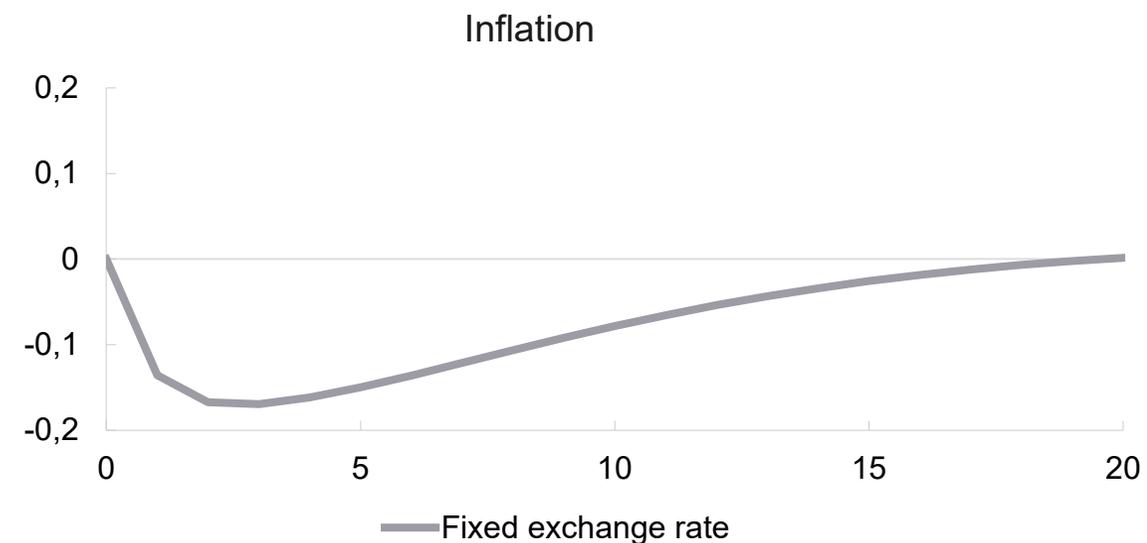
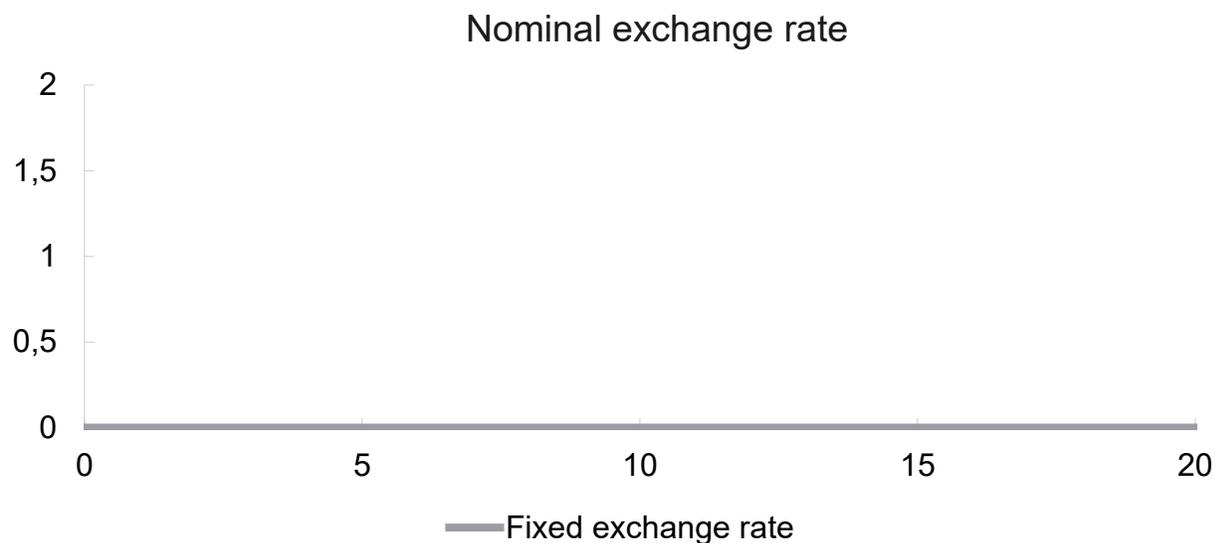
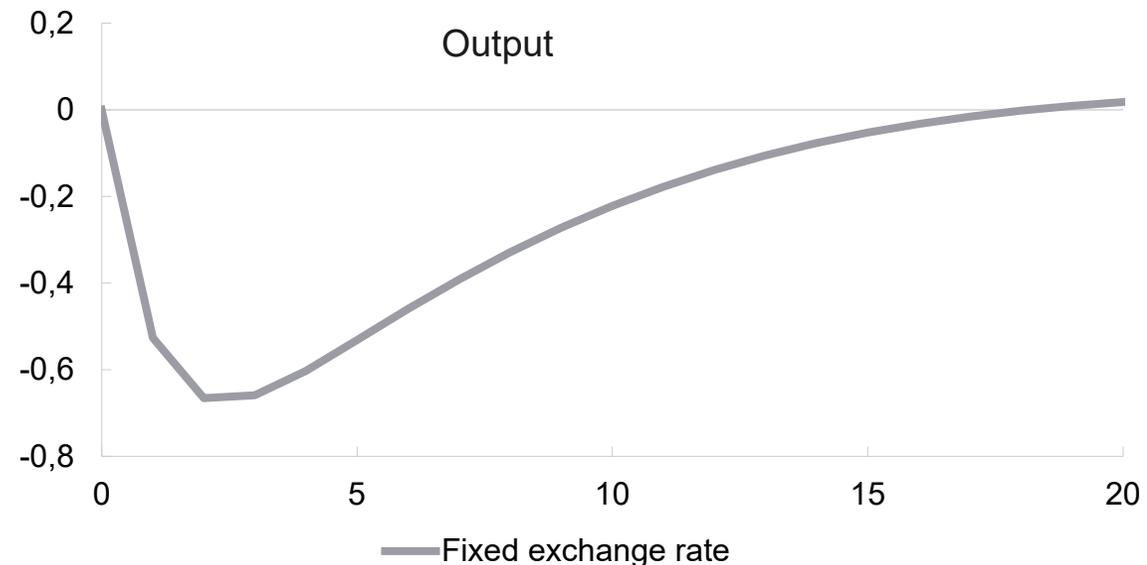
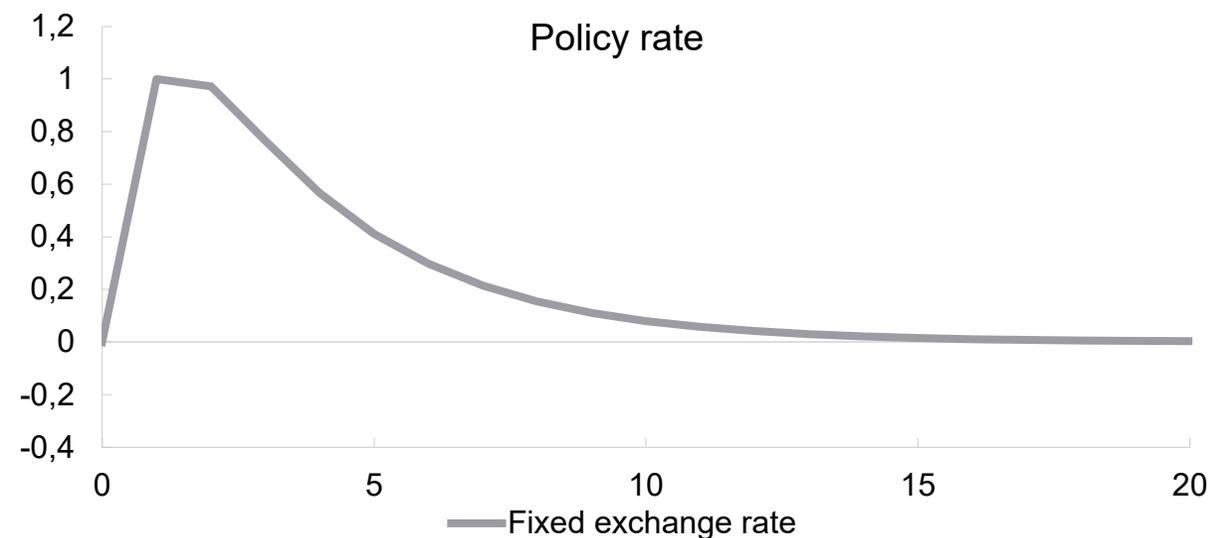


Higher foreign interest rates – flexible inflation targeting

Source: Norges Bank



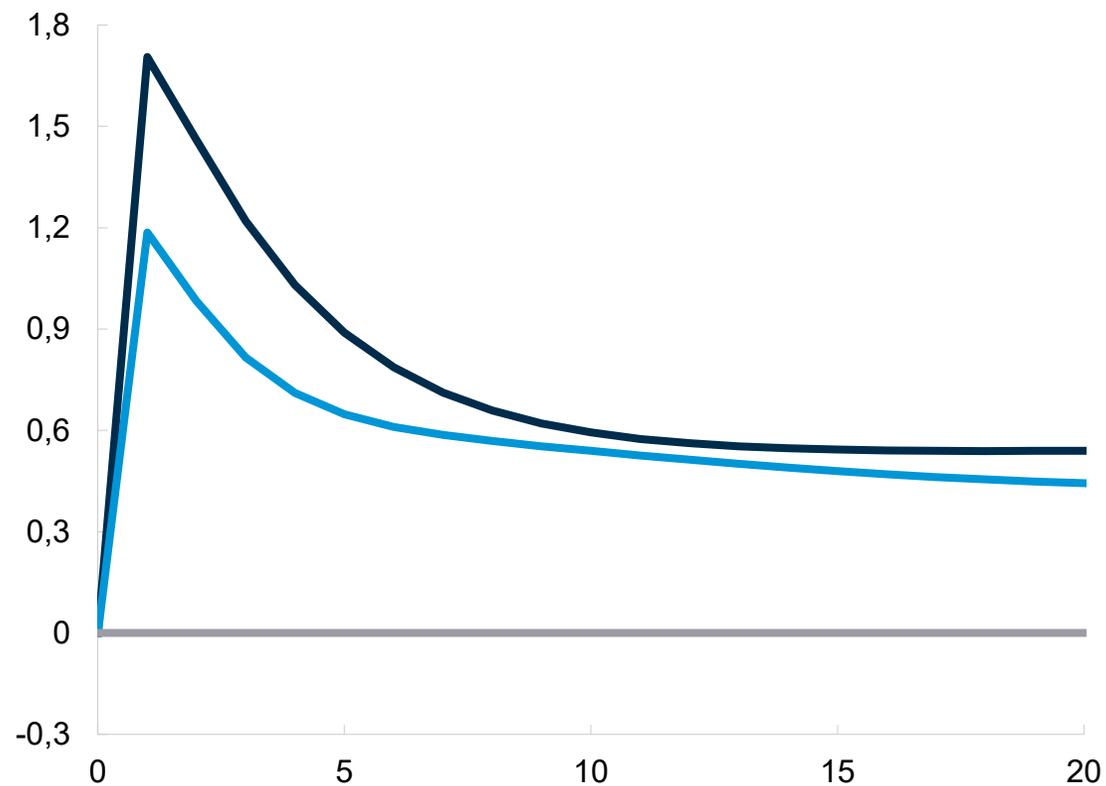
Higher foreign interest rates – stabilising the exchange rate Source: Norges Bank



Higher foreign interest rates – nominal and real exchange rate

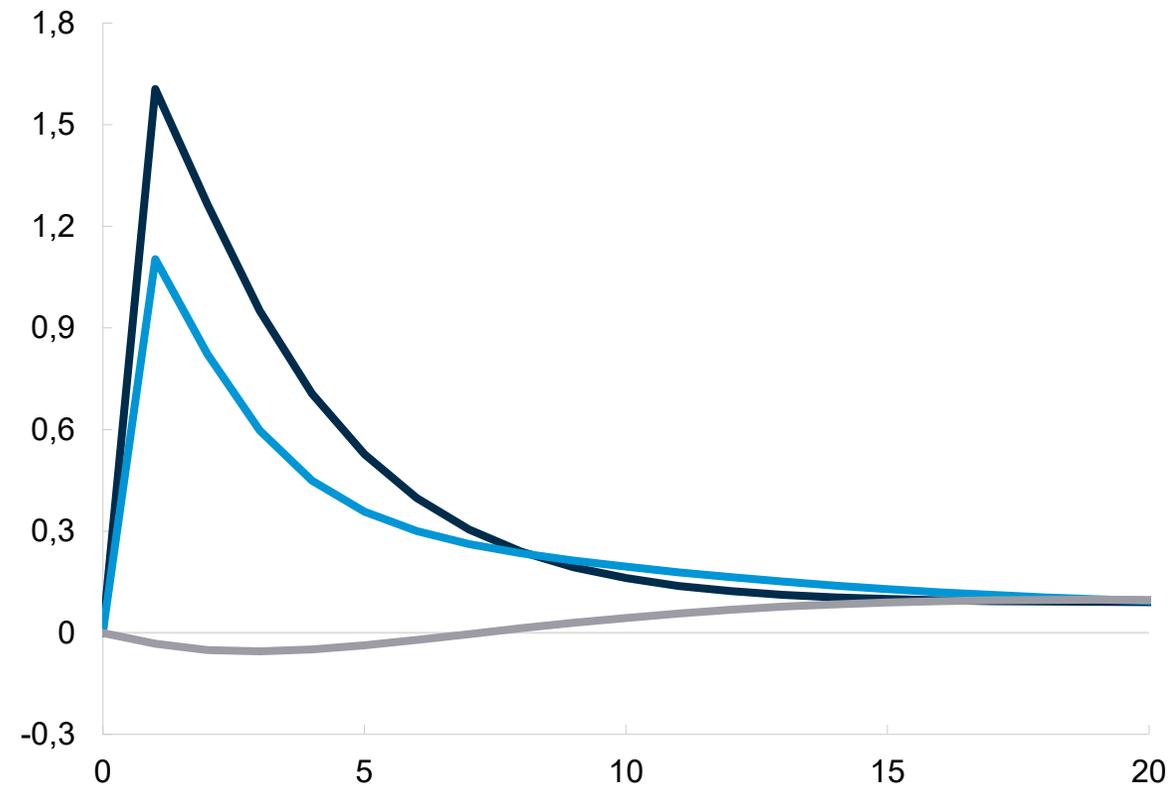
Source: Norges Bank

Nominal exchange rate



More flexible Less flexible Fixed exchange rate

Real exchange rate



More flexible Less flexible Fixed exchange rate

Conclusion

- Flexible inflation targeting means that we can promote other aims in response to shocks.
- Monetary policy is now geared towards bringing inflation down to that it approaches target somewhat further out.
- A floating exchange rate is what enables us to some extent to choose our own path.





Thank you for the attention!