Discussion of
Alexander Rathke, Tobias Straumann and Ulrich Woitek:
Overvalued: Sweden’s Monetary Policy in the 1930s

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Symposium “The Euro: (Greek) tragedy or Europe's destiny?”
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Put into context…

- Increasing popularity of inflation targeting since the 1990s
- Increased interest in price level targeting by academics and central bankers (e.g. as an option for Japan)
  - Pro: lower long-term variability of prices
  - Contra: higher short-term variability of prices (and output)
- Only one historical example: Sweden after 1931
- Simultaneously: very fast recovery of Sweden from the Great Depression
- Oversimplified conclusion: price level targeting caused the fast recovery from the depression
Main findings

- **Narrative part:**
  Price level targeting strategy was only rhetoric, Sweden did **not** pursue a strategy directed at stabilizing the price level
  - Instead, the Riksbank was mainly concerned about stabilizing the exchange rate with the British Pound

- **Model:**
  The Swedish growth miracle can instead be explained by the undervaluation of the Swedish currency
  - It was an export-led recovery

- **Not an innovative monetary policy (price level targeting) is responsible for the fast recovery, but a conservative one (fixed exchange rates with an undervalued own currency)**
Narrative part

• Timing of events:
  – September 1931: Swedish authorities abandoned Gold standard and announced the new strategy of price level targeting
  – July 1933: Official pegging to sterling
  – Quotations from Riksbank governor are from period after this (9/33, 36, 38): also evidence for strategy before 7/33, or only justification for official peg?

• Simultaneously stabilizing prices and exchange rate with only one instrument (interest rate) difficult: did rhetoric of Riksbank concerning price level targeting change after 7/33?

• Do your findings (no active stabilization of prices by Riksbank) preclude a positive effect of the announcement of price level targeting?
Index = 100 for September 1931.

- Source: Berg & Jonung (JME, 1999)
Role of expectations

• Your conclusion: Riksbank did not actively stabilize the price level
  – But: we still observe stable prices between 33 and 35
• Advocates of price level targeting:
  – price expectations of citizens were anchored
  – deflationary development was stopped
  – mitigated the output decline
• Citizens’ expectations important: (rhetoric of) price level targeting could still be efficient in the short-run
  – Is there historic evidence concerning the credibility of the announcement of price level targeting?
The Model

• Presentation of DSGE model is a bit confusing:
  – Which assumptions are standard in the literature: household, firms, market clearing, …?
  – Should make clearer which modifications explicitly take into account the Swedish situation in the 1930s

• What is the decision rule of monetary policy?

• Counterfactual analysis: no real devaluation
  – How is the model modified?

• Was the Krona also undervalued against other trading partners’ currencies?
  – Descriptive statistics of export shares could be helpful
Possible further applications of DSGE models?

• Application to study to which variable the Swedish monetary policy reacted, i.e. British interest rate or Swedish price level (in addition to narrative part)
  – Lubik & Schorfheide (JME, 2007) use a generic Taylor-type rule where monetary policy reacts to prices, output, exchange rates

• Use in a counterfactual analysis a Taylor-rule which reacts to price level
  – Covas & Zhang (CJE, 2010) compare welfare effects of inflation targeting vs. price level targeting in Canada