Comments on ”Report on ‘Inflation targeting is a success, so far: 100 years of evidence from Swedish wage contracts’ by Klas Fregert and Lars Jonung, May 26, 2008” by anonymous editor.

Klas Fregert and Lars Jonung

The use of a linear regression with 7 observations:

Since the regression of length against wage inflation variability fails to convince the reviewer beyond the graph, due to the low number of observations, we certainly consider deleting the regression. On our part, we felt that the use of degree-of-freedoms adjustment implied by the *t*-distribution made the regression admissible, but appreciate that this is a cause for concern. Regarding the claim that the regression is based on an incomplete model, we are not sure if the reviewer questions the derivation of wage variability as an ideal proxy given the assumptions of the Gray (1978) model or if he considers the Gray model incomplete.

Real uncertainty may lead to longer contracts

We dismissed the Danziger hypothesis model of contract length as a positive function of real uncertainty on two grounds: the consistency of the long-run data with the Gray model and the lack of support for it in the latest previous study (see footnote 10). In addition, we have failed to find evidence in the historical material on this effect, while there are several instances when the parties refer to the unclear business cycle situation when entering into short contracts. Finally and most importantly, we have dismissed the hypothesis as at odds with the historical evidence: long contracts are associated with stable output growth *and* stable inflation, e.g. during the last period of the “Great Moderation”, well documented on a global scale. The reviewer’s point is well taken and we will be more explicit about our reasons for dismissal of the real uncertainty effect.

The definition of a regime

We will clarify that our regime division is one of policy regimes rather than monetary regimes to take account of the reviewer’s point that a floating exchange rate regime as such or a “full employment regime” are not proper monetary regimes. What we label the “full employment regime” is one without a long-run nominal anchor. We will check our language to clarify our division into periods, which in itself we believe is conventional and used in many cross-regime studies.

The centralization effect on length

We included centralization in our regression as we relied on an extension of the Gray model by Groth and Johansson (2004). Instead of the expected positive effect, we found a negative effect on contract length. The reviewer's interpretation of centralization causing shorter contracts during high inflation is interesting. We will consider it briefly if we retain the regression.

What is the best evidence for the success inflation targeting?

In the last paragraph the reviewer mentions previous evidence on the success of inflation targeting: the quick convergence to low inflation and the decrease in the dispersion across forecasters of expected inflation around the target. The reviewer's comment alerts us to that there are several measures of the success of inflation targeting in addition to the mean and standard deviation of the inflation rate stressed in most studies. In addition to the long sample across many regimes, we stress that our measure, contract length, is an uncertainty measure which is closely related to inflation uncertainty. We will make some further reference to the literature on inflation uncertainty for comparison with our measure, including the dispersion among forecasters. All the suggested measures of inflation uncertainty are open to interpretation as analyzed i.a. by Giordani and Soderlind (EER, 2003). We have found only one study on the effect of inflation targeting on the dispersion of inflation expectations (negative as expected), Working paper 2007-11, Banco de México.