Excellence in Asset Management

Tito Nícias

"Is There Too Much Certainty When Measuring Uncertainty? A Critique of Econometric Inflation Uncertainty Measures with an Application to Brazil"

Comments by Gino Olivares
Chief Economist, Opportunity Asset Management, Brazil
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To keep in mind

“I often put the choice this way: You can get your information about the economy from admittedly fallible statistical relationships, or you can ask your uncle. I, for one, have never hesitate over this choice.”

Alan Blinder; **Central Banking in Theory and Practice**

“In Brazil, even the past is uncertain.”

Pedro Malan; former Brazil’s Finance Minister

Comments

- Nice paper, but not easy reading.

Three good points :

- Point 1: In some cases, the rational expectations paradigm has imposed too much restrictions on both theoretical and applied research. Economists used to (and many like to) assume too much certainty when dealing with uncertainty.

- Point 2: Unfortunately both temporal and theoretical inconsistencies are still frequent in economic research. It is an almost-ethical problem in economics.

- Point 3: Brazil is the textbook case of how serious, pervasive, and persistent the costs of price instability can be. Some of these costs still survive today, even in a low inflation scenario.

Comments

But there are some points deserving more discussion:

- I am not sure that we can blame the rational expectations paradigm for all the problems we economists have when dealing with uncertainty. In fact, we owe a lot to it!

- Bernanke and Mishkin (JEP 97): *"Inflation is largely unpredictable and hence not finely controllable"*. What is the exact meaning of stable inflation? What is an acceptable level of inflation uncertainty? What should be the evaluation horizon?

- Does "low inflation + well-anchored inflation expectations" encompass "low inflation + low inflation uncertainty"? I vote Yes.

- What should be the role of private inflation expectations in monetary policymaking?

Comments

The paper is naturally linked to very interesting and promising lines of research:

- Studies of properties of survey expectations: Gallo, Granger, and Jeon (IMF SP 02); Giordani and Söderlind (EER 03); D'Amico and Orphanides (Fed mimeo 06); Ang, Bekaert, and Wei (Fed wp 06), Mehra (Richmond Fed 06).

- Monetary policy with imperfect knowledge: Orphanides and Williams (IT book 04, RED 05). Example taken from paper on RDE 05: *"… we show that in the presence of perpetual learning careful monitoring and responding to the public's inflation expectations may lead to significant improvements in economic stabilization performance that are not evident under rational expectations with perfect knowledge."*

Tito, please continue writing on these topics!

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opportunity@opportunity.com.br

Rio de Janeiro

Av. Presidente Wilson. 231 28º floor
20030-021 - Rio de Janeiro – RJ
Tel.: 55 21 3804.3434 - Fax: 55 21 3804.3480

São Paulo

Av. Brigadeiro Faria Lima. 2277 17º floor
01452-000 - São Paulo – SP
Tel.: 55 11 3039.1201 - Fax: 55 11 3039.1240

www.opportunity.com.br