

The information content of the natural interest rate for central bankers

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Abstract

Since the mid 1990's much interest of the academic literature has been devoted to the natural rate of interest (NRI). However, central bankers are relatively reluctant to introduce this concept into their day-to-day decision making process. One possible reason is the high variability of the natural rate as measured for the short term interest rate, being the central bank's instrument.

In this paper, on the basis of Polish experience, I show how, despite the described deficiency, the NRI concept can yield important information for a central banker. First, an econometrically tractable definition of the NRI can be helpful for monetary authorities, seeking to stabilize inflation after a long process of disinflation. Second, for a country trying to join a monetary union there exists an additional information content of the estimated NRI. The bigger the difference between the candidates and the Unions natural rates, the more likely the "Portuguese" scenario of a widening current account after adopting the common currency. Theoretical considerations are supported by econometric estimation of the NRI for Poland. The country is currently finishing disinflation and on track to join EMU in a few years.

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