Principles 1 & 2 A Clear Nominal Anchor and Consistency Between Objectives

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Hello everyone, I'm **Susanna Grigoryan**, an economist at the **Central Bank of Armenia** and a **Level One student at the Global Forecasting School**. In this video, we'll turn to the first two principles that lie at the very heart of modern monetary policy frameworks — the principle of a **clear nominal anchor** and the principle of **consistency among objectives**.

The success of modern monetary policy rests on a small set of guiding principles that make policy credible, consistent, and transparent. Among these, the first two are foundational. Without a well-understood anchor, monetary policy loses focus and credibility. And without consistency among objectives, even a credible anchor can lose its meaning over time. As **Freedman and Laxton (2009)** emphasize, these principles are not theoretical — they form the operational backbone of successful inflation-targeting frameworks around the world.

Let's begin with the first principle — **a clear nominal anchor**. Think of it as the compass of monetary policy — the fixed point that helps everyone navigate uncertainty. It's what gives households, firms, and investors confidence about the future value of money. In an inflation-targeting regime, that anchor is the **publicly announced inflation target**, supported by credible communication and consistent actions.

The anchor plays three essential roles. First, it shapes expectations by giving people a benchmark for wage and price setting. Second, it enforces discipline, limiting short-term political or opportunistic pressures. And third, it builds credibility by anchoring inflation expectations, which makes policy more effective and predictable.

According to **Freedman and Laxton (2009)**, an effective inflation target must be **numerical, symmetric, and forward-looking**. In practice, this often means specifying a range — for example, one to three percent — with a midpoint focus. This approach provides flexibility without losing credibility. When expectations are well anchored, both inflation and output volatility decline, creating measurable welfare gains.

Canada's experience in the early 1990s illustrates this powerfully. Even before inflation had fully converged to the target, long-term interest rates began to fall because markets trusted that the Bank of Canada would deliver. That credibility made policy more effective. New Zealand's experience followed a similar logic — while its early framework focused on institutional design, Canada refined the analytical process that supported it.

Now, let's move to the second principle — **consistency among objectives**. A central bank must ensure that all its goals work together rather than against each other. When inflation control serves as the foundation, other objectives — such as growth, employment, and financial stability — can be pursued sustainably. But when short-term goals compete with price stability, credibility is undermined and everyone loses.

Freedman and Laxton (2009) showed that successful inflation-targeting regimes align all objectives under a single overarching mandate: maintaining low, stable, and predictable inflation. In well-designed frameworks, short-term trade-offs are recognized, but long-term consistency is never sacrificed. It's about being disciplined and flexible at the same time.

The **Bank of Canada's framework** demonstrates this principle vividly. By focusing on price stability as the path to long-run prosperity, the Bank avoided the temptation to fine-tune short-term outcomes. Similarly, the **Reserve Bank of New Zealand** evolved toward a flexible inflation-targeting regime, allowing for temporary deviations from the target during shocks while maintaining its credibility and long-term anchor. This alignment of objectives has been key to maintaining stability — especially in small open economies where exchange-rate and output fluctuations can be large.

Empirical evidence supports these lessons. Countries with clear nominal anchors and consistent objectives — such as **Canada, New Zealand, the United Kingdom**, and later **the Czech Republic** — have all experienced lower macroeconomic volatility and faster recoveries from shocks. Studies by **Freedman and Laxton (2009)** show that the greatest gains in credibility occurred where targets were explicit, communication transparent, and objectives consistent with one another.

These results remind us that clarity and coherence are not just principles of good design — they are measurable sources of public trust and economic welfare.

Finally, let's turn to what these principles mean for **Armenia's FPAS Mark II framework**. In FPAS Mark II, these first two principles define the structure and purpose of the entire forecasting and decision-making process. The **nominal anchor**, expressed as a clear and forward-looking inflation objective, guides scenario design, forecast discussions, and communication. **Consistency across objectives** ensures that the Central Bank's messages to the public, government, and financial sector are coherent and aligned.

This disciplined yet flexible framework allows policymakers to make decisions that are both credible and adaptive to uncertainty. It embodies the broader philosophy of **prudent risk management** that defines modern inflation-targeting practice.

To sum up, these first two principles — a clear nominal anchor and consistency among objectives — are what make monetary policy credible, coherent, and resilient. They ensure that even in uncertain times, central banks stay focused on what matters most: maintaining public trust and long-term stability.

In our next video, we'll move on to **Principles Three and Four**, exploring how monetary policy interacts with fiscal policy and the real economy. Thank you for watching, and I look forward to seeing you in the next episode of the **CBA Academy**.

See you there.

Literature & Further Reading

- Adrian, T., Obstfeld, M., & Laxton, D. (2018). *Advancing the Frontiers of Monetary Policy.* IMF.
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