

QUASI EX-ANTE INFLATION FORECAST UNCERTAINTY

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ABSTRACT

We argue that the *ex-post* measure of forecast uncertainty developed from the distribution of inflation forecast errors differs from the corresponding *ex-ante* measure because of the impact of monetary policy decisions. We derive a proxy for inflation uncertainty, called *quasi ex-ante* forecast uncertainty, which is to an extent free from the effects of monetary policy decisions. This proxy is computed using the parameters of a weighted skew normal distribution fitted to forecast errors. This in turn leads to the development of the measure of the *compound strength* of monetary policy and the *uncertainty ratio*, which shows the relative impact of monetary policy on reducing inflation forecast uncertainty. A nonlinear relationship is found between compound strength and the measures of the independence and transparency of central banks for 38 countries. The *quasi ex-ante* forecast uncertainty is used for computing the inflation forecast term structure for the BRICS countries (Brazil, Russia, India, China and South Africa), the UK and the US. It is concluded that the greatest policy effect in reducing inflation forecast uncertainty is for countries which conduct either well-established and relatively pure inflation targeting policy, like South Africa and the UK, or clandestine inflation targeting, like India and the US. The smallest reduction is for countries like China and Russia that mix inflation targeting with exchange rate stabilisation.