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Title	Inflation, Inflation Uncertainty, and a Common European Monetary Policy
Author(s)	Fountas, Stilianos
Publication Date	2001
Publication Information	Fountas, S., Ioannidid A. & Karanasos M. (2001) "Inflation, Inflation Uncertainty, and a Common European Monetary Policy" (Working Paper No. 0054) Department of Economics, National University of Ireland, Galway.
Publisher	National University of Ireland, Galway
Item record	<a href="http://hdl.handle.net/10379/1195">http://hdl.handle.net/10379/1195</a>

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# **Inflation, Inflation Uncertainty, and a Common European Monetary Policy\***

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**Working Paper No. 54**

**September 2001**

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\* Acknowledgements: The authors would like to thank Alex Cukierman, Soren Johansen, Marika Karanassou and Paul Mizen for helpful comments and suggestions. They are also grateful to participants in the 5<sup>th</sup> Annual Conference on Macroeconomic Analysis and International Finance (Crete 2001) and the conference on EMU Institutions and Macroeconomic Policies (Milan 2001). The usual disclaimer applies.

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## **Abstract**

The relationship between inflation and inflation uncertainty is investigated in six European Union countries for the period 1960 to 1999. EGARCH models are used to generate a measure of inflation uncertainty and then Granger methods are employed to test for causality between average inflation and inflation uncertainty. In all the European countries, except Germany, inflation significantly raises inflation uncertainty as predicted by Friedman. However, in all countries except the UK, and possibly Italy, inflation uncertainty does not cause negative output effects implying that a common European monetary policy applied by the ECB might not lead to asymmetric real effects via the inflation uncertainty channel. Less robust evidence is found regarding the direction of the impact of a change in inflation uncertainty on inflation. In Germany, the Netherlands, and to a lesser extent Spain, increased inflation uncertainty lowers inflation while in the UK, Italy, and to a lesser extent France, increased inflation uncertainty raises inflation. These results are generally consistent with the existing rankings of Central Bank Independence.

**Keywords:** EMU, Exponential GARCH, Inflation, Inflation Uncertainty

**JEL Classification:** C2, E31