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Tiivistelmä-Referat-Abstract <p>This thesis considers the relationship between inflation and inflation uncertainty in Finland, Germany and Sweden in the past 35 years. The hypotheses by Friedman (1976) and Cukierman and Meltzer (1986) are considered. We also investigate whether the introduction of the common monetary policy on the euro area in 1999 has influenced inflation uncertainty in Finland and Germany. In addition, we examine whether the introduction of inflation targeting in 1993 by the Finnish and Swedish central banks have significantly affected inflation uncertainty.</p> <p>It is commonly accepted, that the main cost related to inflation arises from inflation uncertainty. Friedman (1976) suggested that higher inflation leads to higher inflation uncertainty, and therefore policies lowering inflation should also reduce uncertainty and thus the costs related to inflation. Cukierman and Meltzer (1986) proposed a reversed causality relationship, where higher inflation uncertainty leads to higher inflation. These hypotheses are discussed in the theoretical part.</p> <p>Inflation uncertainty is modelled with GARCH-in-mean (GARCH-M) specifications, where the conditional variance of inflation serves as a proxy for inflation uncertainty. The GARCH-M model also allows for determining the direct relationship between inflation and uncertainty. Asymmetric effects of uncertainty to positive and negative inflation shocks are determined with the GJR-GARCH-M model. The CGARCH-M specification, which differs between long term and short term uncertainty, is also utilised.</p> <p>Friedman's hypothesis is broadly accepted in the empirical part of the thesis, while support for the proposition by Cukierman and Meltzer cannot be found. Thus policies lowering and stabilising inflation, such as inflation targeting, should reduce inflation uncertainty. Although some evidence in favour of a decline in inflation uncertainty since inflation targeting was introduced by the Bank of Finland and the Riksbank can be found, the results depend on the preferred specification. In addition, inflation uncertainty seems to have increased rather than decreased in Finland and Germany in connection to the EMU, although the results are diverse and especially for Finland the size of the effect is almost negligible. However, despite the clear decline in average inflation during the past 35 years, no significant decline in inflation uncertainty has occurred in connection to the ECB.</p>			
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