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A CEPR/ESI Conference "Old Age, New Economy and Central Banking"

14 September 2001

A shrewd title for the conference! You see, "Old Age", in its ambiguity, is meant to be the gracious way to include central bank decision making, and the occasional central bank governor in these discussions. For this I am thankful. My colleagues in the Bank know that long ago Juha Tarkka converted me to the view that policy oriented research, and constant dialogue with other research institutions, is increasingly important for us. The policy relevance of this particular conference is certainly proof of this. In order to engage productively with the academic world, central banks have to allocate sufficient resources to research, and, as Juha Tarkka has argued in this institution, in order for such an effort to be worthwhile, the investment must be on a consistent, long term basis, and it must be strictly focused.

I appreciate the privilege of being allowed to address this gathering.

Coming to the topic of the conference, let me admit straight away that the more I read and hear about the New Economy, the more my own interpretations shift towards the conclusion that the New Economy is neither unique nor new. Even the exuberant rate of return expectations and the related over-investment into itc in the second half of the 90's seems a repetition of behaviour in connection with major technological advances in the past.

As is to be expected from a central banker, I would certainly be very sceptical about monetary policy doctrines carrying New Age connotations. Nevertheless, the operating environment of monetary policy has changed. But it has been a very gradual change, resulting at least as much from deregulation and internationalisation as from the adoption of its technology. That process has been going on for a long time, long before anyone had invented the "New Economy". From a monetary policy point of view the two important elements of that long term change are, in my view, <u>first</u>, that markets' access to relevant information is identical to that of policy makers, in real time and with few exceptions; <u>second</u>, that trading in financial markets has become (technically) ever more efficient and indeed on a globalized basis.

Although most of this got under way long ago, it may be that on the official community started adjusting to this change in the environment rather slowly, often reluctantly. Not least for this reason, the relatively recent prominence of credibility, transparency and accountability in research agendas has been such an important development. It had to emerge as a major issue in the wake of the changed environment, and in the light of some painful regime failures in the early 90's. The greater emphasis on price stability and the independence that in a great number of countries was thought to be necessary for a central bank's credibility and effectiveness certainly were an important elements in promoting interest in accountability and transparency.

I would not say that this globalized situation is a more difficult environment to cope with for a central bank, but it is certainly different. It is a healthier situation in many repects. The very existence of market anticipations and real time reactions is a powerful force tending to weed out what one might call "rhetorical and political window dressing" from policy making. The real time flow of information by itself brings a kind of inevitable de facto transparence and at least a measure of accountability. It is easy for the market to see and to assess economic policy in general and monetary policy in particular. This is a healthy development; after all, all interest and exchange rate policy impact households and companies in major way.

Also the macroeconomic behaviour of economies changes, although in subtle and less easily identifiable ways.

Some say that productivity growth has shifted the Phillips curve inward, in the US and perhaps in some other economies, possibly for a lengthy period, meaning that higher productivity growth would coincide with – or could be made to coincide with - a widespread expectation of solid price stability continuing, allowing lower unemployment without fuelling inflation. – This would be an extremely attractive prospect. But we really cannot judge whether, in what social and political circumstances, and where, this is at all likely. And where all would seem to turn out nicely, prudently we would have to assume that at some stage the constellation would turn around and real wage demands would catch up with productivity growth.

What we do know is that every assumption about productivity growth, for the next few years at the very least, will be uncertain, to say the least.

This means that some of the standard pillars of policy debate, like output gaps and nairu's, are eluding us. They may remain useful conceptually but are nevertheless neither quantifiable nor a priori stable enough to be useful when it comes to deciding responsibly on policy.

And what about the transmission mechanism of monetary policy? We have identified a number of channels and effects, but how much do we really know about their relative importance in the kind of fluid world in which we live – in that "slice" of a constantly evolving constellation that we happen to inhabit at any given moment, with balance sheets, market structures, institutions, behaviour patterns shifting all the time. How much of the accumulated analytical research could possibly provide ground solid enough to allow reasonable assessment of the likely consequences of alternative policy choices? Analytical work is advancing impressively on all fronts, but at the same time the world has gone into a mode of continuous change.

Thus there is probably less and less of theory that one could responsibly commit monetary policy to.

Fortunately, as we take on board all these vagaries, at the same time we seem to be getting rid of some inconvenient ballast that perhaps looked a little bit too conspiratory for comfort, namely the notion that unanticipated policy may reduce real disturbances. What a relief. Unanticipated policy is not an enormously credible possibility in the kind of world into which we have been moving. Ambiguity is a poor policy to sell; it assumes an uninformed public and an uninformed professional market. Fortunately, we do not have that.

All clearly specified monetary policy decision rules, like the popular Taylor rule along with all its variants, depend on reasonably solid knowledge about key inputs, one being the output gap, or equilibriu real interest rates, etc. My lay impression is that not much of that is available with the kind of probability that one would look for in public policy discussions.

This means that the credibility of monetary policy cannot be based on a central bank locking itself in by means of a specific irrevocable commitment. The possibility of such locking in of the central bank features prominently in analytical debate outside the central banking community, but it is probably an illusion, a will-o'-the-wisp? (Currency board regimes being a separate regime altogether, and I do not think we are generally looking for last resort regimes.)

All this is not a problem for the ECB in particular. It is a reality for all central banks operating in market economies. This will be clear to those who have read Bob Woodward's recent account of monetary policy making in the US in the 90's. I suggest that it be read with professor Mankiw's recent essay as a companion.

Whenever monetary policy really matters, i.e.. when the outlook is a cause for great concern, there is so much uncertainty in the air about current and future behaviour, including previous policy decisions still working themselves out in the pipeline. Any policy measure to be taken will overlap and interact with many other past and future decisions.

So there we are, pretty naked (or perhaps: naked, but not pretty).

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Obviously, so are those who analyse and comment on central bank policy. For that reason, the commentary does not always advance our understanding of what would be a way forward. This applies equally to criticism as well as the occasional approval.

There is another reason: It is often difficult to precisely pinpoint the target and focus of a comment. Quite often a comment is not really about how the ECB conducts policy but about whether and how Maastricht should be changed. Often a desire to achieve a shift in the objectives of ECB policy is involved, away from the primary role of price stability.

I am of course more interested in suggestions as to how we might best accomplish the task within our mandate, by which we are bound. Of course the mandate may also be an interesting subject of inquiry, but it belongs in a different compartment.

For the ECB, there can be no question about the primacy of price stability as an objective. The Treaty is very explicit on this point. Other possible objectives, including the exchange rate, are strictly subordinated.

I have some difficulty imagining how we would in practice pursue secondary objectives in parallel with a primary goal, having only an interest rate at our disposal. There would occasionally be scope to let those secondary concerns weigh in the setting of rates, but it could never be anything systematic and consistent. One wonders whether analytically a case can credibly be made for such on/off occasional fine tuning of occasional objectives. In popular political debate, there are, as you know, constant demands of this kind, so this is not an impertinent remark to make.

Having expectations of low inflation, i.e. monetary stability, firmly in place is really irreplaceable in providing the conditions for pursuing all those other policies immediately concerned with the real economy and human welfare. This is in my view no minor point.

Getting expectations of monetary stability firmly is in itself an enormous job for monetary policy. My personal prejudice is that, apart from good faith, transparency is more important than anything else. We cannot hope to forecast accurately. Nor can we be sure about the precise impact of our decisions. And since the public knows this, and is in any case more enlightened than we the establishment like to think, it does not enhance credibility to pretend that we know everything and are always fully in control. It is enough, but then also very important, that the public knows that the central bank is not shy about adjusting its view as the facts change.

Transparency clearly means different things to different people. To me, its essential content is that the broad public has

- clarity about the objective(s) of monetary policy
- clarity about the central bank's diagnosis of the economic situation and the outlook
- certainty about the central bank's determination to pursue consistently its declared objective.

Communication then becomes quite important. Above all else, it has to be open , and it has to be directed to a broad public, because this is where the expectations of price stability have to be anchored. It goes without saying that correctly guiding the "markets" is also important, but this is so for somewhat different reasons, and it is a less difficult job. The financial markets are sophisticated in this area and I would claim, that whatever their posturing, they are rarely misled.

Communication is an area where the ECB is often faulted by the media and the markets. This being the case, we should take it seriously, of course.

But perhaps the critics are both right and wrong. It is not helpful if the public and the markets are confused by what they perceive as possibly contradictory statements about the intents and reasoning in monetary policy, or if the information is too scant to allow the public to make an assessment of the policy. This is an area in which the ECB probably can and should improve.

But there is also another angle to this. Every policy decision results from weighing a number of pros and cons. In the end a judgement is made. It is an unambiguous outcome that can and will be communicated as it comes out from the discussion. But, it is also a fact that the pros and cons remain, along with the mass of partly contradictory indicators, as the basis of the decision. We should therefore perhaps not be shocked if the members of the decision making body, in their efforts to "open up the decision" for the public by explaining the various considerations that went into it, use their own words and thereby risk being interpreted as representing different nuancings. It is self evident, and desirable, that members of a decision making in the the area of public policy bring their own views to the table, as the input for the process of coming to common decisions.

Some of the central banks practising inflation targeting even publish summary minutes or voting records. Outside analysts have not been of the opinion that this would have reduced their credibility, quite the contrary. A relatively broadly based engagement with the media and the broad public is a hallmark of the ECB. This is in part due to its non-federal institutional basis. But it is also more in tune with a world in which everyone who so wishes has equal and real time access to facts, information, analysis and forecasts, and in which we know that nothing, literally nothing but the trivial, is certain.

In line with what I earlier set out regarding transparency, I believe in accepting and indeed encouraging open debate in all areas of public policy.

So, even if some of the debate about the ECB's transparency and its communication profile has been tongue in cheek, it is, as usual in an engaged debate, for a good cause, with great conviction and in good faith.

My personal conclusion from all this is that a devoted involvement on the part of the academic community is highly desirable. If it is to weigh in public debate, it must of course be visible, which by the way is important also as a counterweight to the populist brand of debate that tends to get more attention.

My second conclusion is that central banks, the Eurosystem central banks included, should consider own research as fundamental to their ability to participate in the shaping of policy and in the debate. Their involvement in the public debate is needed; otherwise the academic community has no one to debate with.