Peterson Institute for International Economics

Central banking for open economies in a changed world
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[00:05:11.19] - Adam Posen

If we could ask everyone to take their seats, please. We'll get started in a moment. When we're dealing with central bank governors, we try to start on time. There's this little thing called markets out there. Hello everyone and welcome back to the Peterson Institute for International Economics. I'm Adam Posen, the Institute's president. I will not be moderating today. I am delighted and proud that our longtime colleague Patrick Honohan, former governor of the Central Bank of Ireland and leading applied economist in many fields, will be moderating today's panel. But I just wanted to welcome our in-person high-level guests as well as our many friends around the world online for today's event, part of our spring meetings programming. It's on the one hand, given the serious things going on in the world, it is not light thing to be springy. But on the other hand, the fact that people of good faith trying to serve their publics and the world can come together and speak frankly about the challenges and try to come together constructively continues to put spring in my step and motivate the Peterson Institute. And one of the things we are proud of doing is around the IMF, World Bank, G7, G20, G24, G60, G-whatever meetings, convening groups of officials, particularly central bankers, former central bankers, and others to talk constructively to the general public in the interest of world.

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And today is a perfect example of that. We are very fortunate to have four first-rate sitting central bank governors who are confronting the theme of today, which is if you're a small open economy, which is everybody but the US and China. How do you manage in a world of energy shocks, in a world of geopolitical uncertainty, in a world of changing reserve quality, in a world that we're in? And again, my distinguished colleague Patrick Honahan will be introducing each of the governors and moderating the discussion. I just wanted to make two other points. The first is, that we are doing a lot here this week, and we're hoping many of you will join us for more than just this event, um, including later this week, uh, some events regarding international imbalances and financial stability and the— what I would call decentering of the dollar. Um, and apropos of that, I want to announce that Klaus Nott the former Dutch Central Bank Governor and former Chair of the Financial Stability Board, is now joining the Peterson Institute as a distinguished visiting fellow. And watch this space, there will be others coming. We're very proud to take the serious central bankers and give them space, time, and a little bit of constructive criticism.

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On how to think about things. But with that, let me turn it over to my colleague Patrick for today's event.

[00:08:58.20] - Patrick Honohan

Central banking for open economies in a changed world. Well, I think a very appropriate topic for us to discuss today, and the four countries represented by our speakers are certainly countries that have benefited from not only their open economies but an open world trading system. So it's a very interesting time for central banks, both in the sense of this week and next week and next month, but also this year and next year. Let me not take time talking here.

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Let's—

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let me tell you who we have. We will begin with Jose Luis Escrivá, he's the 71st governor of the Bank of Spain. He was appointed in September 2024. Because of that, of course, he's ex officio a member of the ECB Governing Council. So he has a vote on the euro interest rate decisions. He did many things in his career up to now. European Monetary Institute, the precursor of the ECB, he was a senior official in that in the 1990s. He then worked with BBVA Bank, Banco Bilbao Vizcaya Argentaria. And then he worked at the Bank for International Settlements in Mexico. And then he was the head of Spain's fiscal watchdog. Following that, 2020 to '23, he was the Minister for Inclusion, Social Security, and Migration. So I think he has a very— he's seen it from all, not just both sides, but all sides. After him, we move on to Anna Brehman. Anna is the Governor of the Reserve Bank of New Zealand, the inventor of inflation targeting— not herself personally, but their bank. Her PhD is from the Stockholm School of Economics. She worked at the World Bank. She worked at the Swedish Ministry of Finance.

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She worked at Svedbank. And the Riksbank, where she was first deputy governor. And she joins a small and select group of individuals who have been governor of a central bank of a country other than their native land. I think that's a very interesting profile. After Anna, we have Martin Schlager. Martin is the chairman of the governing board of the Swiss National Bank. He's been that since May 2022. His career— his PhD is from the University of Basel. His career has been mainly at the Swiss National Bank, periods of university teaching, and at the IMF. And what was I going to say about him? Yes, I was going to say— I was going to remind you, not a surprise, that of the four countries, the Swiss wins out in terms of low inflation. During my lifetime, I just calculated this morning, Swiss inflation averaged 2.1% per annum. So quite an impressive performance going well before the invention of inflation targeting. Final speaker is Chang Yong-Rhee. Chang Yong is the governor of Bank of Korea. But if you come back in 2 weeks' time, he won't be the governor of the Bank of Korea because it's the end of his term, 4-year term.

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That they get there. He's been that since April of 2022. His PhD is from Harvard. After an academic career in the United States and Korea and official positions in Korea, he was Chief Economist of the Asian Development Bank. He was then Director of the IMF Asia-Pacific Department, 2016-2022. So he'll be the last speaker. Each of them will speak for about 8 minutes. This podium, and then I want them to all sit up here, and we'll have a bit of a discussion, and then Q&A from the audience. So be preparing your questions. So first of all, José Luis.

[00:13:05.21] - José Luis Escrivá

Good afternoon, and thank you very much for, for this invitation. 8 minutes, I will jump immediately to the presentation. In this first slide, in a nutshell, what I would like to convey to you is what I think are the 4 major challenges central banks are facing now, we are facing now, and organized according to 4 functions. First, financial stability, I think, is the growing increasingly over time of the non-bank financial institutions sector and trying to grasp the interlinkages they may have with traditional banking sector. On payment systems, we need to design or redesign our role as central bankers in a world which will be also increasingly over time tokenized in many respects. And supervision, those who have supervision like us, I think the keywords are to me modernization in some respects and simplification of the frameworks. And monetary policy, that is going to be the center of my presentation, I think, not surprisingly, we need to deal with extremely high uncertainty and try to design policies that are robust in this context. Robust monetary policy under high uncertainty. To me, the key tool to deal with this is scenarios. We need to work internally and also in communication with the scenarios.

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And the reason for that is because We are in a context of Nantian uncertainty and in this context where risk in the very fat tails, in the tail risk might materialize. COVID was one of these, but think for a moment that the oil price shock that we had is also a tail risk, as you can see in this slide. So I think that Against this background, we really need to work in order to be able to deal with this extremely uncertain scenario or world with the scenarios. Also because sometimes we are confronting with distribution without model, without model or b-model. And certainly the standard tools, linear ones, are not appropriate for that. And in doing so, in designing and working with the scenarios, both in our internal decision-making and also to some extent in our communication, we face trade-offs. One first trade-off is the distribution of responsibilities between the staff and us as governing, as decision-makers. And the staff normally are responsible for the central scenario, but I think when we are working about alternative scenarios, they need to represent correctly the uncertainty that we feel internally in the decision-making bodies. That's the reason we need to think about it and to rethink how these responsibilities are shared.

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The number of scenarios. I mean, I hear there is also a trade-off between richness and complexity. It needs to represent the entire distribution, but at the same time, we need to streamline in order to be able to be operative. And then external communication, this is to me very difficult. Because we have to be transparent and open, but at the same time, I think if we just were to communicate all this complexity in which we have to make the decisions, probably we would confuse many people. We have to be prudent in this respect. So the challenge is also how to construct the scenarios. I have taken as an illustration what we have just done in the Governing Council of the ECB for the previous meeting, and we continue working on that. And we have also worked in the Bank of Spain in a similar fashion for our analysis for the Spanish economy. So first, a central scenario, which is a traditional baseline scenario, should be made on market prices, on technical assumption, as we have done for some time. And this is, by the way, this is a scenario that came up with the cutoff date of March.

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I'm using as a representation of the scenario one particular variable that you can understand is the most important one now, which is oil. We work with an alternative scenario where the shock in terms of oil is more intense also, but the duration differs not too much. And a third scenario, a tail-reality scenario, which, as you can see in the chart, is not only more intense, but also the duration is longer and probably we don't end up where we started. But more importantly, I would think in the design of the scenario is not only the shocks, the duration and the size of the shock, but also how we model with our instruments the agent's reaction. In the central scenario, I think makes sense to use our regular elasticities of our models, but what we are working with alternative scenarios in addition to the size and the size of the shock, I think we need to work with, and we are doing so, with the stronger impact via remaining with traditional channels, but amplifying some of the impacts on the channel. Finally, when we are in detail, I think it's important, but we already witnessed that this might prove relevant in 2022, for instance, that we work with nonlinearities, with asymmetries, with more intense second-round effects.

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This is the way I think we need to work for internal discussion. For external communication, as I said, this is more tricky. And I think in this context, there should be a sort of caution, in particular, in one particular respect, which is the reaction function. I think that while in the centralist scenario, we all do it, we use market prices, our expected policy embedded in the yield curve. For the alternative scenarios, this is not so easy. Internally, I imagine we work with optimal policy rules, with different reaction function as regards how we are going to react to these new potential scenarios. But this is very difficult to disclose and would be counterproductive actually in the current. So I think that's a hindrance when we communicate. Also, I think— is very relevant at the current juncture, and we were discussing actually in the table, is the fiscal policy reaction. So no policy change scenarios that are the normal way of dealing this might not be the right ones at the current juncture, and anticipating fiscal policies might also relevant. In a way, what we are dealing now is the traditional dilemma that we face central banks when dealing with this scenario, which is, Early gradual response or just wait and see and maybe if needed at a certain point, if more decisive action.

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It's not clear-cut how to deal, but certainly this is what we are discussing, all of us in our, in our, in our councils at present. How to confront this dilemma, I would say, in practice and how we are doing, I imagine all of us. First, I think we need more than ever to monitor data in real time. It's much more important now incoming information and how to digest it than projections. So we need to work, and this is just an example of the anchoring of expectations with real-time data in the euro area, that's to see that so far we haven't seen too much change, but certainly we need to continuously ask ourselves whether the central scenario is being validated or not. And if so, we continue basically monitoring real-time data. If not, if we perceived that maybe we can be moving to alternative scenarios which may complicate our policy looking forward, and this at the current juncture may have to do in particular with the probability that the war evolves in one direction or another in the months to come, I think in this particular case, we need to continue working with the scenarios, potentially update the scenarios, redefine them if needed, and continue giving probably more weight to incoming information versus a central forecast.

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I mean, this is the only way to deal with uncertainty. Very difficult situation for all of us. Because of this uncertainty. But internally, I imagine this is the way we are dealing with it, with nuances, with one tools of another, but there is no way out to that. And in communication, as I said, to me, this is complex. This is complex because in principle, for transparency purposes and for you to be understood, you would like to try to convey as much as you deal with and examine internally in your boards and your decision-making. But in such a situation, if we really do it fully, I think it might prove very difficult to do it with clarity. And at a certain point, we face a trade-off. So I think that we need to filter out. We need to filter out for effective communication all the uncertainty we are working internally with and the instruments we are doing so and also with the scenarios. And it's time to finish, but this is actually the last slide. Thank you very much.

[00:23:12.19] - Anna Breman

So thank you very much for inviting me. I took office on December 1st last year. I moved across the globe from Stockholm, Sweden to Wellington, New Zealand. When you move countries, you of course try to prepare as much as you can. You read up, you talk to as many people as possible, you visit the country. But there's all the certain things that doesn't become really real until you're there. And one thing that I wanted to share with you is When the Middle East crisis hit on the weekend of March 1st, I do what you do as a governor, which means you contact your staff, you make sure you're operational ready, you make sure that people are prepared to reprioritize, make sure we can do all these scenarios that people are talking about. And I prepared to communicate because I expected questions from the media, just, you know, exactly how high will inflation be? How weak will growth be in this scenario? What will it mean for New Zealand? And this is where I realized that I was new to the country, because the key questions that were in the media the first week, it was, will we have access to fuel, petrol, diesel, and jet fuel?

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How many days of storage do we have, actual numbers of days? And will there be rationing? And how will the government prioritize in case we need to ration. And then, of course, all the question on inflation and growth and so forth started coming. But I'm mentioning this because my first point is really that the situation we are now in some countries, not all, but in some countries, this is a question of security of supply. And as economists, during our modeling, I'll come to monetary policy, We have to consider that for some countries in the Pacific Islands, it's already visible. In New Zealand, just to make sure you don't misunderstand me, storage levels are fine. There is no rationing, but there are preparedness in case this situation becomes prolonged. The second point I wanted to make is that this is, it is a classic supply shock in many ways, higher oil prices, gas prices, et cetera.. But it is a severe disruption of supply chains, global supply chains. And again, if you live in an island nation, you understand the importance of the supply chain. So I want to be very concrete here because when we look at the modeling and the effect on inflation, we have to take into consideration that there are some things that we will not see immediately, well, can very easily model how high inflation will go.

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Fuel prices, petrol is up 35% in 5 weeks. That's 4% of the CPI basket. Diesel is up 106%, but that's mainly used in commercial. So there will be some indirect effects, et cetera. But the effects of the severe supply disruptions that are already happening will come through the system and it will take time. And they're much harder to forecast. Just to give you 3 concrete examples, one that, you know, has been discussed a lot is fertilizers. Also obvious when you live in New Zealand, it's a large agricultural sector. We're fine. We're going into winter. Storage levels are high, but the Northern Hemisphere needs this right now. There might be less planting, which might end up in fuel— not in fuel prices, but in food prices in 6 to 9 months. For New Zealand, the question that we have to consider is not just will we get the ships with the fuel, it's also will we get the ships into the harbors so that all our large exporting sectors can get their goods out to the end consumers. That's again, it's a risk scenario, but that's the kind of supply chain issues we have to consider.

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And the third one I wanted to mention that I personally didn't think about originally is plastics. Because if you have a large agricultural sector, we're producing food, we're 5 million producing food for, 40 million people, you need plastics to wrap the food to go on those ships that needs to get into the harbor. And currently that is being disrupted by the situation in the Middle East because those are based on petroleum products. So we, as economists, we have to consider the security of supply and the disruption to supply chains. And then finally, what does it mean for monetary policy? Well, in our case, I have to give you very briefly the background. We have a policy rate, the OCR, official cash rate, at 2.25%. We have had about 3 years of approximately zero growth. The export sector has been performing really well, but domestic demand has been weak. This year was when we were expecting to see broadening of economic growth and inflation more reliably at the 2% target. Core inflation is still close to target, but headline inflation is a little bit on the high side at 3.1%. You get a supply shock. You can model it in the direct effects, a little bit of the indirect effect, as I said.

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But how do we do this when our target is not near-term inflation, of course, it's medium-term inflation? That's how the Reserve Bank Act is written for good reasons. And we have to weigh the near-term supply shock the uncertainty of the supply chains and the security of supply? Well, one way is, of course, to work with different scenarios, which I think is a very good idea. The other one is to have the preparedness to act at all times. We have communicated. We had a monetary policy meeting last week. We had consensus. We hold the OCR unchanged at 2.25%. But we said that we're ready to act decisively and timely as needed if we see risk to medium-term inflation. But in those risks, it's not just a simple equation of will we see weaker growth and a little bit higher near-term inflation. We have to consider this complex effect on the supply chains that is hitting the global economy right now. Thank you.

[00:29:49.49] - Martin Schlegel

So, ladies and gentlemen, thank you very much for the invitation. As has been mentioned many times before, the conflict in the Middle East has pushed up energy prices. This means that inflation is likely to increase globally. In the coming quarters. The question is, what does it mean for central banks? And so I think there are two questions that we have to answer as central banks. So how to respond to these rising energy costs? And probably also what lessons can we draw from this post-pandemic inflation surge that we saw after the pandemic? So I will first outline the Swiss experience. During the post-pandemic inflation episode, and then also draw lessons for today. But before I do that, let me explain to you two key characteristics of Switzerland. So the first one is Switzerland is a small open economy, as I just learned everyone claims. And Switzerland is really small, but it's really also very open. So we tend to say that every other franc is earned abroad. Switzerland is a strong exporter, but we are also a strong importer, because a large part of the consumer basket is also imported. So this is roughly one quarter of the consumer basket in Switzerland is imported.

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This was the first characteristic. And the second characteristic is our currency, the Swiss franc. And the Swiss franc is not a normal currency. The Swiss franc is one of the few safe havens today. So whenever there's a crisis in the world, the Swiss franc tends to appreciate. You can see this on the right-hand chart, even if these events have nothing to do with Switzerland. So being open and having a safe haven currency means Switzerland is strongly exposed to external shock. And what does it mean then for monetary policy? So it means that it's not advisable for us to use a point target for inflation. And this is taken into account with our definition of price stability. We define price stability as inflation from 0 to 2%. So no point target. But this strong exposure to these external shocks has also implications for our monetary policy instruments. So our main instrument is the S&P policy rate. That's a short-term interest rate. But because Switzerland imports a large part of the CPI basket, exchange rate is also very important for inflation. And to achieve our goal of price stability, we also use FX interventions if necessary. So in 2021, after years of low inflation in Switzerland, inflation was globally going up.

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And there, you know, then there were multiple forces at work. So there was supply constraint because of this disrupted supply chains and also labor shortages. Demand was fueled by fiscal stimulus, but also because of this pent-up demand and consumption after the pandemic. And all this happened against a backdrop of loose monetary policy on a global level. So in this environment, you remember well, inflation started to rise globally. And in Switzerland, you can see it on the left-hand side, inflation returned from negative into positive in early 2021. That's on the left-hand side. This increase was initially driven by rising energy prices. And then in late 2021, imported inflation excluding energy also started to rise. And then the war in Ukraine in early 2022 lifted energy prices further. This increased the inflation pressure further then in Switzerland. So by mid-2022, this price pressure had spread to domestic items also in Switzerland. And headline inflation in Switzerland rose to 3% and was clearly above our target of zero. To 2%. So how did the SNB fight this inflation pressure? We used a combination of policy rate hikes and foreign currency sales. You see this on the, on the right-hand side.

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As a first step, we allowed the Swiss franc to appreciate in the second half of 2021. And the stronger franc limited the pass-through of import inflation into the Swiss CPI. At that point, inflation in Switzerland was about 3%. And then in the second half of 2022, we started selling foreign exchange reserves. So until the end of '23, we sold roughly 150 billion Swiss francs. This is a bit less than 20% of GDP. So that's quite a big number. And by June 2023, the S&P policy rate had reached 1.75%. This is a cumulative tightening of 2.5%age points within one year. And then inflation returned to our price stability range. So overall, by combining FX sales with policy rate hikes, have brought inflation back into the S&P's policy stability, price stability range. So what are the lessons that we can draw from this inflation episode? I think two important lessons are we have to monitor second round effects very continuously and we have to tighten decisively when there are signals for the second round effects. Maybe on the second round effects. In the first half of 2022, Swiss firms increasingly passed these higher energy and input costs to consumers.

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The broadening of price pressures also become more and more clear when looking at the relevant items in the CPI. So at our June '22 Monetary Policy Assessment, headline inflation was around 3%. And with these clear signals that the second round effects were materializing, we acted without hesitation. We stepped up the policy rate and sold FX reserves in the market. So this early and very decisive tightening curbed the transmission of these higher input costs and kept inflation expectations anchored. So what does this mean for the current situation? It means that we are monitoring things closely. But as you know, uncertainty is high and much depends on this— how these energy prices develop further. And I would say at this stage, it's too early to say whether we will see a repeat of the 2021 2022 situation. So let me now turn quickly to the last monetary policy decision. At our last meeting in March, we decided to keep the S&P policy rate unchanged at 0%. So in the short term, the inflation forecast is higher than it was in December. But in the medium term, inflationary pressure is more or less unchanged. And what you also can see is that the inflation forecast remains in the, in the range of price stability between 0% and 2% over the whole forecasting horizon.

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But uncertainty about this inflation forecast, of course, is currently quite high. So given the conflict in the Middle East, our willingness to intervene in the FX market has increased. And a rapid and excessive appreciation of the Swiss franc poses a risk to price stability. So we will continue to monitor the situation closely and adjust our policy if necessary. Thank you very much.

[00:39:17.52] - Chang Yong Rhee

Okay, thanks very much for the invitation, and I'm really honored to have my last public events at PIIE, which I have a full respect. And also, I want to ask for excuses because with a few days left, it's very hard to prepare the slide and the written speech. So excuse my motor hazard problems, but I'll mention 5 points regarding the conjunctural issues of this Iran events on Asia and especially for Korea. The first thing is, unlike Russia-Ukraine war, I think Asia is in the line of the straight fire and we will be more affected. And for example, in Korea, 70% of our oil import is coming from Middle East. And except Japan and China and Korea, not many middle-income and low-income Asian countries has fallen the oil reserves. In our case, as Anna mentioned, we probably have about 200 days of reserves. Japan, 250 days according to what they say. But I do not want to mention the country's name, but many low-income and middle-income Asian countries have a very couple of weeks, uh, reserves. So if the current situation continues more than a month now, from now on, I'm sure that it's not just a price effect but also the quantity effect will significantly affect many low- and middle-income Asian countries.

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My second point is that even though Asia is mostly affected, it will have a very large repercussion to the global market. Anna mentioned many supply issues, but I can echo because not many people know Korea is an oil exporter. We import a lot of crude oil from Middle East, but we have a very well-developed refinery industries. So for example, we export our jet fuels to the United States and our share of the jet fuel consumption in the United States is about 20%. So if the Korea refinery is not working properly, sooner or later, it will definitely having a large price impact on the travel aviation and the jet oil prices. And fertilizer is one other example, but also plastic bags. And we are using NAFTA a lot to produce plastic bags, but plastic bags they are using for mostly the delivery of the food services., and it will definitely affect the domestic consumption too. And many people say that why we cannot import, because it's their time, US oils instead of the middle-income oils, and then this may lessen this kind of problem. The problem is that our refinery facilities are designed to handle heavy crude oil from Middle East.

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So in order to use a light crude oil, they need to change the facilities But many businessmen said it will take about 6 months. But at this moment, because a lot of uncertainty, they are not willing to spend the investment. Maybe it's good for the long-term diversification of the supply, but in the short term, you never know what will happen. So they are delaying their investment to change these facilities, which means that even if we can import American oils, it can be used for other purpose, but this kind of supply chain impact won't be mitigated. My third point is specific to Korea, but we have now not only the oil shock, but also we have a positive super semiconductor cycle shock. So we are very lucky because if we just have oil shocks, then we will have a more severe, serious negative impact. But even that, we have a huge export boom through the semiconductor supercycle. And whoever wins this AI competition in software side, whether it's going to be Google, whether it's going to be OpenAI, we believe that they need a semiconductor. So our two major semiconductor companies will do well. And they told us that at least for the next 1.5 years, kind of supply is already presold.

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So it's good news in the short term, but what makes our central bank, as you usually already worry about the risk concern, is that looks like a market, Korean market, including external market too, likely having a kind of perfect— assuming the perfection in the means that currently when you look at the stock prices, is this assuming that this Iran war will end in a couple of weeks rather than a couple of months. And at the same time, they are based on the assumption that our AI supercycles will continue at least 1 or 2 years. But it's good news for us temporarily. But if one of the two assumptions goes wrong, whether the Iran war lasts more than a week and more than a month, that's a problem. Also, if the supercycle ends soon, then we'll have a double whammy. So this is a problem. My first point is that this is related with the vulnerability, I mean volatility in our financial market. Many people cite the volatility of our stock exchange, stock market prices and exchange rate as evidence that Korea is mostly affected and quite vulnerable to this shock. In some sense it's true, but it's a little bit overexaggerated because this is related with the supercycles.

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Our stock prices in the last couple of months increased more than 100%, the world best performance of the stock prices because of the semiconductors. Immediately after the Iran war, in 2 days, stock price dropped by 20%. And after that, it fluctuated like 5, 10% daily depending on what Mr. Trump says. So it's quite volatile. But the main reason why it drops significantly is because it increased so rapidly, you know, because semiconductor cycles. Likewise, exchange rate volatility has been quite high in the last 1 or 2 months. It's because the stock price increased more than 100%. Many foreign investors think it's a good time to cash out. So we see the huge outflows from the, our foreign investment in our stock market. So definitely our exchange rate is affected by the what is happening in Iran. But also what— because it's partly reflecting the, the— our stock price moved really rapidly. On the other hand, our bond yield has increased, but the increase of bond yield reflecting the higher inflation expectation is in line with, uh, bond yield in other countries. So that's my point. And then my last point is that what's going to happen from now on, it really depends on the intensity and the duration of this Middle East events.

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And it's very hard to predict when this— how long it's going to end. So I won't jump into, you know, so we actually in last week we had our monetary policy committee meeting and we decided to hold our interest rate at 2.5%. We call this strategic patience because we don't know what's going to happen. You know, our financial market price move kind of volatility depending on what's happening in Iran. So for the time being, we have to watch what's going to happen. And but definitely, I think in Asia we will see more trade-off between the inflation and the output, because unlike Europe and others this time, because the Middle East shock, we will have a more shock to not only the price but also the growth. I'm very happy that— I shouldn't say happy, but I'm happy to see my successor is well-known scholar in the world, and he will take care of this serious problem for me. Thank you.

[00:48:03.11] - Patrick Honohan

to have questions from the floor. Think about that. I have a couple of questions myself to throw into the table here to see who might take them up. So this is a supply shock. The textbook says you just look through it.

[00:48:19.29] - José Luis Escrivá

Huh.

[00:48:20.32] - Patrick Honohan

You don't have to do anything. And the last time we faced a supply shock, people started saying like that, and they were criticized. And one of the criticisms might have been that you didn't take account of the preconditions, a lot of high liquidity in the system, a lot of big savings in the system because of the pandemic. I wonder, do you see the preconditions as being different this time, therefore encouraging a return to the look-through this— look through the supply shock? Or do you think that the lesson from the last time was let's move faster than we did last time? I know you don't want to say you're going to move it at the next meeting, but just from an intellectual point of view, do you— anybody want to offer a view on this?

[00:49:08.40] - Martin Schlegel

Thank you very much. That's a very interesting question, and of course the situation is totally different right now. But if I remember correctly, there was exactly the same argument that we had when inflation went up. It was clearly a supply shock. We thought, because the story with this pent-up demand was all— was coming later. And therefore, this was my point actually in the presentation. So probably it's just a supply shock. You can look through it. But you really have to look very closely at the second-round effects. And if we see some signs of second-round effects and inflation getting too high, then central banks should act. Early anti-Sasekho.

[00:49:52.20] - Patrick Honohan

Yes, Anna.

[00:49:58.12] - Anna Breman

Well, I did give a speech on this 2 weeks ago approximately, so I won't go through the details, but it's— I think it's really important to treat each shock as different because there are— that's why I try to stress that there are some very particular features of this shock that we have not seen before. And it's also much more different across countries than it was at the end of the pandemic. So at the end of the pandemic, most countries have had the COVID some form of shutdowns, which meant the savings were high, there was some pent-up demand, and we got supply disruptions like now. And we had the war that pushed up energy prices.. And it was not just a supply shock, there was also very high demand at the same time. Currently, it's very different across different countries. And in the case of New Zealand, we had weak demand, we estimate that we have a rather large output gap to start with, we have modest wage growth, it wasn't the case at that time. But even if the conditions are different this time, the shock is somewhat different. I think some of the lessons from That time is that we do need to take supply shocks very seriously.

[00:51:13.37]

We can't only look at medium and long-term inflation expectations. Short-term inflation expectations can also matter. Firms' pricing behavior can change. And it's easier to pass on costs when consumers can understand where the cost pressures are coming from. So I still think that even though the conditions are different, We should be cautious and we should look at all the excellent research that come out since that time. Thank you.

[00:51:41.14] - Patrick Honohan

Changyoon, you want to say something as well on it?

[00:51:43.29] - Chang Yong Rhee

Quickly, I understand this theoretical argument, but in practice, at least for Korea cases, we see that inflation expectation is really affected by the lagged inflation. So it's interesting to differentiate theoretically, but in practice, I'm sure that this time when the short-term interest inflation increases, this time it will definitely have a kind of impact on the long-term expectation too. So it's very hard to differentiate.

[00:52:11.44] - Patrick Honohan

No, well understood. I want to ask another question. And of course, we're all focused on the price movements, but this is a situation— and there was some mention of stock prices. They've been— they've moved up very fast in recent years. There's a lot of growth of financialization, a lot of exposures, and there could be a downturn, a significant downturn because of the war. So there's a macroprudential issue that you will probably want to be fielding as well as monetary policy price stability. What do you think about that? Is that on the back burner? We're too busy dealing with price stability, or should you be tightening macroprudential tools? Or, and maybe particularly for Chang Yong, very extensive macroprudential tools in Korea. Are you using those— I mean, you in the sense of the government and the central bank— are you using those as a prudential concern, or are they partly steering the macroeconomic balance?

[00:53:16.45] - Chang Yong Rhee

Our Bank of Korea does not have direct tools in macroprudential policies. It's mostly the Financial Services Commission who has these tools, but we have been part of the group which consults the financial services to do these things. And this macroprudential policy has been very important because recently we have a very high consumer debt over GDP ratio. At the same time, our housing price has increased quite significantly last couple of years. But this time, I think especially when my successor has to raise the interest rate if inflation is really going rapidly, then given that unlike 2022, our growth momentum was relatively weak, still we have a lot of household debt ratio is quite high. So he has to, and I mean with the government, we have to be well balanced, you know, policy, not just looking for the price stability but also the financial stability. So, the macroprudential policy is one of the important issues at this moment.

[00:54:22.43] - Patrick Honohan

Before I ask José Luis to comment on this, prepare your questions please. And there are two ways of asking a question because I'm going to come to the audience immediately now after José Luis comments. There's a microphone at the back and there's a roving mic which will deal with the people in the front.

[00:54:40.59] - José Luis Escrivá

So, José Luis, okay, on the macroprudential tools in Europe, in the European Union, macroprudential tools are primarily national, not euro-wide, and the Bank of Spain indeed has potentially the capacity to deploy tools. We have already doing so with CCYB, countercyclical buffer, capital buffer. And now we are— in Spain, there is a sort of— the real estate market is gaining momentum, so that's something we are monitoring very closely also because of history, but not only that. So, and we have a number of instruments, the so-called borrower-based measures, so we could really impose constraints to banks in terms of lending standards in a way or another. We haven't still done it, But we are certainly working a lot on that. But we have realized, it's important, that these kind of tools, if you deploy it as a central banker, you are confronted with a dilemma because they may have— you may achieve some of the results that you expect in terms, for instance, of lower real estate prices, but they have strong distributional effects that you need to factor in advance.

[00:55:57.19] - Patrick Honohan

People think it's tough for central banks to raise interest rates, but it's much tougher to put in borrower-based restrictions that cut out particular classes of society from the housing market. Who's going to ask the first question? Please identify yourself and where you're from.

[00:56:13.27] - Audience

Thank you very much. Beat Ziegenthal, Roccos Capital. One general question maybe to all of the panel. Of course, everybody always says we will act if we see second-round effects So my question would be, you know, where would you look for that and how long do you think it takes? And also, how long you can wait? And maybe that follows to my specific question for Governor Escriba. In the ECB's case, where do you see the scenario currently between— is it closer to the baseline or to the adverse? And if you think you might have to tighten anyway, then why not be kind of upfront and get the maximum signaling? Effect? Thank you. Hello.

[00:57:01.49] - José Luis Escrivá

I mean, in terms of real-time monitoring, I think inflation expectations sometimes is difficult to gauge, but of course, it's something that you are— you have to look very, very closely. But wages, I mean, it's probably the most clear candidate, and there are surveys, there are data that we can monitor. So I think this is the first candidate to be really watching, watch carefully in the months to come for second round effects. I would say that if you had asked me a few weeks ago, probably I would tell you that we were moving from the central or basically to the adverse one. But it's also true that when you look at these scenarios and you compare with market prices, oil and future prices and gas prices as well, Actually, the central scenario is materializing very closely over the last 6 weeks. So in a way, the question is whether we basically believe in market prices as a good indicator over the medium term about how things are going both, or whether there might be supply disruptions that are not sufficiently considered by the market at present and may impact further. I think that this is not an easy— question to answer and basically is part of, I think, the debates we are having.

[00:58:31.49] - Patrick Honohan

This is an example of you mastering the problem of communication in difficult circumstances, I think, that you already alluded to. Anybody else want to add on this point? Please, Agnieszka.

[00:58:43.26] - Anna Breman

I mean, what we have communicated is, of course, we will watch out for all the regular measures that you look at, like, you know, if you see core inflation starting to pick up, not just headline inflation, wage growth, medium-term inflation. I do think we need to watch short-term inflation expectations as well, but we know they will go up because of— they would just be following headline inflation. I think one of the things I didn't mention before I was considering mentioning is that in small open economies, you tend to get more volatility in the data. And that is a challenge for us. We see that in terms of inflation numbers. We still only have quarterly inflation numbers. We will get monthly inflation numbers next year. I'm looking forward to that. But the GDP data tends to be both lagging, volatile. So what you mentioned before, just looking at much as possible at real-time indicators will help. But we will always have a degree of uncertainty when we make the decisions, and we have to still make a judgment whether we see the risk being high enough so you need to act.

[00:59:53.50] - Audience

Hi, thank you. Dove Ziegler from the D.E. Shaw Group. A question about currency policy because that was raised in two of the presentations. Currency could be an important shock absorber. Oil is denominated in dollars. How are you thinking about the risks of second round effects that are compounded by the currency channel and using that as an effective tool to mitigate some of the supply shock?

[01:00:15.19] - Patrick Honohan

Must be for Martin.

[01:00:18.27] - Martin Schlegel

Thank you for the question. So is the currency a shock absorber in terms of inflation? It can be, like if we look at this energy price shock in Switzerland right now. Because if energy prices globally rise, then the Swiss franc appreciates at the same time. It dampens a little bit of this increase in oil price shocks. But generally, it's not— this safe haven currency of the Swiss franc is not helpful for economy because exactly in times of crisis when there is low demand from abroad anyways, the Swiss franc appreciates, makes it even more difficult then to export our goods. I mean, Swiss exporters, they don't produce mass stuff. They're really like very highly specialized. Sometimes they are world leaders in really a niche that they are in. Nevertheless, Swiss franc is important also for them. But for us as the Swiss National Bank, we really, when we intervene in the FX market, it's really only about price stability. We only intervene in the FX market for monetary condition reasons, i.e., so Swiss franc, the Swiss franc inflation stays within the range of price stability.

[01:01:34.18] - Patrick Honohan

I wonder, do you ever face international difficulties when you're deciding on sales or purchases of foreign exchange. Do you have to coordinate? How does that work these days?

[01:01:44.58] - Martin Schlegel

Well, we are an independent central bank and we have a clear mandate, so we do not have to coordinate our FX interventions with others. But it's— I mean, we are here in Washington. It's also very clear that the US Treasury is looking at these FX practices quite closely. Last autumn, we had this joint statement together with the Swiss Treasury and the US Treasury basically said that what we do in the FX market, intervening in the FX market, is really like for monetary policy purposes. It's not for gaining an unfair advantage for Swiss exporters and not to prevent an adjustment of the current account.

[01:02:29.42] - Patrick Honohan

Who's the next question? This will be the last question, looking at the time. Please.

[01:02:39.44] - Audience

Right, Søren Rødde, Point72. Thank you very much for all the presentations.

[01:02:42.37] - Patrick Honohan

By your set, please.

[01:02:43.56] - Audience

Sorry?

[01:02:44.32] - Patrick Honohan

I didn't hear the name.

[01:02:45.54] - Audience

Søren Rødde from Point72 Asset Management. Thank you very much for the presentations, everyone on the panel. I had a question, particularly for Governor Estiva. You mentioned prices have moved closer to the baseline scenario, but you also mentioned in your presentation very helpfully that the baseline scenario assume standard elasticity. So can you see a world where you've got baseline scenario shocks but nonlinear effects? And would that put you in the middle scenario that President Lagarde described, that I think in her words required a moderate policy response? Thank you very much.

[01:03:24.27] - José Luis Escrivá

Indeed, I mean, the instruments that we use I mean, the state of the art of the instruments we use have difficulties in capturing nonlinear effects of the one you described and might materialize in the future. So we have to be cautious concerning the reliability of basically the projections that we may have based on adjustment in our models in order to capture these kind of elements. So I think there is not only uncertainty about the environment and external shocks and duration, but also there is, let's say, model uncertainty when we want to take into account elements that we may have witnessed in period episodes, but there is not sufficient regularity over time in order to be able to be sure the extent to which this time will materialize and when and how. So that's the reason why the situation is particularly in Antian and very difficult to go. I mean, the only alternative policy way of dealing with this is basically incoming data, real-time data, trying to combine robustness with a robustness approach, different models, different datasets at different horizons, and Basically, wait and see. It seems to me, and try to, at a certain point, try to come to the conclusion that you are closer to one of the scenarios.

[01:05:05.27]

But still, we are far from that.

[01:05:06.50] - Patrick Honohan

I see that monetary policy and central banking has not become any easier since I left the business. This is the end of our session. We have just reached the time. That's the most important job, is to finish on time. We are on time. A round of applause for the four governors, please.