

ECB Listens

Virtual PIIE Event
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MIT-Sloan School,

NBER & CEPR



Evolution of Monetary Policy



Montagu Norman

Governor of Bank of England, 1920-1944

Source: <https://www.bankofengland.co.uk/about/history>



2 Key Developments

1. Structural changes to inflation dynamics

2. More volatile and globalized financial markets



#1: Inflation Dynamics

From
wind....



To the
“stars”....

Taylor rule & Phillips curve

$$i_t = r^* + \pi_t + \theta_\pi (\pi_t - \pi^T) + \theta_y (y_t - y_t^*)$$

To ????

Less pre-emptive?

More outcome based?



Risky Post-COVID

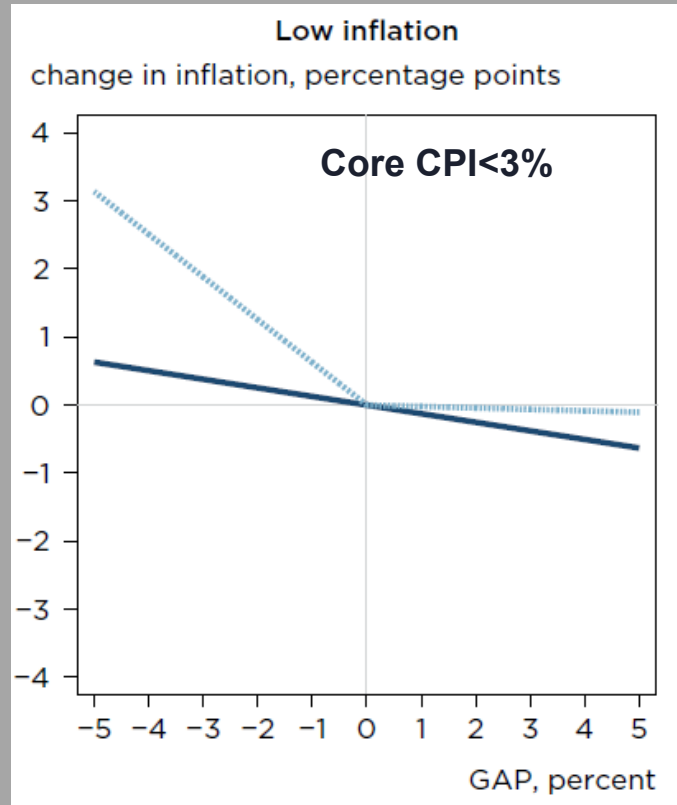
What if parameters change again?

	GFC to COVID	Post COVID ?
y^*	Increased labor force participation	Decline in participation in older cohorts
r^*	Lower neutral interest rate	Increase from COVID-induced \uparrow productivity? demographics? (Goodhart and Pradhan)
θ_π	Sticky inflation expectations	Inflation expectations \uparrow after sharp pickup from temporary factors
θ_y	Flatter Phillips curve	Curve steepens at low unemployment (nonlinearity)? (Forbes, Gagnon, Collins)



Non-linearity

US Phillips Curve for Core CPI



Source: Joseph Gagnon and Christopher Collins, “Low Inflation Bends the Phillips Curve”, April 2019

Updated with global factors in Forbes, Gagnon and Collins, “Low Inflation Bends the Phillips Curve around the World,” PIIE Working Paper 20-6.



Implications

MODEL UNCERTAINTY WILL CONTINUE

1. **Hard to act pre-emptively**
 - More likely to be “behind the curve”
2. **Will need to be nimble and flexible**
 - Avoid forward commitments
 - Prepare for sharper adjustments
3. **Changes to price stability mandate: “inflation below, but close to, 2%”?**
 - **Symmetric**
 - No need to change inflation focus
 - Better measure than HICP?
 - Medium term / 2 years? (BoE)
 - “Sustainable”?
 - Core HICP?



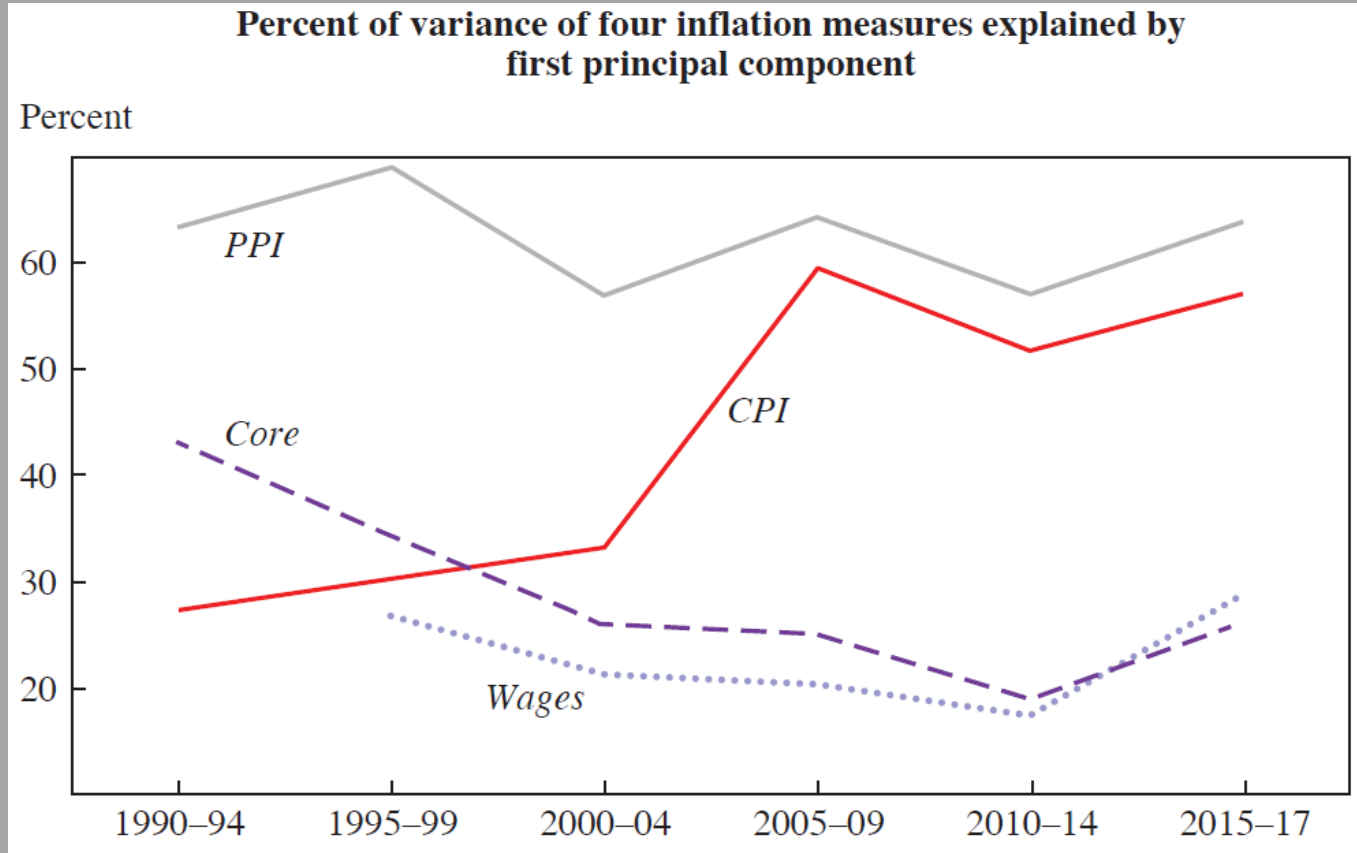
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Global Factor in CPI



Source: Kristin Forbes, "Inflation Dynamics: Dead, Dormant or Determined Abroad,"
Brookings Papers on Economic Activity, Fall 2019



Changes in Role & Responses

New Role	<i>Important Questions</i>
<i>Not just “lender of last resort” but “market maker” and “liquidity provider” of last resort</i>	<i>What markets? What is dislocation? How to reduce moral hazard?</i>
<i>Expansion of types of tools and facilities</i>	<i>How does capital get allocated? Who bears credit risk? How to unwind?</i>
<i>More coordination with fiscal authorities</i>	<i>How much coordination? What if objectives do NOT align?</i>



For More...



Coming on June 3-4



Implications

- 1. Elevate importance & more active use of macroprudential tools**
 - Reduce need to “clean up” in future
 - Expand regulatory perimeter
- 2. Make new tools “conventional”**
 - Especially given limited appetite for lower policy rates
 - Way to separate tools for monetary policy & financial stability?
- 3. More fiscal/monetary policy coordination?**
 - Informal, should not be a constraint
 - Instead: fiscal/financial stability coordination?



ECB Presidents



Will Duisenberg
1998-2003



Jean-Claude Trichet
2003-2011



Mario Draghi
2011-2019



Christine Lagarde
2019-