GETTING GLOBAL MONETARY POLICY ON TRACK

EDITED BY

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PREFACE

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This volume is based on the conference Getting Global Monetary Policy on Track held at the Hoover Institution May 2–3, 2024. This conference and volume are the third in a trilogy, the first two of which were *How Monetary Policy Got behind the Curve—and How to Get Back* and *Getting Monetary Policy Back on Track*. This is also the fourteenth Hoover Monetary Policy Conference and associated volume.

John Taylor offered welcoming remarks at the preconference dinner, stressing the importance of policy rules and posing a central question: Why not have a global 2% inflation target?

Condoleezza Rice offered welcoming remarks on the global strategic situation and its economic implications.

In the first panel, on Europe, Klaus Masuch and Luis Garicano spoke of the fiscal foundations of the euro, the structures that have been put in place to ensure a clear separation between monetary and fiscal policy, and how those structures were weakened through a series of crises. They also addressed how to reform the euro to avoid any temptation to print money to finance government debts.

Markus Brunnermeier discussed digital central bank currencies, in particular the euro. Among other issues, Brunnermeier highlighted the tension between private systems, which like to print money but care less about resilience, and public systems that may be less efficient and more political.

Yuriy Gorodnichenko noted how inflation is declining in Europe with no rise in unemployment. The current disinflation shows the

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opposite pattern of the early 1980s' US disinflation during the tenure of Federal Reserve chair Paul Volcker. Looking forward, however, Gorodnichenko pointed to strained public finances, commodity shocks, war, and international decoupling that could hurt economic performance and bring inflation back.

Last in this panel, Luigi Bocola also considered the fiscal limits on monetary policy for the euro. On how inflation emerged, he showed through clever asset-market estimates of monetary policy rules that the Fed and the European Central Bank became much more dovish in 2020. Both central banks may be afraid to raise rates that would hurt banks and government finances.

Emilio Ocampo began the panel on emerging markets with a description of the structural and political problems in Argentina that have led to bad policy over decades.

Juan Pablo Nicolini gave a broad picture of Latin American inflation history. Many countries have moved from habitual inflation to much better control in recent decades.

Zhiguo He gave an overview of monetary policy in China. The central bank is not independent, he asserted, and it is also charged with broad support of economic policy. Ross Levine closed out this panel with an overview of inflation and central bank actions in emerging markets. He questioned some of the premises for independent central banks and argued that the link from tools (interest rates) to inflation is vague. Most of all, he argued that financial regulation should not be pursued by an independent central bank. Other regulatory agencies have more political accountability, and he argued that that may be a good thing for financial regulation as well.

Amit Seru began the session on financial regulation with a clear and condensed version of several academic papers on banking. He argued that the entire US banking system looks a lot more like Silicon Valley Bank than we should be comfortable with, including mark-to-market losses, negative mark-to-market equity, and large uninsured deposits. Many banks are regulated alternately by federal

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and state regulators, and the switches between them reveal a lot of discretion at work. Unregulated and not-(yet)-too-big-to-fail shadow banks voluntarily fund themselves with considerably more equity than government-protected banks do. That observation contradicts the widespread assertion that banking requires massive leverage and cannot withstand higher capital requirements.

Darrell Duffie gave an overview of how US Treasury markets suffered turmoil in 2019 and 2020 and described some of the structural and regulatory causes of that turmoil, along with recommendations to fix that market. Christina Parajon Skinner focused on the foundations of bank regulation by an independent Fed, which does not have the accountability of most regulatory agencies. She noted that "financial stability" and "safety and soundness" are undefined and thus open to expansive interpretation. She pointed out that regulatory policy is closely aligned with global policy set by the Basel Committee, which has no democratic input from Congress. She also noted the great power vested in the vice chair of the Federal Reserve.

Finally, Carolyn Wilkins discussed the Bank of England's actions in 2023 when overleveraged pension funds melted down as interest rates rose. She described how the bank sold securities for monetary policy actions while simultaneously buying them to prop up the pension funds' asset values in an effort to stem the crisis.

In her lunchtime address, Hester Peirce gave a rousing talk on regulatory expansion by the Securities and Exchange Commission (SEC). She listed many examples from the humorous—the SEC's move to make animated characters the Stoner Cats a security—to the serious, such as new rules to regulate fund advisors. She stressed how the SEC is moving from rules of the game to "prudential" or supervisory regulation, directly controlling how people invest.

Opening the session on labor markets, Steven Davis discussed the recent work-from-home trend. He showed how it is increasing employee satisfaction and also allowing somewhat lower wages as workers and employers split the benefits.

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Marianna Kudlyak presented her research with Bob Hall arguing that the slow decline in unemployment that is characteristic of most economic recoveries does not represent a "lack of demand" remediable by more stimulus but rather reflects the slow search-and-matching process of normal labor markets. At a minimum, when the Phillips curve—the relation between inflation and unemployment—is written as inflation = expected inflation + constant times excess unemployment, and when inflation sits at 2%, one can infer that there is no "excess unemployment." Emi Nakamura presented her own research on the Phillips curve, showing that it moves around a lot and that forecasts are systematically wrong. She gave a great overview of all the theories surrounding where inflation came from in 2021.

In the session on central bank strategy reviews, Athanasios Orphanides described how interest rates deviated from most rules. He advocated improvements in how policy rules could be better integrated into the policy process to avoid a repetition of past policy mistakes.

Mickey Levy and Charles Plosser also reviewed how the current Federal Reserve strategy went wrong in the postpandemic inflation. They argued for greater commitment to the 2% inflation target, using rules as guidelines, abandoning forward guidance as a separate tool, benchmarking more closely to rules, and improving the economic projections.

Jón Steinsson emphasized the supply, fiscal, and relative demand shocks of the pandemic. He argued that a strategy focused on the worry in the late 2010s that inflation was 1.7% rather than 2% at the zero bound led to too-loose policy. He emphasized the importance of anchoring expectations and stressed that adherence to rules is only one way to achieve credibility.

Closing out the panel, Larry Summers offered a clear but dissenting view, arguing against formal targets or rules at all and sug-

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gesting that projections and forward guidance are unhelpful. This was an interesting progression. Each of the panelists dealt with an increasingly complex set of issues. Summers came up with a natural implication: give up on all this complex strategizing. He advocated five points:

1. A return to humility. The Fed should just state general values: "Whatever it takes." "A strong dollar is in the national interest."
2. No forward guidance in normal contexts.
3. No quantitative easing except when necessary to maintain market functioning and liquidity (as Darrell Duffie describes). Integrate debt-maturity management policy between the Treasury and the Fed.
4. No cacophony. Stop publishing competing speeches about what to do.
5. No specific numerical targets.

Naturally, this out-of-the-box view provoked great discussion.

Amir Yaron led off the monetary policy panel, explaining how the central bank of Israel handled the huge financial shocks of the October 7 attack by Hamas and the subsequent war, perhaps emphasizing Summers's point about the futility of rules around unexpected shocks.

Having a large part of the labor force off at war while others have been forced to leave their homes is a big negative supply shock, Yaron asserted. He went on to discuss how small, open economies must think about exchange rates in their policy strategies.

Austan Goolsbee discussed how to improve the statement of economic projections, in particular by linking Federal Open Market Committee members' inflation, employment, and interest rate projections together so that people can understand the economic reasoning behind them.

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Finally, John Williams gave an overview of how central banks have evolved, focusing on rules, transparency, and attention to expectations and thus central banks' commitment to eventually reaching their inflation targets, even if there are bumps along the way.

Edward Nelson gave the dinner talk. Based on his outstanding two-volume intellectual biography of Milton Friedman, Nelson related how Friedman and other commentators approached the inflation of the late 1970s, a period in some ways eerily similar to the current moment. Friedman saw the inflation coming, which many others did not, and of course argued for better monetary policy to contain it. So many of the arguments of the time are still around, especially the many excuses for inflation other than monetary and fiscal policy.

It was an exciting and engaging conference. We hope you enjoy reading about the proceedings. We're looking forward to the next annual Monetary Policy Conference in May 2025.

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