Central bank policies after the crisis

Blinder, Alan S.; Ehrmann, M.; de Haan, Jakob; Jansen, David-Jan

10 Central bank policies after the crisis

Alan Blinder, Michael Ehrmann, Jakob de Haan and **David-Jan Jansen**[1]
Princeton University; ECB; De Nederlandsche Bank; De Nederlandsche Bank

Ten years after the financial crisis, a key question is whether the various changes in central bank policy that have been introduced since will turn out to be temporary, or whether these changes are here to stay. To shed light on this question, we have conducted surveys among central bank governors and academic economists covering four themes: central bank mandates, central bank policy tools, central bank communication, and the relationship between central banks and government.[2]

Central bank mandates

Several central banks have seen their mandates expanded after the global financial crisis. This tendency is also reflected in the survey results, which show that a majority of respondents (62% of central bankers and 54% of academics) have reconsidered the mandate of their central bank, in countries affected by the crisis and in non-crisis countries alike. Moving away from the predominant pre-crisis view that central banks should mainly be concerned with price stability, many respondents in our surveys mention that financial stability considerations should also be part of the central bank mandate.

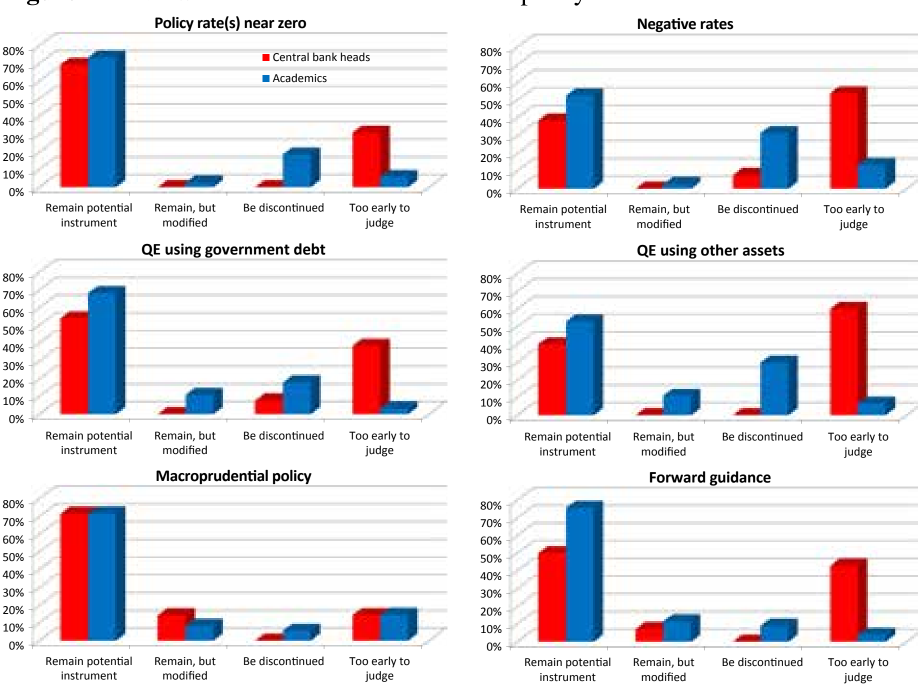
1 The views expressed here are those of the authors and do not necessarily represent the views of the European Central Bank, the Nederlandsche Bank or the Eurosystem.

2 See Blinder et al. (2017). The surveys were conducted between February and May 2016. Responses were received from 55 central bank heads and 159 academics. The latter are members of the NBER and CEPR research networks. While the central bank responses are highly dispersed geographically, most academic respondents are from the US, the UK and the euro area.

Policy instruments

Confronted with a massive financial crisis and its repercussions, as well as stubbornly low inflation rates, central banks have resorted to a large number of new policy tools. The survey has covered respondents' opinions about the most important ones – namely, low policy rates, negative policy rates, asset purchase programmes, macroprudential measures, and forward guidance. Figure 1 provides the corresponding responses. Central bank governors are typically more cautious in their responses than academics, often finding it too early to come to a final assessment of a particular tool. A more detailed analysis reveals, however, that those central bank governors who have previously deployed a particular tool are more likely to think that this tool should remain in the central bank's toolkit, be it in its current or a modified form (for details, see Blinder et al. 2017). Academic economists, in contrast, tend to have made up their mind and favour keeping most of the new tools. The area where both respondent groups are in greatest agreement is macroprudential policy, with large majorities proposing its further usage.

Figure 1 Views on the future of central bank policy tools



Notes: The figure reports response shares obtained from academic economists (blue bars) and from central bank heads in advanced economies (red bars).

Source: Blinder et al. (2017)

Central bank communication

Before the financial crisis, central bank communication had already evolved into a major instrument in central banks' toolkits (Blinder et al. 2008); the crisis reinforced this trend. The survey results show clearly that central banks have stepped up their communication efforts (more than 80% of central bankers and academics think that communication has intensified), and there is consensus that these changes are here to stay, or will go even further.

Communication can be very effective. A well-known example is ECB President Draghi's "whatever it takes speech" in London in 2012. Prior to this speech, markets had started pricing currency convertibility risk into the government bonds of several stressed euro area countries. Draghi's unequivocal statement and the subsequent announcement of the ECB's Outright Monetary Transactions (OMT) Programme calmed markets without spending a single euro under this programme.

Forward guidance about policy rates has become a major communication device (Moessner et al. 2017), but central bankers and academics have different views on its future. Most academics would like to relate the time horizon over which the central bank foresees keeping policy rates low to incoming data, whereas central bankers prefer purely qualitative forward guidance (the horizon of which is tied neither to economic data nor to calendar dates). A better understanding of the effectiveness of different types of forward guidance is therefore warranted. Coenen et al. (2017) provide some evidence in this direction by testing how forward guidance shapes private-sector expectations, and whether these effects differ across different types of forward guidance. By looking at how government bond yields respond to macroeconomic surprises and by studying the disagreement across economic forecasters, they show that forward guidance has been more credible when tied to a distant future calendar date, or when tied to incoming data (in contrast to forward guidance that is purely qualitative or tied to a calendar date not too far in the future). Credibility of forward guidance is furthermore strengthened in the presence of an asset purchase programme, indicating that the various monetary policy tools interact and therefore should not be judged in isolation.

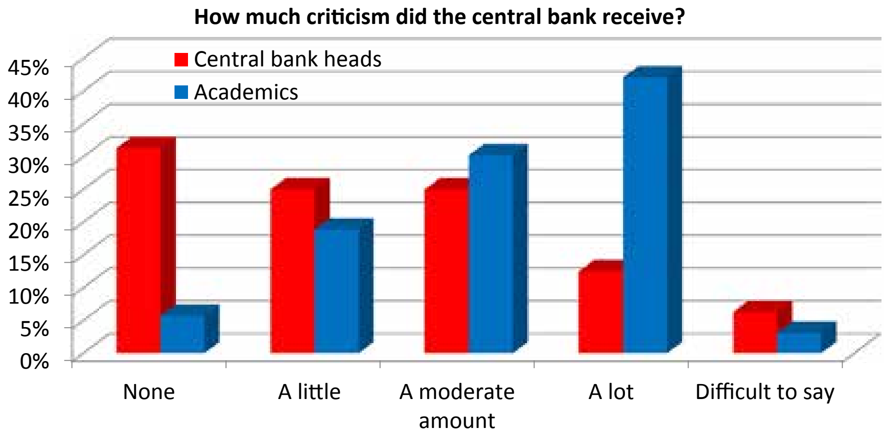
Central bank independence

In some countries, the central bank's crisis-fighting efforts did not go undisputed. Academics in particular perceived that their central bank has received considerable criticism (Figure 2). They are also more concerned about changes to their central bank's independence from government, with almost 40% seeing moderate or even substantial threats to independence – in contrast to more than 70% of central bankers seeing no or only little threats to independence.

Alesina and Tabellini (2008) argue that delegation of decision-making authority to non-elected bureaucrats is especially beneficial when the tasks are technical in nature and policies do not have first-order distributional effects. This sounds like monetary policy. Although conventional monetary policy transfers wealth between borrowers and lenders, it is widely believed that the primary impact of policy rate changes is on output and inflation and that its distributional effects are secondary. However, macroprudential and unconventional monetary policies may have stronger distributional consequences than conventional monetary policies.

Furthermore, financial support to ailing financial institutions and asset purchase programs imply a non-trivial chance that the central bank, and thus indirectly the country's taxpayers, will suffer a loss. For this reason, they are often called *quasi-fiscal policies*, a term that suggests that such actions constitute a kind of government spending. The survey results show that central banks which resorted to unconventional monetary policies, and in particular those that purchased assets other than government debt, were more likely to have received criticism for their actions. What is more, the likelihood that a central bank governor sees no threat to independence is considerably smaller in countries where the central bank has received a lot of criticism and in countries where there was a public discussion about the central bank's mandate (for details, see Blinder et al. 2017).

Figure 2 Assessment of the criticism central banks have received in their crisis-fighting efforts



Notes: The figure reports response shares obtained from academic economists (blue bars) and from central bank heads in advanced economies (red bars). Source: Blinder et al. (2017)

Final remarks

The financial crisis has changed the way central banks conduct policy in several dimensions. Due to the severity of the crisis and the need for central banks to act quickly, there was often only little time to consider the pros and cons of the various measures. Still, the results of our surveys suggest that most of these changes will stay. We do therefore expect the central bank of the future to operate with broader mandates, to employ a wider range of tools (especially macroprudential tools) and to place even more emphasis on communication.

References

Alesina, A and G Tabellini (2008), “Bureaucrats or politicians? Part II: multiple policy tasks”, *Journal of Public Economics* 92: 426-447.

Blinder, A, M Ehrmann, J de Haan and D Jansen (2017), “Necessity as the mother of invention: Monetary policy after the crisis”, *Economic Policy* 32(92): 707-755.

Blinder, A S, M Ehrmann, M Fratzscher, J de Haan and D Jansen (2008), "Central bank communication and monetary policy: A survey of theory and evidence", *Journal of Economic Literature* 46: 910-45.

Coenen, G, M Ehrmann, G Gaballo, P Hoffmann, A Nakov, S Nardelli, E Persson and G Strasser (2017). "Communication of monetary policy in unconventional times", ECB Working Paper No. 2080.

Moessner, R, D Jansen and J de Haan (2017), "Communication about future policy rates in theory and practice: A Survey", *Journal of Economic Surveys* 31(3): 678–711.

About the authors

Alan Blinder is the Gordon S. Rentschler Memorial Professor of Economics and Public Affairs at Princeton University. He is also Vice Chairman of the Promontory Interfinancial Network, and a regular columnist for the Wall Street Journal. Blinder served as Vice Chairman of the Board of Governors of the Federal Reserve System, June 1994–January 1996. Blinder has written scores of scholarly articles, and authored or co-authored 20 books, including the award-winning *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*. Blinder earned his A.B. at Princeton University, M.Sc. at London School of Economics, and Ph.D. at MIT

Michael Ehrmann is Head of the Monetary Policy Research Division in the ECB's Directorate General Research. Previously, he worked as Director in the International Department and as Head of Research at the Bank of Canada, and held various positions at the ECB, including Head of the Financial Research Division. His research covers central bank communication, monetary policy transmission, international finance and household finance. It has been published in leading academic journals, including the *Journal of Finance* and the *Review of Economics and Statistics*. He holds a PhD in Economics from the European University Institute in Florence, Italy.

Jakob de Haan is Head of Research of De Nederlandsche Bank and Professor of Political Economy, University of Groningen, the Netherlands. He has been Scientific Director of SOM, the graduate school and research institute of the faculty of Economics and Business of the University of Groningen. He graduated at the University of Groningen, where he also got his Ph.D. He has published extensively on issues like public debt, monetary policy, central bank independence, political and economic freedom and European integration.He is member of the editorial board of *Public Choice, European Union Politics,* and the *Journal of Common Market Studies*, He has been editor of the *European Journal of Political Economy*, and has been President of the European Public Choice Society. De Haan has been Visiting Professor at the Free University Berlin (2003/4), Kiel Institute (2002, 2010), and the University of Munich (1999). He is also Research Fellow of CESIfo.

David-Jan Jansen is a policy adviser in the Financial Stability Division of De Nederlandsche Bank. He received degrees in economics from the University of Groningen (Dr 2006, MSc 2002) and a degree in history from Utrecht University (BA 2011). His publications include articles in *Economic Policy*, the *Journal of Economic Literature*, the *Journal of Money, Credit and Banking*, and the *Review of Finance*.