



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Rethinking Economics *in Central Banks* after the Crisis

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Introduction

- Before the crisis, central banking was “easy.”
 1. Largely involved setting a single interest rate.
 - Cost of mistakes “small.”
 2. Implementation of policy seen as a separate process.
 3. Macro prudential policy was little used and seemed unimportant if not hypothetical.
 4. Rules of thumb & simple tools helpful.
 - E.g., Taylor rule, HP filter ...



Impact of Crisis

- The crisis has changed all that:
 1. Old rules of thumb and standard tools seen as unreliable.
 - Neutral interest rates & potential output highly uncertain; ...
 - Phillips curve appear to have flattened.
 - Microprudential regulation & supervision insufficient.
 2. ZLB has made interest rate policy (almost) obsolete:
 - Market operations more important (LTROs, SMP, OMT, QE).
 3. Need for macro prudential policy, with which central banks have little experience.



Economics in Central Banks

- Huge increase in demand for economic analysis.
 - How do we best meet that demand?
 - Audiences for economics in central banks and universities.

Dornbusch (1988):

As a student and early in my career, models and results were exciting ... Today my interests are in ... policy-oriented research. The difference is subtle: in modelling the main interest is in the structure and the implications; in policy-oriented research ... the central issue is to capture a problem even if one does not write down the whole maximization problem ... there is broad complementarity between modelling and identifying and “painting” issues.



The Central Bank Audience

- How can we cater to policy makers?
 - Policy makers have short time horizons.
 - Short periods in office.
 - Discount “things that haven’t happened yet.”
 - Want robust, practical & policy relevant analysis.
 - Interested in economics as a useful tool and not in displays of “technical virtuosity” (Summers, SJE, 1991).
 - Avoid “complexity for complexity’s sake.”
 - 1/3 World Bank reports never downloaded.

The Central Bank Audience (cont.)

- Scientific community values strong and novel findings excessively (Manski 2010).
 - Requires implausible assumptions.
 - Shapes the views of central bank economists.
 - Provides strong incentives.
- Will new findings stand the test of time?
 - Findings reversed by plausible alternative assumptions, definition of variables or sample period?
 - Robustness important.
 - Filtering of new economic analysis.

The Central Bank Audience (cont.)

- Dominant paradigms?
 - Have seen theories come and go.
 - “Fine tuning” vs. “broad exploration” (Caballero, JEP, 2010).
 - Diversification (Summers, SJE, 1991).
- Simple policy rules, if feasible:
 - Common in many policy areas (Haldane, JH, 2012).
 - Seen as credible by the public and policy makers.

Conclusions

- Crisis has led to huge demand for economic analysis.
- To be influential among policy makers:
 - Need to recognise the audience.
 - Focus on the main, robust messages.
 - Avoid unnecessary complexity.
 - Take a broad perspective, recognising that few findings are immutable.