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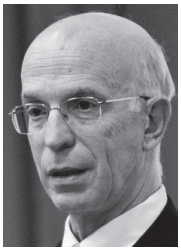
Monetary Policy after the Crisis



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TRANSITORY OR PERMANENT CHANGES IN MONETARY POLICY?

A key question today is to what extent changes in monetary policy introduced during the financial crisis will prove to be temporary, or whether we are seeing permanent changes in the practice of monetary policy. In Blinder et al. (2016), we aim to shed light on this question by discussing four themes: the mandate for monetary policy, the instruments, the role of communications and the place of the central bank within government. We discuss insights from academic research on these themes and present the results of two surveys of 55 central bank governors and 159 academics which we conducted between February and May 2016.[1]

The financial crisis has transformed monetary policy in various countries, which is most clearly shown by the range of unconventional instruments deployed, such as asset purchase programs, forward guidance and negative interest rates. The severity of the crisis and the resulting urgency to act did not leave much time to weigh up the pros and cons of different options. Necessity was often the mother of invention. We conclude that many of these changes are here to stay and expect future monetary policy to be more often based on a broader central bank mandate. Furthermore, the central bank's toolbox will contain a broader range of instruments than before the crisis, in which communications play a key role. Increasing erosion of central bank independence cannot be ruled out.

THEME 1: BROADER MANDATES, ALSO IN NON-CRISIS COUNTRIES

Broader central bank mandates appear to be gaining support. A majority of the respondents indicated that the crisis had caused them to reconsider the central bank mandate, central bankers (62 percent) even more so than academics (54 percent). Central bankers whose countries were affected by the crisis in particular have reconsidered the mandate. Thinking, however, has changed more broadly: central banks in non-crisis countries, for instance, are also likely to have reconsidered their mandate. The underlying tendency reveals that respondents particularly favor widening the mandate to include financial stability; a preference expressed, remarkably, to the same extent among countries not directly hit by the crisis. This represents a fundamental shift from the pre-crisis consensus that central banks should primarily aim for price stability.

THEME 2: BROADER RANGE OF INSTRUMENTS

In quite a few countries, the crisis does not seem to have affected the basic approach to monetary policy in a drastic way. This is clearly illustrated by the fact that 70 percent of central bank governors did *not* consider using interest rates near zero, negative rates, or quantitative easing (QE) in any form. In that sense, the world of central banking has not changed nearly as much as concentrating on the Fed, the ECB, the Bank of England, and the Bank of Japan, or, for that matter, on the academic literature, might indicate.

Opinions on the future use of these unconventional monetary policy instruments differ. For example, there is far from any consensus on the future use of QE. Some 21 percent of central bankers believe purchasing government bonds should *not* be a routine instrument in the future, whereas nearly 40 percent think it is too early to make a call. Academics are more positive, as 68 percent believe that purchasing government papers should remain an option.

Similarly, opinions on the use of negative interest rates differ. Only 22 percent of central bank governors wish to keep this option, whereas over half think it is too early to say. Again, academics are more unanimous: 53 percent would leave the option open of using negative interest rates in the new normal.

The only common ground between central bankers and academics is the use of macro-prudential instruments. In line with wider mandates, three quarters of respondents – both central bankers and academics – are of the opinion that these instruments must continue to be available.

Lastly, a notable aspect is that central bank governors who deployed an instrument previously are keener to keep it for future use should the need arise. The likelihood of a positive assessment of QE (using government papers) is 25 percentage points higher if a central bank governor has used the instruments (Table 1, column 3).

THEME 3: EVEN MORE COMMUNICATIONS ABOUT MONETARY POLICY

It was evident before the crisis erupted that communications play a key role in monetary policy (Blinder et al. 2008). Our surveys show that the importance of communications increased further during the crisis. Over 80 percent of the central bank governors stated that they intensified communications during the crisis. Roughly half indicate that they plan to keep using communications, and 20 percent state that they will even step up communications.

Probably the best-known example of communications during the crisis is the "whatever it takes" speech of Mario Draghi in July 2012, but communications increased on a much larger scale. For example, the Fed-

[1] The academics are members of renowned research networks (NBER and CEPR). Most respondents are from the United States, the United Kingdom and the euro area.

Table 1

Effect of use of instruments on their positive assessment

	1	2	3	4	5	6
	Low interest rates	Negative interest rates	QE using government papers	QE using other assets	Macroprudential instruments	Forward guidance
Increase in likelihood of positive assessment	41 *	17	25 *	15	40 *	43 *

Note: Marginal effect (in percentage points) for probit model in which a (0, 1) variable based on responses from central bank governors was the dependent variable. Based on 55 observations. * = significant at the five percent level.

Source: The authors.

eral Reserve and the Bank of Japan both announced formal inflation objectives in early 2012. The Fed also started hosting press conferences following interest rate decisions, the Bank of England decided to disclose the minutes of monetary policy meetings sooner and the ECB began to publish its monetary policy accounts in early 2015.

Probably the most complex form of communications, forward guidance, became more prominent after the initial lower limit of nominal policy rates had been hit, helping to steer rates by managing expectations. Roughly half of the central banks in our sample say they used some form of forward guidance during the crisis. Those who used it are 43 percentage points more likely to assess this instrument positively (Table 1, column 6). A clear consensus is still lacking, however, on the exact form that forward guidance should ideally take. The biggest group of central bankers (39 percent) prefers qualitative forward guidance, but around a quarter tends to make it dependent upon incoming economic data (data-based or state-contingent forward guidance). Again, consensus is far higher among academics, with nearly 70 percent opting for data-based guidance.

THEME 4: CHANGING CENTRAL BANK INDEPENDENCE?

During the crisis, central banks in many countries faced increasing criticism. Nevertheless, our respondents indicate that central bank independence has remained unchanged to date. However, academics in particular are concerned about independence going forward. Almost 40 percent feel independence is jeopardized either "to some extent" or "to a great extent".

Central bankers are less worried about their independence, with over 70 percent indicating that their institution's independence over the next few years is a subject of no or minor concern. As our samples were not fully comparable, with most academics being from the United States, the United Kingdom and the euro area, we also made a comparison with central bank governors from advanced economies. This group of central bank governors, which makes for better comparison with academics, also states that independence is not a primary concern.

REFERENCES

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