Monetary economics is a different specialty

Colloquium in honour of Claudio Borio

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One reason why I am particularly glad to be here this afternoon is to provide witness that academic economic study can be beneficially continued, even after formal retirement. I do very much hope that Claudio will continue the good work that he has now done for so many years here.

Another reason for being glad to be on this panel is to have the opportunity to emphasise that monetary economics is not only a distinct and separate branch of wider macroeconomics but is even in several ways in some considerable tension with it.

Thus, macro is primarily abstract, theoretical and largely mathematical, whereas monetary economics is more practical, empirical and quite largely historical. Macro focuses on the achievement of equilibrium by forward-looking representative agents who have rational expectations. In contrast, monetary economists are worried about disequilibria, in particular financial crises, often partially driven by myopic, speculative financiers. As you know, a major part of Claudio's work has been about the necessity of achieving financial stability, as an essential complement to price stability.

Another distinction between monetary and macro economists is that macro economists tend to relate the basic decisions being made by the representative agents just to interest rates, without having much regard for the transmission mechanism via the financial system in between. A major focus of Claudio's work has been to emphasise that financial conditions can vary over time, independently of both the real economy and the level of interest rates. For example, one of his main papers has been "The financial cycle and macroeconomics: what have we learnt?".[1]

One of the interesting aspects of the changing nature of macro and monetary economics has been how concern and emphasis on regular cycles, whether trade (business) cycles or financial cycles, has fallen away. It seems to have been largely replaced by a view that at any point in time there is something of a normal state of economic affairs, though regularly disturbed by erratic shocks.

But this normal level is determined by a series of starred variables, r*, u* and y*, which cannot be directly observed. In this they share the typical macro features, being abstract, theoretical and unobservable! Monetary economists, like Claudio and myself, are not comfortable with this, any more than we have been comfortable with the whole DSGE (dynamic stochastic general equilibrium) paradigm.

[1] Borio, C (2012): "The financial cycle and macroeconomics: What have we learnt?", *BIS Working Papers,* no 395, December.

Indeed, in so far as central bankers have bought in wholesale to this new paradigm, Claudio has provided something of a running critique from the viewpoint of more traditional monetary economics. As a monetary economist myself, I have greatly welcomed this. At times it may have been a bit sensitive for this to have been done at the BIS, but it has been exceedingly good in my view that Claudio's excellent monetary economics has continued to have had such a central outlet.

I do hope that he will continue with the good work in future, whatever retirement will bring. And that the special viewpoint of monetary economics, as so ably represented by Claudio – and William White, Manager of the Monetary and Economic Department before him – will continue to have a welcome home here.