

Robert Holzmann: The central bank of the future - opportunities and challenges

Opening remarks by Dr Robert Holzmann, Governor of the Oesterreichische Nationalbank, the Austrian central bank, at the Oesterreichische Nationalbank (OeNB) Economics Conference and SUERF Conference Colloquium, Vienna, 11 June 2024.

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Check against delivery

Distinguished guests,

Welcome to this year's OeNB Economics Conference and SUERF Colloquium.

Let me start by thanking you all for joining us, both virtually and in person. I would also like to extend my sincere gratitude to the distinguished speakers, panelists and researchers who have agreed to honor us with their contributions to this event. And last but not least, a heartfelt "thank you" also goes to all the people involved in the organization of this event.

Last year, we celebrated the 60th SUERF Anniversary and the 50th OeNB Economics Conference, but in a different venue. As a belated gift, we are privileged to be back in this beautifully refurbished cashier hall – our Kassensaal.

As we gather once again for this conference, let's take a moment of reflection and anticipation. Last year, our discussions centered around the theme Monetary policy in uncertain times: Towards robustness and resilience. It was an exploration of the challenges facing our economies amidst the backdrop of unpredictability. In my introductory remarks at last year's conference, I spoke about the "prophetic capacities" of OeNB-SUERF conferences. This year, I plan to harness this prophetic power as we embark on a journey to discuss and design the central bank of the future – a central bank that is not only reactive but one that is well-equipped to navigate the complexities and uncertainties that lie ahead.

Some reflections on current challenges

As we reflect on the first 25 years of the euro, we cannot overlook the challenges we faced. Many of these challenges have left legacies that will continue to shape our future journey:

One of these challenges stems from the necessity of employing unconventional monetary policies that arose when we found ourselves at the effective lower bound. The consequence of these policies is the accumulation of vast balance sheets, which now exert pressure on central bank profits. This puts central banks in a delicate position. While our balance sheets now consist of assets yielding low interest rates, commercial banks enjoy a substantial 3.75% interest payment through our deposit facility. This differential has led many central banks in developed countries to report losses, some of them significant.

Though these losses may not immediately harm the functionality of central banks, they do raise some questions. Scenarios may emerge where central bank independence may come under threat due to financial strains. The crucial question whether central bank finances are relevant for fulfilling our mandate will be rigorously debated in tomorrow's policy session. We are at a pivotal moment that demands careful consideration and collective engagement.

Second, while we will listen to some new ideas during this conference, also concepts that were treated somewhat neglectfully during the past episode of very low interest rates, are welcome. As an example, I refer to the link between money growth and inflation, which was found to be virtually non-existent in the very low inflation period. But recent research by the BIS (Borio et al., 2023) finds that in high-inflation regimes, it is indeed helpful to incorporate money growth in inflation forecasts as it improves them substantially. Moreover, our own research suggests that money growth has leading indicator properties and can therefore be helpful for identifying inflation regime changes (Ringwald and Zörner, 2023).

I think this is an excellent example how we would have delivered better forecasts in the post-pandemic inflation surge by simply acknowledging the importance of certain factors in different economic regimes. Overall, this highlights the regime dependency we face in the conduct of monetary policy. We should therefore be open to concepts that are probably of less importance today but might be helpful after a regime change in the near future.

The central bank of the future: coping with an ever-changing environment

As we delve deeper into our discussions, I would like to highlight two key topics that warrant our attention: unconventional monetary policies and the concept of r-star.

The response of central banks to the effective lower bound through the adoption of unconventional monetary policies marked a paradigm shift in policymaking. These measures expanded our toolkit, enabling us to navigate through challenging economic landscapes with greater flexibility and potency. However, as time has passed and more data have become available, it is imperative that we assess whether these measures have indeed achieved their intended objectives. Moreover, dedicated research has delved into the potential side effects of these policies, providing valuable insights into their efficacy and impact.

To shed light on these crucial questions, my team has undertaken a rigorous systematic literature review of the empirical literature surrounding unconventional tools, which will become available soon. Through an exhaustive analysis of approximately 130 academic papers published since 2008, we have gained valuable insights into the effects of various unconventional measures on key economic dimensions such as price stability and financial stability (Stelzer, Spisso and Zörner, 2024). Our findings indicate strong evidence that many of these measures, including quantitative easing policies, have successfully achieved their intended goal of boosting inflation and growth. However, the picture becomes less clear when examining the effects of quantitative easing on financial stability. While some studies suggest positive effects, others raise concerns about potential risks and unintended consequences. It is very important that

we take these findings seriously as we move forward. Learning from both successes and potential errors of the past will be instrumental in shaping our future policy decisions.

As a last point here, I would like to turn our attention to the concept of the neutral or equilibrium real interest rate, commonly known as r -star as a guidepost for monetary policy. In recent years, there has been growing interest in understanding the dynamics of r -star, which is the equilibrium rate that neither stimulates nor contracts the economy. Estimates indicate a declining trend of r -star, which might even reach or fall below zero in some cases, although more recent estimates suggest a slight increase. While some may view r -star as a "blurry guidepost for monetary policy," as stated by BIS research (Benigno et al., 2024), I believe there is intellectual value in this ongoing debate. If we were able to engineer a re-rise in r -star, we could potentially revert to a less distortionary conventional monetary toolbox while simultaneously enhancing welfare.

So, the question arises: How can we increase r -star, and what structural policy interventions are necessary? From my perspective, there are three main avenues for this. First, an increase in total factor productivity, facilitated by initiatives such as digitalization, artificial intelligence, and policies aimed at mitigating climate change – perhaps best in a disruptive way in the vein of Schumpeter – may increase r -star. Second, it could be beneficial to enhance the labor market participation rate, ensuring that a larger portion of the population is actively engaged in the workforce. And finally, facilitating capital flows from the Global North to the Global South could help by fostering economic development and investment opportunities in emerging economies. My paper on these ideas is under preparation but unfortunately not fully ready for this conference.

Communication is key

I would like to address a final, yet crucial aspect: the communication of complex monetary policy concepts to the broader public. Effectively communicating such complex matters not only fosters accountability and trust but also plays a pivotal role in shaping inflation expectations – an essential component of monetary policy transmission. As we navigate through uncharted territory and confront the potential challenges facing the central bank of the future, it is imperative to reiterate the paramount importance of communication. Effective communication is and always will be key to our success. I am delighted to announce that our opening keynote presentation today will be delivered by Professor Orphanides from MIT, who will illuminate the critical role of central bank communication. His insights promise to enrich our understanding and provide valuable guidance as we endeavor to communicate with clarity and transparency.

Central bank strategy reviews as a pivotal element

Let me once again ask the question: How can we equip the central bank of the future to effectively navigate unforeseen challenges?

I would like to highlight a best-practice example for a forward-looking approach – the strategy review of the ECB in 2021. This comprehensive review examined the suitability of our monetary policy strategy for both present circumstances and the future. While its

primary focus was on addressing the effective lower bound constraints, it also laid the groundwork for potential challenges that may arise in the future. Indeed, while the effective lower bound may not be our primary concern at present, it would be imprudent to dismiss the possibility of encountering similar constraints again.

At the recent retreat of the Governing Council in Ireland, we started to discuss the form and content of our mid-term strategy review, to be completed in 2025. This review will provide a further possibility for a forward-looking exercise that explicitly considers recent challenges.

Allow me to conclude my introductory remarks by highlighting additional topics that I deem highly relevant for the future conduct of monetary policy. While unconventional methods have proven effective in times of very low interest rates, they have also left long-term effects that can complicate policy in the current high inflation regime. Thus, it is imperative that we discuss and develop more robust approaches to monetary policy to avoid such challenges in the future. Furthermore, we must not overlook neglected relationships, such as the link between money growth and inflation, as they may offer valuable insights in different economic regimes.

Lastly, I want to emphasize the importance of considering structural change, which can significantly impact inflation developments. Whether it's the productivity slowdown I previously mentioned in my remarks on r^* , or shifts in wage dynamics – understanding these structural changes is essential for informed policy decisions.

I am confident that many of the topics discussed here today and throughout the conference will resurface in one form or another during the ECB's next strategy review.

I wish us all an interesting conference with many ideas to share and take home. Thank you!

I want to thank Thomas Zörner (OeNB, Monetary Policy Section) for his excellent research and support in putting together these opening remarks.

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