MONETARY POLICY POST-PANDEMIC: BALANCING REACTIVITY AND PREDICTABILITY

FRANÇOIS VILLEROY DE GALHAU

JACKSON HOLE ECONOMIC SYMPOSIUM
AUGUST 27, 2022
MONETARY POLICY BETWEEN ART & SCIENCE

• Blinder (1997), *What Central Bankers Can Learn from Academics—and Vice-Versa*
  • “Having looked at monetary policy from both sides now, I can testify that central banking in practice is as much art as science. Nonetheless, while practicing this dark art, I have always found the science quite useful.”

• Blanchard (2006), *Monetary Policy; Science or Art*
  • “Monetary policy can pretend to be close to science if it can be conducted using simple and robust rules […] Monetary policy must be closer to art if it is frequently confronted to new, poorly anticipated and poorly understood, contingencies.”

• Mishkin (2007), *Will Monetary Policy Become More of a Science?*
  • “The progress that the science of monetary policy has made over recent decades has significantly expanded the degree to which the practice of monetary policy reflects the application of a core set of “scientific” principles. […] I will argue that there remains, and will likely always remain, elements of art in the conduct of monetary policy.”
THE SCIENCE’S CORE PRINCIPLES

1. Central Bank Independence
   • Strict separation from fiscal policy
   • Experience of the 1970s and understanding of the inflation bias

2. Inflation Targeting
   • Price stability as a key objective
   • Inflation targets to provide the nominal anchor

3. Interest Rates as a Primary Instrument
   • Less emphasis on monetary aggregates
   • Cashless limit of New-Keynesian models

4. Rules rather than discretion
   • Inflation targeting as constrained discretion
   • Taylor-type rules

5. Communication & Transparency
   • Managing expectations about future policy
   • Forward guidance

Source: O. Garnier’s Presidential Lecture at the French Economic Association
CURRENT IMPORTANT QUESTIONS FOR MONETARY POLICY

• Shape of the Phillips curve
  • Flat? Only temporarily asleep? Convex?

• How do inflation expectations affect inflation?
  • What pass-through of inflation expectations to inflation?
  • What horizon of expectations matter most?
  • What role does past inflation play beyond expectations?

• What about Forward Guidance?
  • What room for it away from the ELB and in an uncertain environment?
4 POSSIBLE LIGHTS FOR A NEW PREDICTABILITY

1. Forward Guidance on the Path < Commitment on End Objectives
2. Being Gradual < Being Orderly
3. Reaction Function when Surprises:
   Risk Management on Inflation > Expectations Management on Interest Rates
4. Normalization ≤ R* ≤ Tightening