BANQUE DE FRANCE
EUROSYSTÈME

MONETARY POLICY POST-PANDEMIC: BALANCING REACTIVITY AND PREDICTABILITY

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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