



# Back to the future: intellectual challenges for monetary policy

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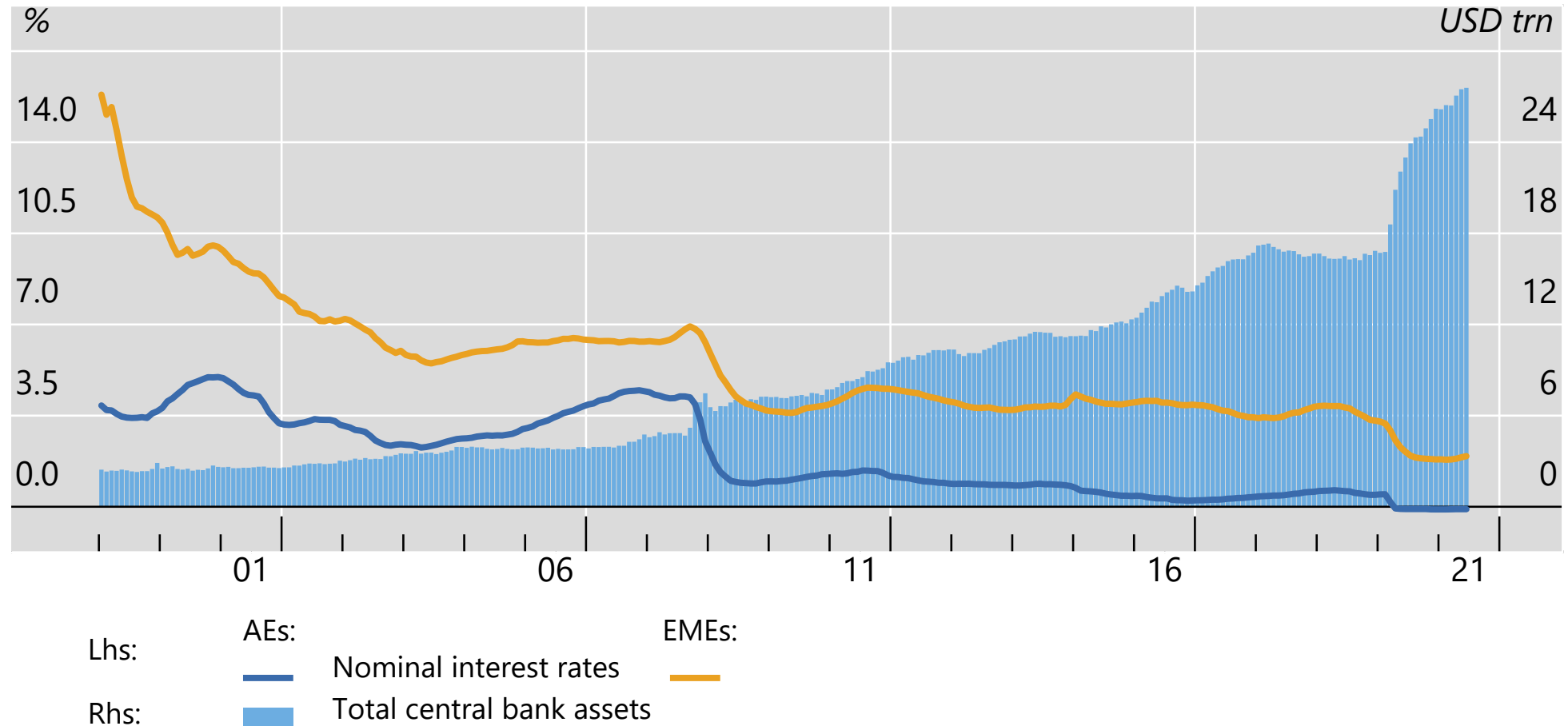
Head of the Monetary and Economic Department

David Finch Lecture, University of Melbourne, 2 September 2021

\*The views expressed are those of the author and not necessarily those of the BIS

# Narrowing room for policy manoeuvre

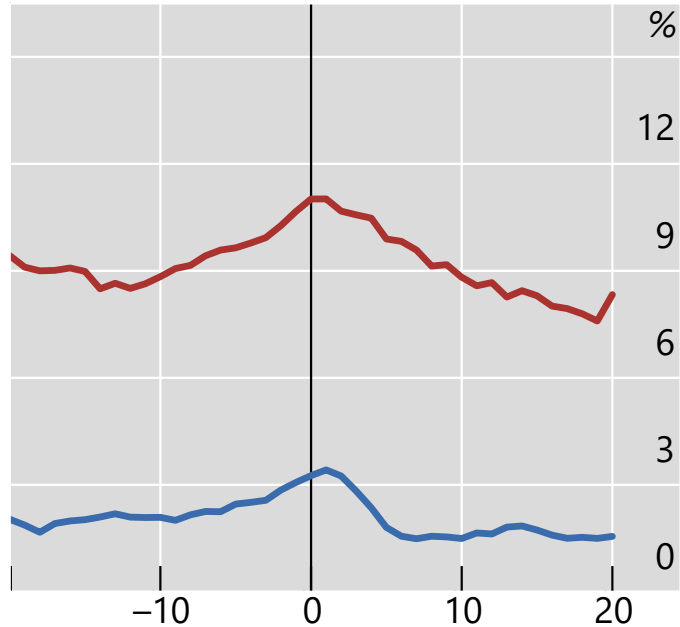
Interest rates and central bank balance sheets



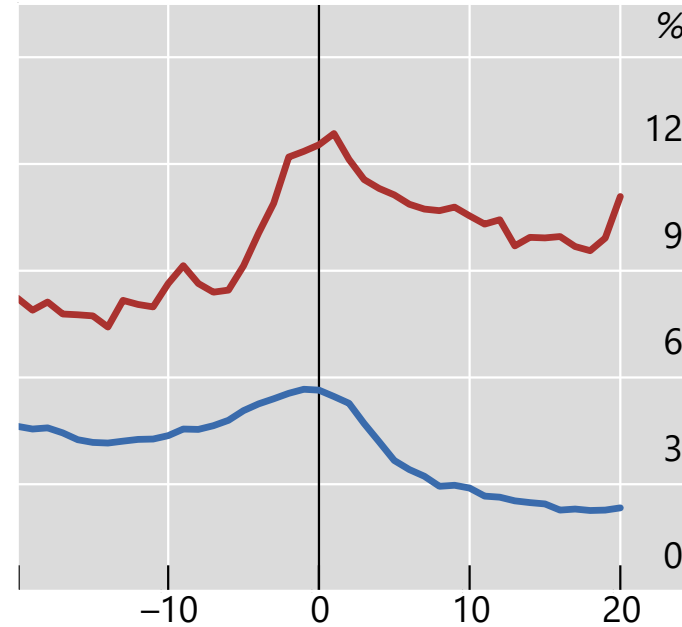
Source: BIS, *Annual Economic Report: Editorial*, June 2018, pp ix–xvi.

# The changing nature of business cycle

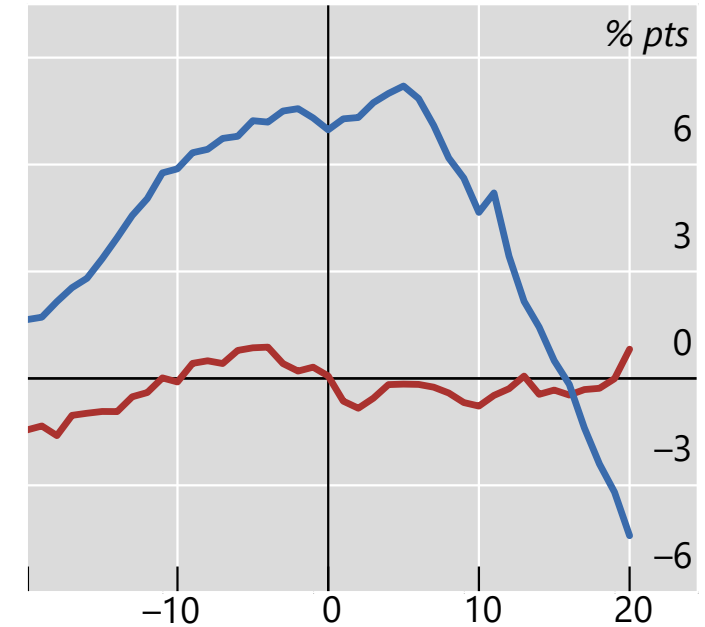
## Inflation



## Short-term interest rate



## Credit-to-GDP gap



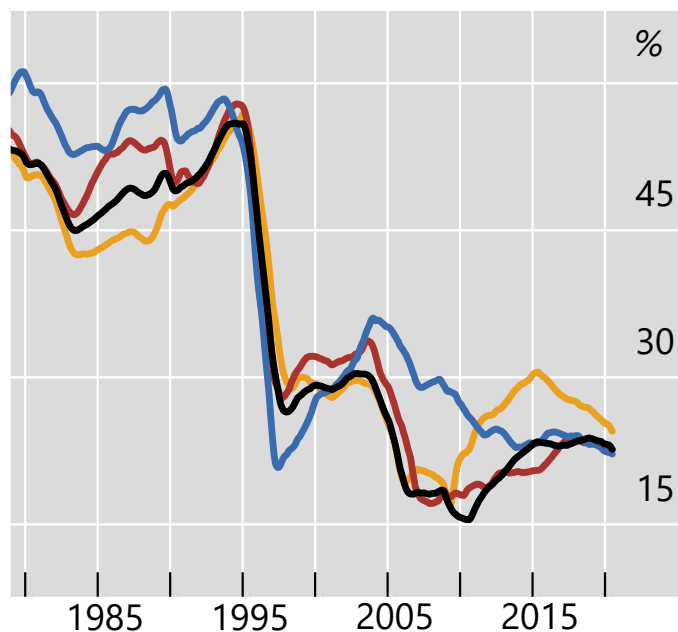
Quarters around beginning of recessions

— 1970-85    — Since 1985

Source: C Borio, M Drehmann and D Xia, "The financial cycle and recession risk", *BIS Quarterly Review*, December 2018, pp 59-71.

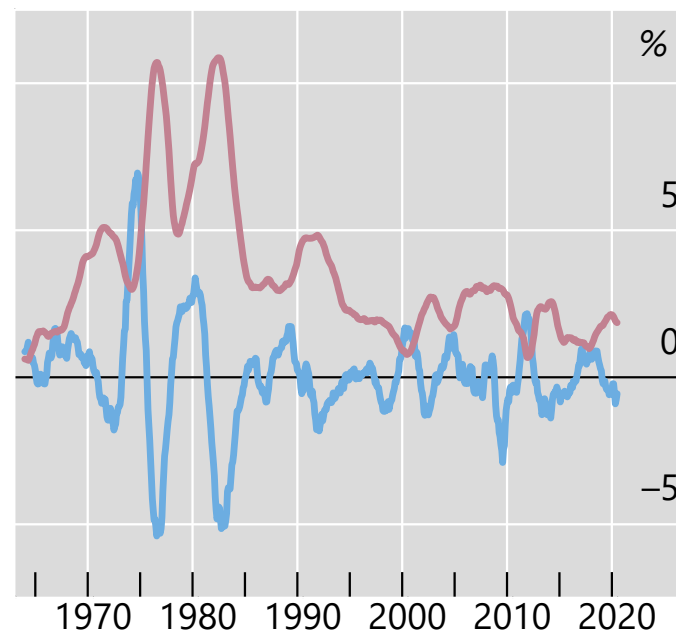
## The common component of inflation drops

Time-varying fraction of variance attributable to the common component



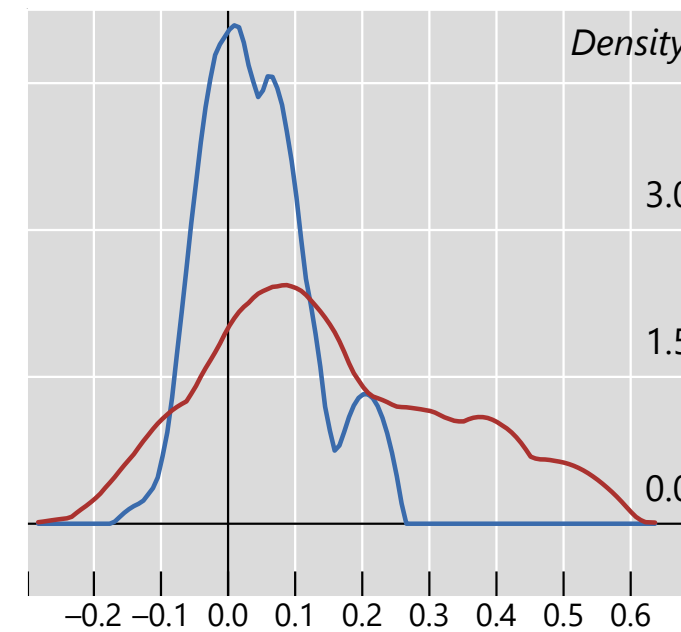
12-month percent change  
 — All sectors      — Services  
 — Durable goods  
 — Non-durable goods

US headline PCE components



— 12-month trend inflation  
 — 12-month transitory inflation

The pass-through of “salient” relative price increases to core PCE has declined



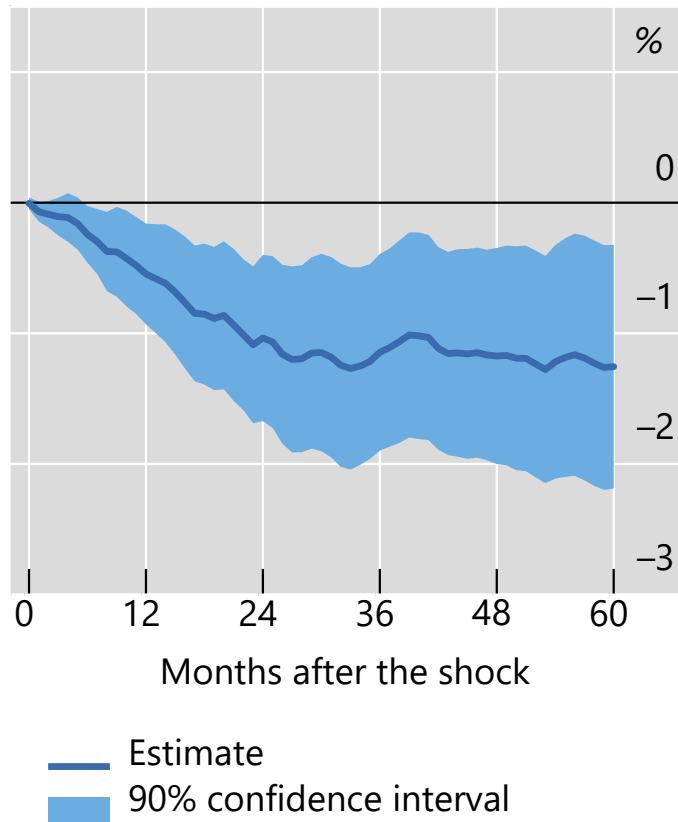
Standardized pass-through coefficients

Sample period: — 1960-1985  
 — 1986-2019

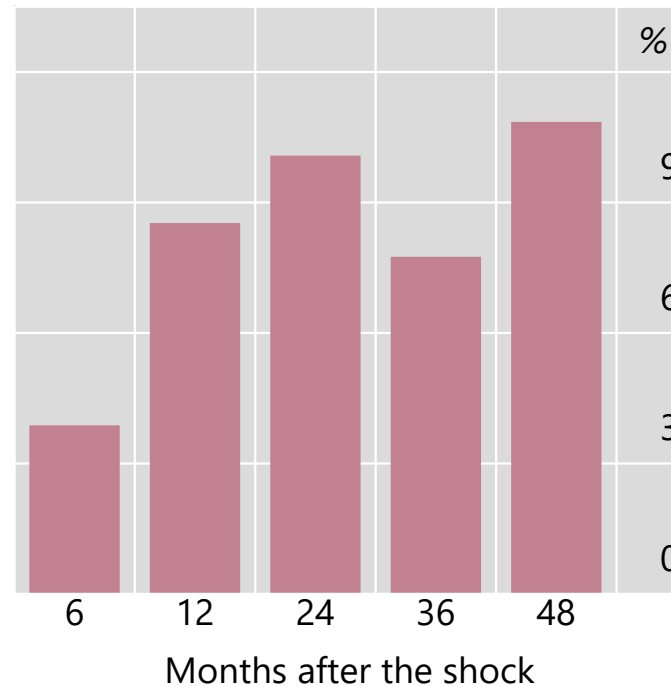
Source: C Borio, P Disyatat, D Xia and E Zakrajšek, “Monetary policy, relative prices and inflation control: flexibility born out of success”, forthcoming.

## Monetary policy loses traction

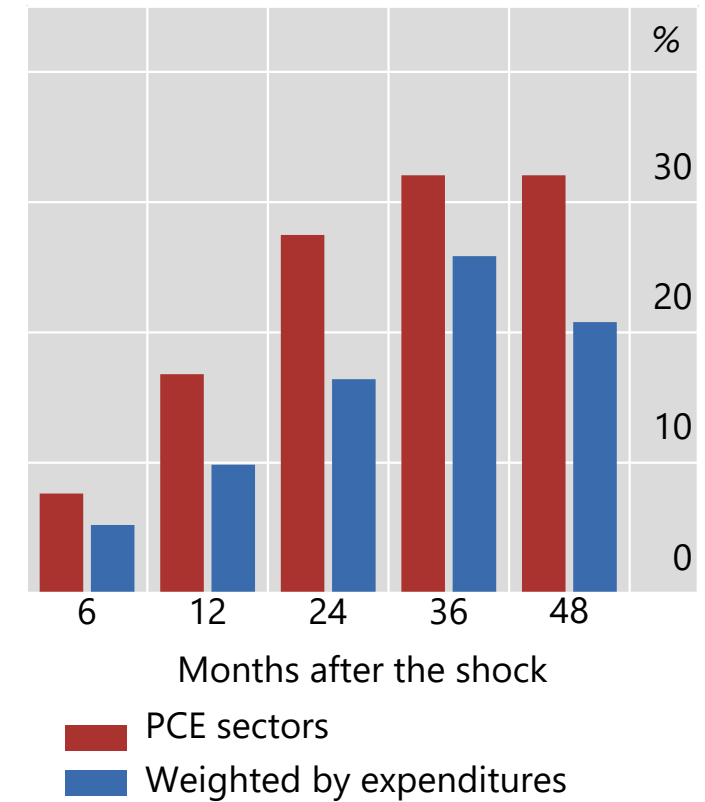
Response of the common component of sectoral price changes



Percentage of sectors with significant sector-specific price response



Percentage of sectors with significant price response



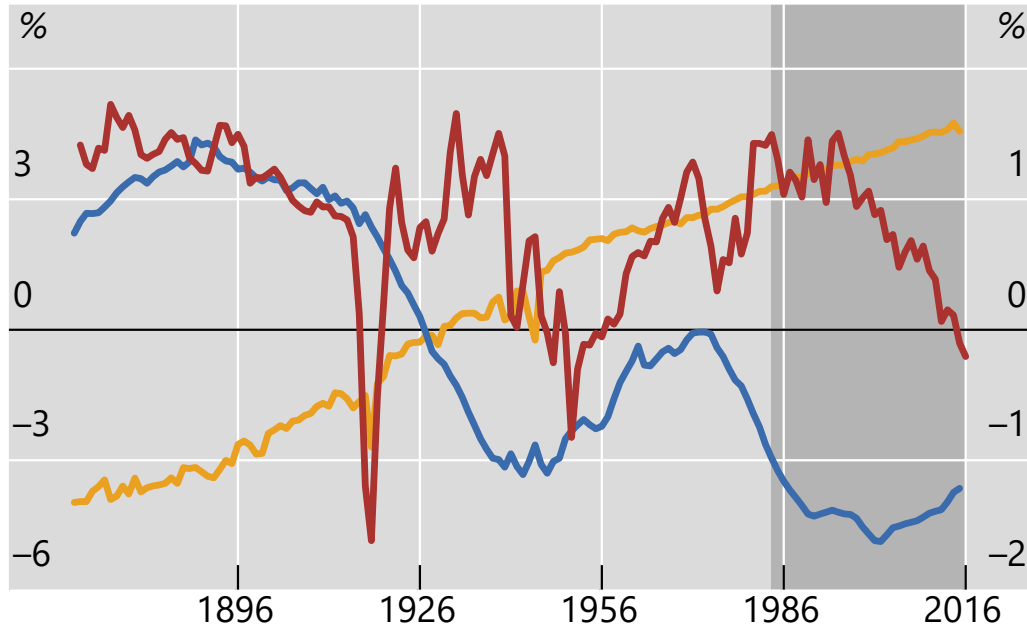
Source: C Borio, P Disyatat, D Xia and E Zakrajšek, "Monetary policy, relative prices and inflation control: flexibility born out of success", forthcoming.



## Annex

# r-star and its determinants

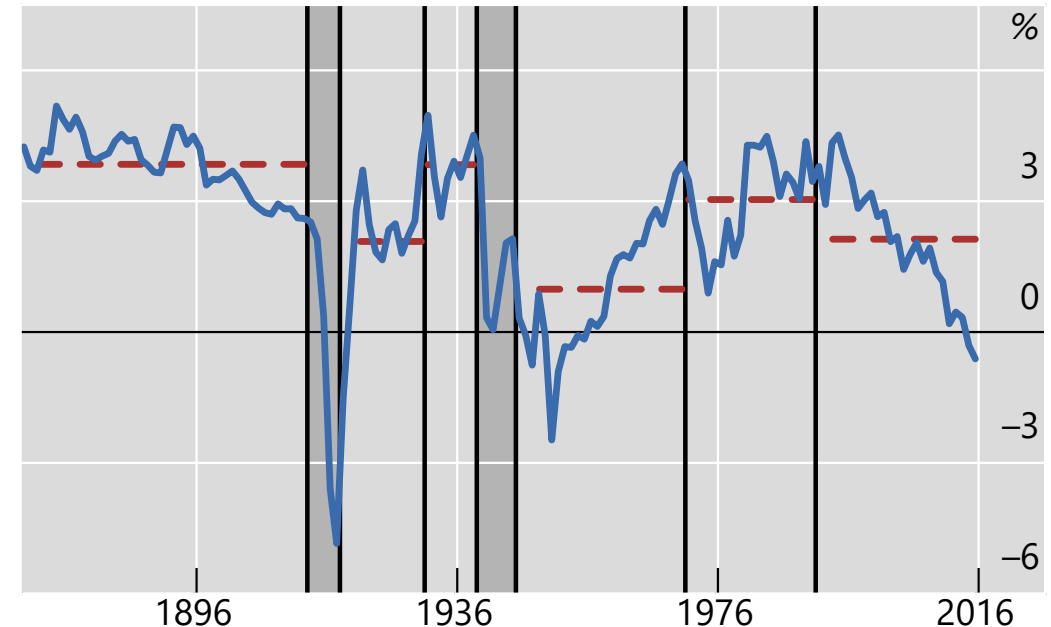
## Demographic variables



Lhs: — Long-term real rates

Rhs: — Dependency — Life expectancy

## Median long-term rate across countries

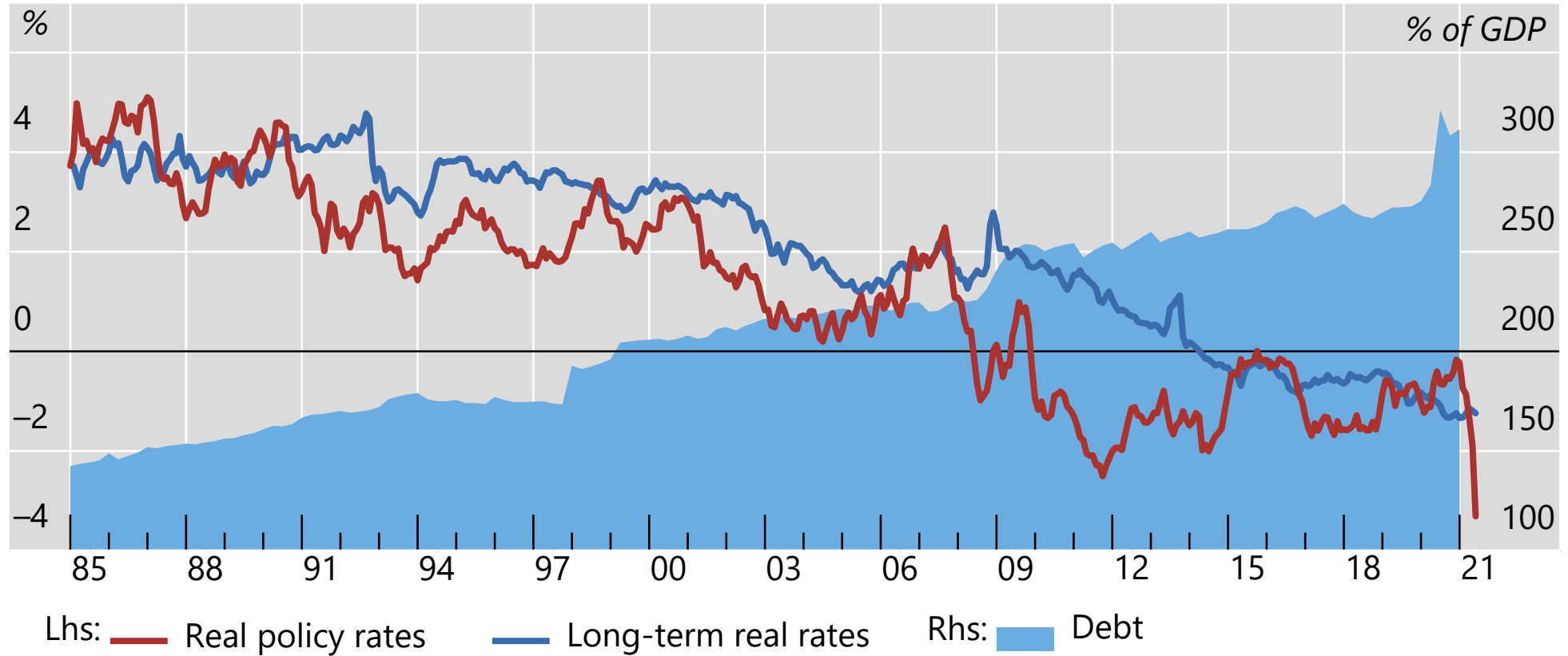


— Median — Average

Source: C Borio, P Disyatat, M Juselius and P Rungcharoenkitkul, "Why so low for so long? A long-term view of real interest rates", *BIS Working Papers*, no 685, December 2017.

# The debt trap

Interest rates sink as debt soars

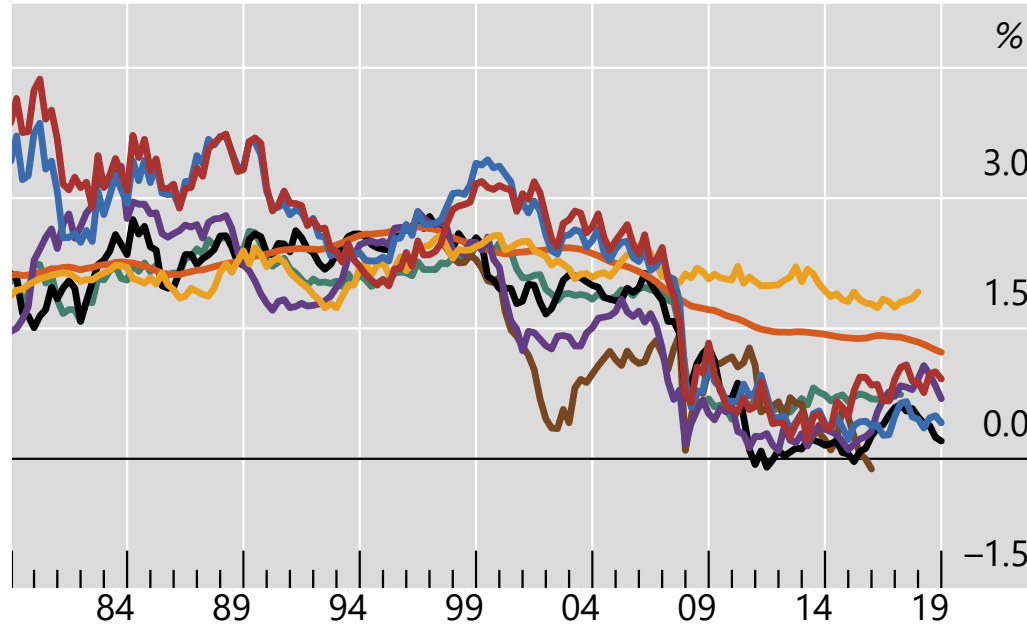


Sources: Bloomberg; Datastream; national data; author's calculations.



# Estimates of natural interest rates

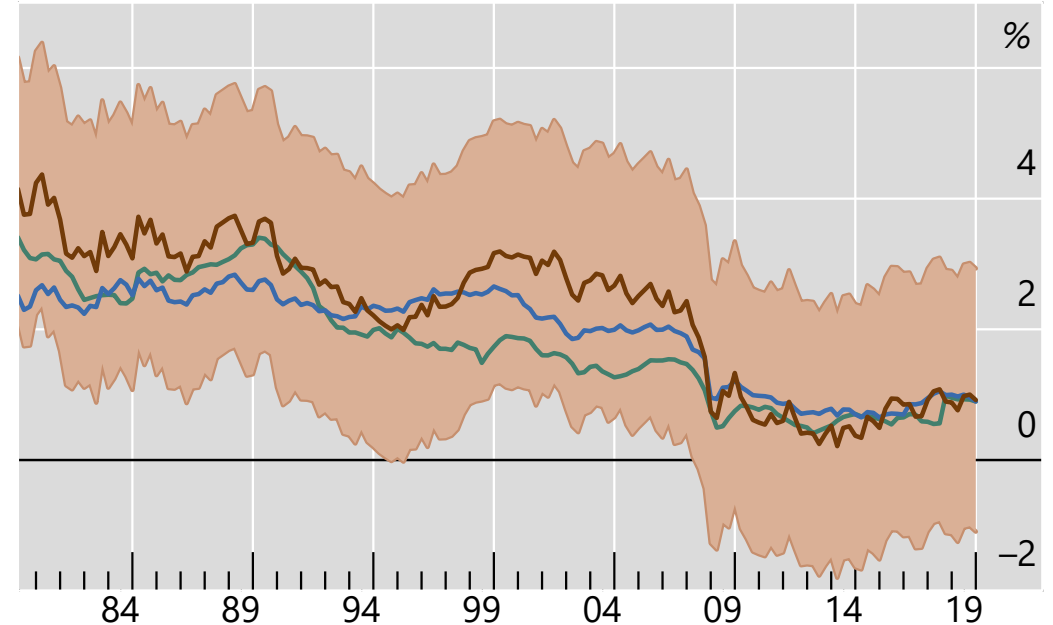
Variation across estimates



r\* estimates for US:

- Laubach and Williams
- Johanssen and Mertens
- Del Negro et al - VAR
- Christensen and Rudebusch
- Holston et al
- Lubik and Matthes
- Del Negro et al - DSGE
- Kiley

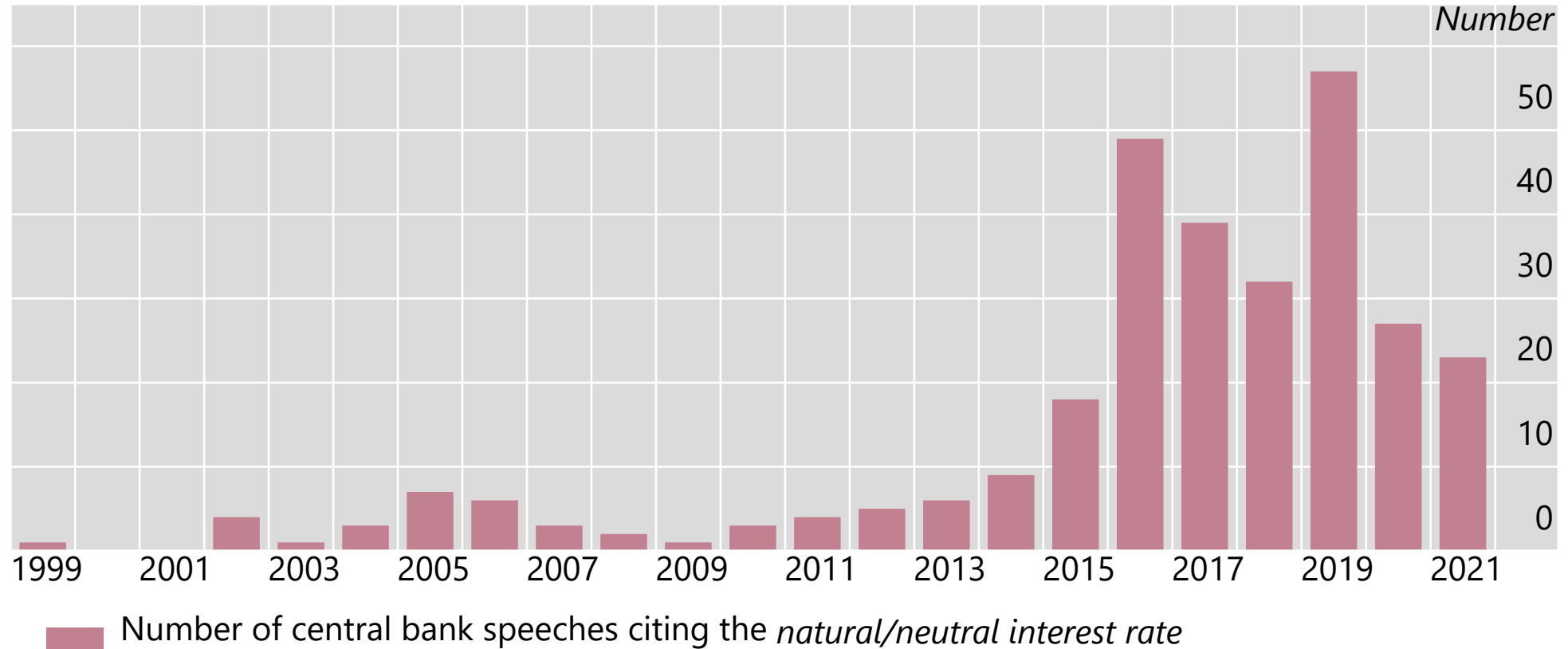
Average estimates have drifted down over time



- Laubach-Williams estimates with  $\pm 1$ -sd confidence band
- Mean of US estimates
- Mean of non-US estimates

Sources: Armelius et al (2018); Carter et al (2019); Christensen and Rudebusch (2019); Del Negro et al (2017); Fries et al (2018); Holston et al (2017); Johanssen and Mertens (2016); Kiley (2015); Laubach and Williams (2003); Lubik and Matthes (2015); McCririck and Rees (2017); Sudo et al (2018); Bank of England (2018); BIS calculations.

## Central bank speeches mentioning the *natural interest rate*



Sources: BIS; author's calculations.