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Editorial

Conference Report on the 51. Radein Research Seminar "Monetary Policy: Current and Future Challenges"

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For Walter Eucken, the founding father of the German concept of Ordnungspolitik, a functioning monetary system was the pre-condition for a functioning economic system. He spoke of the "primacy of monetary policy design".[1] The Global Financial Crisis which mutated into a fully-blown euro crisis in Europe has demonstrated, once again, how powerful monetary disorder can affect the economy. For monetary policy the crisis was a major challenge and for much of the period 2008 to 2018 monetary policy has been in crisis mode. In fact, while the US has come a long way towards "normalisation", monetary policy in the euro zone has only just taken the first timid steps in this direction.

The crisis has brought numerous challenges for central banks. First, they had to fight against the acute danger of a melt-down of the banking system. This operation has been mostly successful, in many cases with the help of governments. However, the deep recession and the need to prop up banks resulted in a crisis of government finance, most notably in some countries of the euro zone. As a consequence, the danger of a break-up of the euro zone appeared. Thus, the Eurosystem was confronted with the – controversial – task of keeping the euro zone intact. Lackluster bank lending and inflation rates hovering stubbornly around the zero line provided further challenges for the Eurosystem. On top of this, in many countries, policy makers have been facing a severe lack of trust in the financial system. This has become highly visible in Switzerland where a popular initiative has tried to bring about a complete re-structuring of the banking system. All in all, in many countries, monetary policy has not yet reached the "normal" again and it seems doubtful whether this will be the case in the future, after all.

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[1] "Die Währungspolitik besitzt daher für die Wettbewerbsordnung ein Primat" (Eukken, 1952/1990, p. 256).

Thus it is not surprising that the Radein-Verein selected, once again, a monetary topic for its annual conference. From February 19 to 24, 2018, the Research Seminar Radein hosted the 5-day conference entitled "Monetary Policy: Current and Future Challenges", for the first time in collaboration with *SUERF* (the European Money and Finance Forum). Participants were invited to submit papers to *Credit and Capital Markets (CCM)*. This selection of papers has been reviewed by the organizing committee and then again peer-reviewed by referees in order to get selected for the special issue, to improve further and finally get ready for publication.

A first set of papers is dealing with current issues in unconventional European monetary policies.

The first contribution "The asset purchase programme of the ECB: motivations, effectiveness and risks" by Stefano Neri and Stefano Siviero (Banca d'Italia) presents a review of the challenges faced by the ECB since the outbreak of the global financial crisis. From 2008 to 2014, the need to preserve the correct functioning of the monetary policy transmission mechanism and ensure the supply of credit to the private sector stretched the limits of conventional monetary policy. In 2015, the risk of deflation led the ECB to start an asset purchase programme. This paper also offers a review of the many analyses that Banca d'Italia staff has produced in recent years on the factors that have brought inflation to unprecedented low levels in 2014 and on the effects of the ECB's asset purchase programme. As a by-product, the paper also shows how policy and research continuously interact, in a closely-knit two-way relationship. On the one hand, policy provides researchers with important questions to be addressed. On the other hand, high-quality research is essential to contribute to policy debates and policymaking.

In his paper "The limits of a negative interest rate policy (NIRP)" Gerhard Illing (LMU University of Munich) analyzes the experience with unconventional measures. In particular, the paper focuses on three non-standard monetary policy measures: (1) the implementation of a quantitative easing (QE) in combination with the strategy of forward guidance to reduce risk- and term-premiums on long-term interest rates, (2) slightly negative interest rates set by monetary policy in order to stimulate economic activity and (3) raising the target rate of inflation to a level above 2 percent. The paper concludes that QE in combination with forward guidance has been effective in lowering long-term interest rates. Moreover, negative interest rates have been successful in pushing the effective lower bound below zero. Both variants of unconventional measures have had significant effects on financial variables and have contributed to stabilizing the real economy. However, these measures come along with the risk of damaging financial stability and central bank independence. Furthermore, they appear to be less powerful and shorter-lived compared to standard monetary policy measures. In turn, raising the inflation target up to 3 to 4 percent seems to be the most promising way to relax the constraint imposed by the zero lower bound by providing a resilient buffer for effective stabilization.

The next contribution “Unemployment as a target for central banks? The case of hysteresis” by Ansgar Belke (University of Duisburg-Essen and Centre for European Policy Studies, Brussels) looks at the de facto importance of unemployment as a target for central banks. For this purpose, he focuses on the strength of links between the demand and supply sides of the economy. He argues that the classical view – that only cyclical policies influence the former and solely structural policies the latter – has been challenged by recent evidence in the wake of the Global Financial Crisis in two ways: first, by the observation that long periods of weak demand can lead to rising structural unemployment and a permanently lower capital stock – the so-called hysteresis effects; and second, by the corollary suggestion that stronger demand fueled, for instance, by monetary policy might be able to reverse such effects. The author cautions that the Blanchard and Summers type of hysteresis approach should not be taken literally and transformed one-to-one into recommendations for monetary policy. He shows that merely referring to the hard form of “reverse hysteresis” and calling for bold counter-cyclical monetary (and fiscal) policies to cope with hysteretic unemployment is neither necessary nor sufficient. Instead, subtler forms of hysteresis should be taken into account. They indeed leave some room for monetary policy to maneuver, but in a much more complex way. If long-term unemployment is stagnating, even a contractionary monetary policy stance would be optimal.

In his paper “Forward guidance, the Neo-Fisherian approach, and the Fiscal Theory of the Price Level” Peter Spahn (University of Hohenheim) assesses various “unconventional” analytical views and policy approaches advanced in recent years to control the value of money, particularly in a scenario of low growth and unemployment. First, he investigates Forward Guidance, a communication strategy by which central banks attempt to decrease the real interest rate by low nominal rates and by creating excessive inflationary expectations. Second, he addresses the Neo-Fisherian approach which suggests, on the contrary, to increase nominal rates immediately to the long-run equilibrium value that corresponds to the inflation target. Third, he puts the “Fiscal Theory of the Price Level” which maintains that goods prices jump to a level that validates the long-run sustainability condition of government debt under scrutiny. He criticizes all three approaches for analytical and empirical reasons.

Finally, Ulrike Neyer (Heinrich Heine University Düsseldorf) analyses the implications of post-crisis developments for the independence of the European Central Bank (ECB). In her paper “Die Unabhängigkeit der Europäischen Zentralbank” (“The independence of the European Central Bank”) she first discusses the different elements of central bank independence and the motivation for making central banks independent and highlights the important role of credibility. In a second step, she briefly analyses the degree of ECB independence before the crisis. Subsequently, two main questions are tackled. First, are new instruments and tasks a threat to ECB independence? And second, can it be justified that an independent institution such as the ECB is endowed with these tasks or is there a democratic deficit? She concludes that one should basically be critical of the Public Sector Purchase Programme (PSPP) and the new responsibilities in banking supervision on both counts.

A second bulk of papers refers to more fundamental issues such as the choice of a monetary system and monetary history.

In their paper "The Swiss Sovereign Money Initiative" Katrin Assenmacher and Claus Brand (European Central Bank) are discussing the proposals of a public initiative (the "Vollgeld-Initiative") in Switzerland that has been rejected in a public referendum in June. The proposal foresaw that all money is created by the central bank and that commercial banks are banned from creating demand deposits. And demand deposits are required to be held in off-balance sheet accounts at commercial banks. The proposal is then compared to its historical predecessor, the Chicago plan. The authors argue that the Swiss initiative would not have tangibly enhanced financial, monetary, and economic stability. Specifically, if implemented earlier, it would not have addressed the root causes of the Global Financial Crisis and would have been ineffective in changing its course and its consequences for Switzerland. Though the "Vollgeld" proposal would have turned commercial bank money into central bank money, close-money substitutes would likely have remained on the liability side of commercial bank balance sheets. "Vollgeld" would also unlikely have redeemed promises of ancillary effects such as a reduction in public debt, more sustainable economic growth, and less complex regulation. According to the authors, forestalling and tackling financial imbalances requires limiting leverage and safeguarding liquidity buffers through bank-level and system-wide rules and regulation.

Juha Tarkka's (Suomen Pankki) paper "What can we learn from the real bills doctrine?" provides a survey of the long-run development of the banking doctrines, focusing especially on the views concerning the appropriate liquidity policy of commercial banks, and how those views relate to the question of solvency. His starting point is the real bills doctrine, which is the classical model of how banks should ensure their liquidity. The paper then follows the development of liquidity doctrines through the historical evolution of the monetary system and banking regulation. On the basis of this survey, some issues are identified on which the historical perspective could shed some light. The relationship between the liquidity of a commercial bank and the real cash flow of its customers, which is the centerpiece of the real bills doctrine, is discussed. This view is contrasted with the main alternatives which emphasize the saleability of the bank's asset portfolio or the pledgeability of the potential collateral assets. The paper also looks at another axis of historical movement, in addition to the solvency/liquidity dimension): the reliance on well-functioning financial markets and the reliance on central banks as a source of liquidity. There have been significant swings along that axis, too. During the latest financial crisis, the need for central bank liquidity sky-rocketed as money markets proved to be unreliable as a source of liquidity; but after the crisis, there has been an ongoing regulatory effort to strengthen bank liquidity by increasing the banks' holdings of liquid securities. The parallels of that scenario with some historical periods of development of the banking doctrines are finally pointed out.

The paper "Money and Credit: Lessons of the Irish bank strike of 1970" by Malte Krueger (University of Applied Sciences Aschaffenburg) deals with an interesting episode in monetary history, the bank strike of 1970 that led to a complete shut-down of the main part of the banking system from May to November 1970. The effects of this strike were surprisingly limited. This had led some observers to conclude that trade credit can easily substitute for bank deposits as a means of payment. In this paper, it is shown why it was possible to continue "business as usual" for an extended time period. Subsequently, the author argues that such a situation would not have prevailed much longer. Due to rising risks for almost all economic actors the use of trade credit would have declined and economic performance would have deteriorated progressively.

On behalf of the organizing committee of the Research Seminar Radein and *Credit and Capital Markets* we wish to thank the authors and referees of the papers for working with us on a tight schedule and the conference participants for stimulating comments that led to papers even more significant for academics and practitioners alike.

This issue (Heft 4) of *Credit and Capital Markets* contains most of the papers of the main conference. The following issue (Heft 1) finally gathers papers from the authors Neyer, Spahn and Tarkka.

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