

Perspectives on Global Monetary Policy

Finding Harmony in the Noise: Transitioning to a New Normal

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*The views and conclusions are exclusively the responsibility of the author and do not necessarily reflect those of the institutions he is or has been involved with.

Navigating by the Stars (r^* , u^* , π^*) in a New Normal (?)



COVID & its Aftermath

-Deep Knightian Uncertainty-



COVID Shock – Policy Response

- Phase 1: 2020 – *Prevent Depression + Stable Financial System*
- Phase 2: 2021 – *Excessive Stimulus / Global Inflation Spike*
- 2022 – : *New Normal (?) Uncertainty on the rise (?)*

New Geopolitical Landscape - Fragmentation

- 1. Russian invasion of Ukraine***
- 2. US-China –between decoupling and rivalry-***
- 3. From Globalization to Nearshoring - GVC / North America***
- 4. Major immigration challenges***
- 5. Political extremes bring trouble and instability***

We have faced Complex and Uncertain Conditions (not a Standard Case)

Fiscal Policy	Labor Markets	Aggregate Expenditure	Inflation	Monetary Response
<p>Massive fiscal spending</p> <p>1. Larger in AEs than in EMs</p> <p>2. Sharp country differences</p> <p>Higher Debt levels</p> <p>Deficits still too high</p> <p><u>Societies hooked on anesthesia</u></p>	<p>Acute Pandemic distortions</p> <p>Labor shortages</p> <p>Early retirement</p> <p>Low participation</p> <p>Vacancies spikes</p> <p>Low unemployment</p> <p>Beveridge threshold ($v/u > 1$)</p> <p>Non-linear Phillips curve -</p> <p>New Tech. (AI)</p>	<p>Massive transfers to households</p> <p>Increase in savings</p> <p>Pent up demand</p> <p>Higher propensity to consume</p> <p>Goods demand spike</p> <p><i>YOLO attitude</i></p> <p><i>-you only live once-</i></p>	<p>Global Inflation Spike</p> <p>Misjudged: fiscal stimulus & households' behaviour</p> <p>1. Labor shortages</p> <p>2. Supply chain shortages</p> <p>π Persistence</p> <p>Highly Uncertain</p> <p>Not Standard Supply & Demand Shocks</p>	<p>Tighter Monetary Policy</p> <p>Contrast between EMs and AEs: <u>timing & vigor</u></p> <p>QE delayed the response in AEs</p> <p>Limited wage catch up</p> <p>Excessive stimulus + late pivot = long hangover (financial woes & excess volatility)</p>

Key Monetary Policy Challenges

- 1 **COVID massive nonlinear shock** -*deep uncertainty- EM type of shock-*
- 2 **COVID mayor social scaring** -*incentives for historically loose policies-*
- 3 **Excessive fiscal transfers** -*“large parachute” allowing for a softish landing and lower financial risks-*
- 4 **Large inflation forecast errors** -*Inflation Forecast Targeting remains your best option -learn & update- use scenarios for potential shocks*
- 5 **Atypical shocks and dynamics require an agile monetary response** -*or risk falling behind the curve & amplifying financial strains-*
- 6 **Post-COVID disinflation** -*well anchored inflation expectations essential*
-*adjust policy rates based on your best forecasts-*
- 7 **Trust & reputation are key** -*need to work every day to maintain credibility-*

8 Robust Monetary Policy under Shocks

- + **Under potential structural changes in the economy and expectations formation:**
 1. ***A stronger response to inflationary pressures is needed***
 2. ***Efficient policies exhibit high degree of inertia***
- + Min-Max optimizes among the worst-case scenarios.
- ☐ ***Under COVID-Knightian Uncertainty: ... to expect the dynamic of a standard supply shock was extremely “optimistic”...***

Key Monetary Policy Challenges

Robust Strategy & Effective Communication

- 1 **Focus on mandate** -avoid distractions-
- 2 **Standard and Flexible Monetary Framework**
 - **Flexible Inflation Forecast Targeting**
 - *Mindful of the effective-lower-bound, but without distorting the framework*
 - Flexible Average Inflation Targeting adds noise due to previous inflation forecast errors -shock dependent-*
 - *Maintain the Navigating Stars (r^* , u^* , π^*) through the storm*
- 3 **Double down on transparency:**
 1. *about the economy, even under deep uncertainty, and*
 2. *about your reaction function and forecasts*
- 4 **Address clearly the spillovers from fiscal policy:**
 - its effects on the economy, inflation and financial markets
 - sustainability challenges -avoid fiscal dominance-
- 5 **Mind the Global Financial System:**
 - Systemically large AEs set the rhythm and tempo, EMs must be in harmony, even if their taste is for a different melody.....



Deep Causes of Instability and Noise

Nations and societies are defined by shared goals and values

- 1 Societies “Achilles’ heel” is polarization and fragmentation.
- 2 Social media has further balkanized our societies.
- 3 Democracies decision-making is shifting from the median voter to extreme positions.
- 4 Polarization puts key apolitical institutions at risk.

Central Banks’ institutional framework and independence are at risk;

their actions must be insulated from political pressures to focus on long-term stability, creating an environment conducive to economic growth and social development.

When a country lacks a broadly shared vision of the future, it cannot enjoy a stable present, as it is continuously pulled into zero-sum quarrels and policy backpedaling.



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