

Hermann Remsperger: Research matters – SDGE models and the financial sector

Speech by Professor Hermann Remsperger, Member of the Executive Board of the Deutsche Bundesbank, at a workshop entitled “SDGE models and the financial sector” hosted by the Technical University of Darmstadt and Deutsche Bundesbank, Eltville, 26-27 November 2004.

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I am often asked what role the Deutsche Bundesbank will be playing - in five or ten years' time - not just in the Eurosystem but internationally as well. My answer is always the same. Over the longer term the importance of the Bundesbank will to a large extent depend on how we position ourselves in the field of research.

I am not saying that because so many distinguished researchers are gathered here today. Nor am I saying it because I am responsible for our research centre.

No, I want to emphasise the role of research because in the field of monetary policy, we are faced time and again with new questions which call for theoretically and empirically founded answers. At the same time there are the familiar old problems such as the stability of the demand for money, which have to be continually re-analysed.

This strive for knowledge is gaining importance also because the influence of National Central Banks within the Eurosystem depends predominantly on the weight of their arguments.

The meetings of the ECB Governing Council are not a debating club for doves and hawks where everyone knows in advance what the others are going to say about interest rates. It is precisely at monetary policy meetings that one has to have a very good idea of where the wind is blowing from in terms of research.

So it comes as no surprise that two focal points of our research agenda are closely tied to monetary policy considerations. One is dedicated to “Goals and effects of monetary policy”. In the context of the monetary transmission process, for instance, we examine the influence of corporate heterogeneity on the effects of monetary policy. In addition, we concentrate on the role of output gaps, exchange rates and monetary aggregates in monetary policy.

The other focal point is concerned with analysing how monetary policy is influenced by several long-term developments in the real sector of the economy. Globalisation of production is one of many examples in this area. Research papers on labour and capital supply as well as on potential growth are further important examples.

However, I do not want to create the impression that central banks are only concerned with monetary policy or with the next interest rate decision. As a rule, central banks direct their attention to both price stability and the stability of the financial system as both subjects are very much intertwined. In my opinion, this simple observation has far-reaching implications for a central bank's research programme.

If a central bank's research is to develop on well-organised lines, it has to be “from the top down”, with the objectives as the primary focus. You all know, that price stability has long been established as the first objective of central banks and therefore price stability has been and will remain the first objective of central bank research. As I see it, financial stability has now become the second top issue for central bank research.

Alongside and in cooperation with other departments, our research centre takes an active role in this field. For example we look at the implications of changes in the German financial system for financial stability, the implementation of lending of last resort functions and the link between the soundness of the banking system and its credit supply.

In addition, other projects are dedicated to the role of financial intermediaries in the business cycle in Germany . Furthermore, we investigate the best framework for implementing stress tests for the financial system in Germany . On top of this there is no doubt that the financial stability issue has a very important international dimension, which is a big challenge for further research.

Last but not least our research concentrates on the refinement of econometric models and forecast methods. In this regard, we are particularly interested in promoting the development of “dynamic

stochastic general equilibrium models” for the use within the Bundesbank. These models have become a backbone of theoretical as well as empirical analysis.

In modern economic research these approaches provide a consistent framework which connects theoretical foundation with empirical evidence. We at the Bundesbank are aware of the necessity to include these methods in our tool box of economic methods.

Consequently, our research programme contains several projects which will use general equilibrium models. As an example, based on earlier papers by Jana Kremer, Giovanni Lombardo and Thomas Werner, the interaction between monetary and fiscal policy, is to be illustrated in more detail. Another project will deal with the cyclical behaviour of beliefs in DSGE models.

The sheer scope of these research topics constitutes a major challenge for research management. Essentially, this is a matter of how research within a central bank is to be organised. I believe research centres like ours at the Bundesbank are essential for creating synergy effects.

But let me also emphasise how much we appreciate the support of our external research professors. They are Professor Jörg Breitung of Bonn and Professor Harald Uhlig of Berlin. We have already benefited a lot from their advice and hope for further fruitful collaboration. And we also benefit from our research council which follows our work with a critical eye and makes valuable recommendations.

Among the members of the research council are Jürgen von Hagen, Martin Hellwig and Manfred J M Neumann. Both Peter Kugler and Axel Weber have now left the council. Peter Kugler's successor is Professor Jürgen Wolters of Berlin. And our President has been succeeded on the research council by Charles Goodhart. Given this council membership I am sure you will agree with me when I end by saying that research really matters at the Bundesbank.

Against this background, I am very pleased to welcome you to this workshop on dynamic stochastic general equilibrium models and the financial sector. The workshop is being hosted by our Economic Research Centre together with economists from the Technical University of Darmstadt.