

## Jean-Claude Trichet: The role of research in central banks and at the ECB

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the ceremony for the Award of the Germán Bernácer Prize, Madrid, 21 May 2007.

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Ladies and Gentlemen,

It is a privilege and a pleasure for me to award today the 2006 Germán Bernácer Prize to Hélène Rey, Professor of Economics and International Affairs at Princeton University, for her outstanding research on financial globalization, exchange rates and capital markets.

I am particularly pleased to be here for two reasons: The 2006 Bernácer Prize Selection Committee is composed of eminent economists that have global reputation and was chaired by Lucas Papademos, Vice-President of the European Central Bank; and I had myself the honour of being in touch with Professor Rey as soon as 1998 when she led a research granted from the “Fondation Banque de France”

I like to think that the Eurosystem has to some extent contributed to the brilliant career of Professor Rey and to her challenging research agenda. First in 1998 and then in 2003 and 2004, she received grants from the “Fondation Banque de France”. More recently, in 2005, she was granted a Lamfalussy fellowship by the Research Network on Capital Markets and Financial Integration in Europe, which is jointly managed by the European Central Bank and the Center for Financial Studies at the Goethe University of Frankfurt.

Financial support for young and bright European economists is one among several ways in which the ECB and the national central banks of the euro area contribute to the enhancement of research in monetary and financial economics. This leads me to a few remarks on the role of and scope for research at the ECB and more generally in central banks.

The main goal of economic research at the ECB is to provide a strong conceptual and empirical basis for policy-making. More specifically, very important aims are to increase knowledge of the functioning of the euro area economy and to provide high-quality models, tools and analyses that are relevant for the conduct of monetary policy and the fulfilment of the other tasks and functions of the ECB.

The general purpose and specific objectives of research in central banks are seldom questioned. A debated issue, however, is whether central banks should be producers or simply consumers of research. Should central banks allocate resources to costly in-house research, rather than buying research output from universities and other research institutions? There are at least four reasons why the ECB – like many other central banks – has decided to develop its own research capability from its start.

First, central banks need research-oriented economists to follow the latest developments in economics and to recognise their potential relevance for policy-making. Let me provide an example based on the sustainability of a country’s external imbalance – a topic that greatly benefited from the work of Professor Rey. The literature has recently pointed to the limits of traditional approaches to the balance of payments, where currency depreciation provides the bulk of the adjustment needed to correct a country’s current account deficit. Traditional approaches fail to realize the consequences of financial globalization for the sustainability and adjustment of the external position. In the presence of variation in asset returns, cross-border asset holdings introduce valuation effects that decouple the dynamics of net foreign assets from that of current accounts, altering the role of the trade balance in correcting a country’s external position. Recent research at the ECB has been very enlightening in this respect.

A second reason for conducting research in a central bank is that a major task of central bank research is to bridge the possible gap between academics and policy makers and to create occasions for interactions with the academic community where the diversity of views can be expressed and discussed. For instance, at the ECB we are convinced that a thorough analysis of monetary developments – our “monetary pillar” – is important for the conduct of monetary policy and for the anchoring of inflation expectations. Our view is supported by the strong empirical link between money growth and inflation over the long-run and by theoretical considerations relating to the ability of monetary and credit aggregates to point at imbalances in the financial system and inflationary risks. Looking at the historical experience, the analysis of monetary developments has helped the ECB to

assess the risks to price stability, to identify the nature of the shocks impacting on the euro area and to signal its medium-term orientation. This has been a key factor in anchoring agents' expectations and in establishing the high credibility of the ECB. To broaden and deepen the monetary analysis we trust that it is important for us to have an ongoing, direct and candid openness to discussion with the academic world. An example is provided by the 4th ECB Central Banking Conference on "The role of Money and Monetary Policy in the Twenty-first Century", where the ECB engaged in an open debate with academics on this important topic.

A third argument to invest in central banks' research is that competition with the academic world ensures adequate monitoring of the quality of models and analytical tools used for policy. For instance, the New Area-Wide Model is a structural macroeconomic model for the euro area that has been developed by staff in DG Research for simulation tasks and scenario analysis. The model is also regularly used to produce research papers that are widely presented in academic conferences and central banks workshops. This provides a quality check and guarantees that a model used for policy analysis is kept up to the highest standards.

Finally, a fourth reason for investing resources in research is that the policy process sometimes requires research output not yet available at universities or other research institutes. The ECB has at times identified issues of fundamental importance for understanding the impact of monetary policy in the euro area, upon which limited information was available. As a consequence, the ECB has decided to lead and co-ordinate research efforts through Eurosystem networks, which involved the ECB and the national central banks of the euro area. The Monetary Transmission Network pursued for three years empirical analyses of the transmission of monetary policy in the newly formed euro area. Macroeconomic time series data were used to estimate a variety of econometric models of the transmission at euro area and national level, while microeconomic data were used to measure the effects of monetary policy on investment of non-financial firms and on the lending behaviour of commercial banks. The Inflation Persistence Network worked for two years at understanding the patterns and determinants of inflation persistence. The network availed itself of an unprecedented data set. The individual price records underlying the construction of both consumer and producer price indices was made available in a large number of euro area countries. Moreover, the network conducted surveys on price setting behaviour in nine countries of the euro area. These databases enabled to understand the behaviour of price setters, to investigate the determinants of nominal rigidities and to empirically test alternative price setting models for the euro area. Finally, the ongoing Wage Dynamics Network aims at identifying the sources and features of wage and labour cost dynamics that are most relevant for monetary policy. It aims at clarifying the relationship between wages, labour costs and prices both at the firm and macro-economic level.

The ECB trusts that research is enhanced by exposure to external ideas and latest advances in the field. This exposure is mainly achieved through regular seminars and conferences. On top of internal seminars given by staff, the ECB weekly organizes an Invited Speaker Seminar and, jointly with the Center for Financial Studies and the Deutsche Bundesbank, a Joint Lunch Seminar. It also organizes a number of conferences and workshops. In 2006, the ECB co-organized fourteen conferences on a broad range of topics, such as the theory and practice of monetary policy, wage and labour costs, financial integration and stability, financial systems and economic growth, payment and settlement issues, financial globalization and integration, financial statistics, and national accounts. Of course, a special interest is devoted to monetary policy issues. Together with the US Federal Reserve Board, the Center for German and European Studies at Georgetown University, and the Center for Financial Studies at the Goethe University, the ECB sponsors an "International Research Forum on Monetary Policy". The purpose is to encourage research on monetary policy issues that are relevant from a global perspective by organizing conferences that are held alternately in the Euro Area and the United States. Another important way to achieve external exposure is through visitors and consultants. Since 2006, the ECB awards one Wim Duisenberg Fellowship per year to internationally renowned experts who are selected to visit the bank. The aim is to promote policy-relevant research that meets the highest academic standards. A number of consultants are also invited to visit the bank and to provide their expertise on major projects or research activities.

Research at the ECB has an important external impact through a number of channels, namely presentation of research economists at workshops and international conferences, dissemination of the networks' research findings, development of new data sets, models and methodologies, and publication of ECB research papers. One prominent way to disseminate research is through the Working Paper Series. In 2006, the Series released 137 Working Papers, with 90 papers authored or

co-authored by ECB staff. These numbers stand high when compared with other institutions (such as the Federal Reserve Board) that are similar in terms of staff and tasks.

Of course, the fact that the ECB conducts its own research does not mean that it does not support – and consume the results of – research conducted outside the bank. For example, the ECB currently contributes to two research networks involving research institutes outside the Eurosystem. I have already mentioned the network on Capital Markets and Financial Integration in Europe, which was launched by the ECB and the Center for Financial Studies to stimulate research on financial integration and financial system structures in Europe, and on the linkages between Europe, the United States and Japan. The second is the Euro Area Business Cycle Network, involving the ECB, the national central banks of the euro area, the Bank of England and the Centre for Economic Policy Research. Its purpose is to achieve a better understanding of the euro area business cycle by fostering empirical analyses on this issue. The ECB is also a contributor to the Centre for Economic Policy Research and a number of other research activities carried outside the bank.

To conclude, I strongly believe that central banks need top-quality research on monetary and financial economics. Although general research of an academic nature might be better-suited for universities and research institutes, there is still scope for central bank economists to conduct research that is relevant for the conduct of monetary policy and for the other functions and tasks of a central bank.

I thank you for your attention.