Introductory remarks by William R White
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Welcome to all, and our apologies for having taken you out of Basel to this distant, but arguably more beautiful, place. The problem was not, as some have suggested, that our excellent BIS staff could not manage this conference so close to the BIS Annual general Meeting. The reality is that Basel is currently hosting the world's largest Art Fair and, even though bookings were attempted over a year ago, there were simply no hotel rooms left in the City. Let us hope that all the participants buy large amounts at high prices, and then we can be finally assured that the period of soft growth in Europe is really over.

This is our third BIS conference of this type, where we bring together central bankers and academics to talk about topical issues. We at the BIS believe strongly that practitioners and interested observers have a lot to learn from each other. This has always been well recognised on the monetary or price stability side of things, and is being increasingly recognised on the financial stability side as well. So a particularly big welcome to our academic participants.

Since I just said these conferences are focused on topical issues, let me give a few words of explanation as to why we chose this particular topic "Understanding low inflation and deflation". Given the recent rapid change in sentiment about a possible strong rebound of inflationary pressure (in the US and China), lessened deflation in Japan, the general trend to better growth numbers almost all around the world, and the resulting emphasis now being put on the need for "exit policies" I feel a little like Lee Marvin (I think) in the movie "The Magnificent Seven". Under heavy and eventually fatal fire, he asks a colleague why they came to Mexico in the first place. The colleague replies "It seemed like a really good idea at the time".

Well I feel much the same. Over a year ago, when we chose this topic, worries about deflation were in fact all the rage. Recall that bond rates had been driven down to very low levels in the US. China was being accused of exporting deflation. And, of course, Japan and Hong Kong had been experiencing deflation for some time. Moreover, global prospects for growth looked very shaky, with equity prices continuing to decline and risk premia in financial markets (especially for sovereigns) going through the roof. In many countries, the "consumer" was holding spending up, but there were also growing fears that rising consumer indebtedness would lead to a downturn before investment kicked in to help support the economy in turn. In short, deflation was either a reality or a real possibility.

What a difference a year makes. The practical question now is whether current, more favourable prospects for growth, with attendant inflationary pressures, mean that this conference is still addressing a pertinent issue. I think it is, for two good reasons.

My first reason is that, with deflation no longer a pressing problem, we now have a certain room for intellectual manoeuvre. One advantage is that, to the extent we wish to continue to focus on the threat of deflation, and in particular what to do about it, we can now perhaps speak more frankly than might have been possible a year ago. Then, some of you might well have worried about effects on markets. Today, for better or worse, the focus of the markets is elsewhere. Thus, a more open discussion may be possible about what to do extricate ourselves from whatever problems deflation might bring; rising real wages, the ZLB problem, the growing burden of nominal debts as prices fall, and finally of course the feedback effects on the financial system. A second advantage of deflation not being a pressing problem today, is that we are not likely to be exclusively preoccupied with measures to get out of deflation. Put otherwise, we do not need to focus solely on crisis management since we are not in a crisis. Rather we have the luxury of asking some longer-term questions which might help us avoid such problems in the first place; crisis prevention rather than crisis management.

One such question is whether all deflations are likely to have "ugly" implications rather than just "bad" ones. Indeed, one might even imagine "good" implications should the deflation be a result of positive productivity shocks? This issue is clearly pertinent to deciding how vigorously policy should lean against potential deflationary pressures. A second longer-term question is whether policy is sufficiently symmetric in leaning against upturns as well as downturns. This issue is clearly pertinent to assessing the dangers of interest rates ratcheting down to the ZLB, or debt levels ratcheting up over time. A third is the question of the conditions required for a country to get into a bad deflation, and what policy steps, or altered policy frameworks, might be suggested to lower the probability of such extremely bad outcomes.

With respect to this last issue, a number of us at the BIS have focused in recent years on the major structural changes taking place in the economic and financial system, and the possibility that these could contribute to "boom-bust cycles" that could in the limit culminate in "bad" deflations. The principle changes are:

1. real economy deregulation and globalisation leading to higher productivity and fewer inflationary pressures;

2. financial liberalisation making credit/asset/investment cycles more likely;

3. monetary regimes increasingly focused on short-run inflation control, to the exclusion of other troubling developments.

The hypothesis we have put forward is that these interacting changes could lead to low inflation, even in the midst of a credit/asset/investment "boom". Then, simple arithmetic would lead one to consider the possibility of deflation during the "bust". This leads to the conclusion that we need to think more about policies that might prove useful in helping avoid longer-term cycles of this sort, while maintaining the benefits of low inflation as well as the efficiencies provided by liberalised economic systems.

My second reason for believing the topic of this conference is still pertinent is that I am not convinced that we are securely out of the deflationary zone, just because CPI inflation may be moving up today. The obvious concern, given that the upturn is a byproduct of massive monetary and fiscal stimulus, is that various financial and other imbalances in the global economy could yet redress themselves in a messy way; bond rates could rise excessively from still low levels, house prices could fall from historically high levels; spreads could widen sharply; the dollar could fall rapidly as trade imbalances widen, carry-trade and leverage could unwind, etc. To my mind, such concerns could, in part, explain the caution being demonstrated in the reestablishment of more normal monetary conditions in a number of the large industrial countries. Should such a redressing of imbalances, perhaps but not necessarily in the context of monetary tightening, have unforeseen, negative effects on spending, we might yet have to confront the problem of too little inflation rather than too much. There is then still merit in analysing how the problems of a bad deflation might be addressed by public policy. Be clear this is not a forecast. Rather it is a low probability event, but one that prudent policymakers and academics should still be thinking about. As I have said before, at this conference and elsewhere, we should always be hoping for the best but planning for the worst.

So to conclude, I think that over today and tomorrow we will still be dealing with relevant and interesting questions. What explains recent low inflation? Has the inflationary process changed? What are the implications for economic welfare; are there perhaps less evident, costly implications as well as the more evident beneficial ones? And finally, what can public policy do to help avoid problems, and to better manage such problems should they occur? The papers prepared for the conference address virtually all of these issues and I thank the authors for the work they have put into them. I look forward to the observations of all of you on these issues, and I thank you for coming here to Brunnen to share them with us.