Mario Draghi: Researching the macroeconomic policies of the future

Welcome address by Mr Mario Draghi, President of the European Central Bank, at the first ECB Annual Research Conference, Frankfurt am Main, 28 September 2016.

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Let me welcome you all to the European Central Bank's first Annual Research Conference (ARC). This is of course not the first gathering to discuss research that the ECB has held in its 18-year history. But the ARC is deliberately greater in scale than the many smaller workshops we have held in the past, covering the whole range of research relevant for central banks. Our aim is to bring together academia and central banks working at the cutting edge of economics. The ARC will be our flagship research event each year, making today's conference the first of many to come.

The ECB commits significant resources to research because good research is the foundation of good policy. It strengthens the theoretical underpinnings of our policy framework, lays the groundwork for the models we use in our conjunctural analysis, and helps battle the terrible twins of empirical macroeconomics: endogeneity and identification. The ability of research to identify counterfactuals allows us to analyse the *ex post* effects of our measures, and to understand the *ex ante* impact of new policies prior to their launch.

As the crisis in the euro area has progressed through its various phases, our need for such research has evidently increased sharply. To meet our inflation objective we have had to deploy a wide array of new measures, some of which had no precedent in recent monetary history, or at least no track record in the euro area. In doing so, we have drawn heavily on the body of academic research into unconventional monetary policies that has built up during the crisis. But at times we have also had to act faster than academia has been able to follow. We have depended crucially on internal research by ECB staff to design, assess and recalibrate monetary policy.

The fragmentation of the euro area financial system in 2011–12, for example, required us to fundamentally deepen our understanding of the monetary transmission mechanism. A declining real equilibrium rate has caused us to adopt a negative interest rate policy to provide the right degree of monetary stimulus, which in turn requires a closer study of the effects of breaking through the zero bound. We have had to learn how an asset purchase programme works in the special conditions of the euro area, characterised by segmented asset markets and bank-based transmission.

We had little choice but to conduct both policy and research in real time. In many cases we were operating in largely unchartered waters. But the important point is that, in each case, we were able to design effective monetary policies to cope with an unprecedented series of shocks. And we did so based on the best insights that research could provide at the time.

But if our internal analysis has inevitably moved ahead of academia during the crisis, we are now eager for academia to catch up. We depend on both internal and external research to help us evaluate what we have done, to scrutinise the various measures we have taken, to offer insights and analyses that equip us for the future. Good policymaking can only benefit from such scrutiny, and we welcome it.

And looking forward, we depend on research to help us in other ways, too. Perhaps most salient today is the theme of the interactions between monetary policy and other policies – what I have elsewhere called "independence in interdependence".[1]

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1 Draghi, M (2016), "On the importance of policy alignment to fulfil our economic potential", 5th Annual Tommaso Padoa-Schioppa Lecture at the Brussels Economic Forum 2016, Brussels, 9 June 2016.

To my mind it is increasingly evident that, when we operate near the lower bound, such interactions are heightened. Properly aligned policies can help buttress each other, while misaligned policies can produce greater side effects. To ensure that monetary policy can be implemented with maximum effectiveness and minimum side effects we need to understand those interactions better.

For instance, we know that if interest rates are to rise safely away from the lower bound, we need structural reforms to raise potential output in the euro area and boost long-run interest rates. But the term structural reform remains somewhat vague. What are the key reforms needed to lift total factor productivity growth, by ensuring optimal rates of innovation and re-allocation of resources to where they are most productive? How do they differ among countries and at different stages of the cycle? Structural reforms are politically difficult, so they need to be based on rigorous research and optimally sequenced to yield quick and tangible results to bolster momentum for continued reform. Along the same vein, we need more robust policy prescriptions on the optimal composition of fiscal policy to promote growth.

We also need to understand better how monetary policy works in the new post-crisis financial landscape. Since the crisis, much research has focused on the role of financial intermediation in macroeconomic dynamics. But given the ECB's newly acquired powers, more research is needed on the interactions between macroprudential regulation, microprudential supervision and monetary policy to help guide policymakers on their optimal mix. Research can also underpin the policies required to complete capital markets and banking union which are key to safeguarding monetary transmission in the face of shocks.

Finally, we need to understand the optimal balance of policy tools in terms of efficiency and equity. We know that failure by central banks to act during the crisis would have had distributional consequences not only on asset and debt holders, but also on the most vulnerable in our society who are disproportionately affected by unemployment. But little is known to date of the distributional consequences of the unconventional tools we have used, either in respect of their impact or over the medium term. Of the range of tools that are effective at delivering our inflation objective, which have the least redistributive effects? And how should we combine those tools and other policies to yield the same benefits while mitigating the costs?

The complex interlinkages between monetary policy and other policies in the aftermath of the crisis have challenged central bankers and academics alike. Setting policy effectively in the new global environment requires a solid foundation of high-quality research. Conferences such as this first ARC provide an excellent opportunity to strengthen the links between policymakers and academics and help create that solid foundation. I look forward to the new insights that these next two days will bring. And, having identified the key areas of further research required for strong and stable growth in the euro area that is shared by all, I look forward to hearing your ideas and analysis at next year's second ARC.