Lucrezia Reichlin Gives 15th Global Economy Lecture at the OeNB

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On December 1, 2010, Lucrezia Reichlin, Professor of Economics at the London Business School, nonexecutive director of UniCredit Bank and former Director General Research at the European Central Bank (ECB), gave the 15th Global Economy Lecture[1] at the OeNB. In her presentation entitled "Monetary Policy in Difficult Times – Lessons and Challenges from the European Central Bank," Reichlin discussed and evaluated the ECB's monetary policy response to the recent financial crisis and drew comparisons to the policies undertaken by the Bank of England and the Fed.

In the beginning of her talk, Reichlin pointed toward the complexity of risks as expressed by widening interest rate spreads in a range of dimensions: policy versus market rates, secured versus unsecured rates, long-run versus short-run rates. Having described the evolution of the crisis and the subsequent ECB policy responses, Reichlin went on to present an empirical framework to quantify the effects of the ECB's standard and nonstandard measures on the aforementioned spreads. In doing so, she drew on her recent research with Domenico Giannone (Université libre de Bruxelles), Michele Lenza and Huw Pill (both ECB). Using a Bayesian Vector Autoregressive Model, she compared the effects of the introduction of nonstandard measures (liquidity policymaking) with two different sets of counterfactuals: In the first exercise, she constructed a nonpolicy scenario without nonstandard measures by assuming an interest rate mark-up on the policy rate. In the second exercise, she compared the actual path of macroeconomic variables with those of model forecasts conditional on the observed path of economic activity.

As a first important result, Reichlin pointed out that the macroeconomic effects of nonstandard monetary policy measures were the same as those of interest rate changes. This suggests that the zero lower bound restriction on nominal interest rates was not an issue in the euro area (unlike in the U.S.A. and the U.K.), which implies that there was no need to substitute nonstandard measures for lower interest rates. Hence, standard and nonstandard measures were used in a complementary way in the euro area, and the monetary transmission process was preserved – again in contrast to the situation prevailing in the U.S.A., the U.K. and Japan. Reichlin further found that the ECB's monetary policy had been successful in preserving the transmission mechanism during the crisis although there was some evidence that this was not the case for the broader money market. This further corroborates the view that the ECB functioned as an "intermediary of last resort" during the crisis, thus largely replacing the market in providing liquidity. Reichlin concluded by alluding to problems beyond the short run and to the need to understand better long-term interest rate stickiness and its implications for banks' funding strategies.

The ensuing discussion centered on the role of the ECB in the current situation. Prompted by a question concerning additional risks as imposed by differing credit spreads between individual euro area countries, Reichlin pointed toward institutional and political risks imposed by the ECB's highly active role in current

[1] *The Global Economy Lecture is an annual event jointly organized by the Oesterreichische Nationalbank (OeNB) and The Vienna Institute for International Economic Studies (wiiw).*

economic policy. According to Reichlin, the ECB is stepping in to compensate for the lack of swift coordination by EU governments. She also agreed to the view that the ECB had made initial policy mistakes in mid-2008, but stressed the ECB's rapid learning process and sound policy responses as from September 2008 onward, which entailed the use of multiple instruments in a complementary fashion. She supported a more active use of collateral as a further policy instrument.