Wrap-up Panel Discussion

The final part of the conference was a panel discussion focused on drawing the various themes of the conference together and considering their implications for inflation management and central bank policies. It began with the panellists discussing the outlook for inflation and summarising their key takeaways from the conference. Panellists then turned to discussing their respective views on various other conjunctural issues before the session finished with a broader discussion among all the conference participants. The discussion was moderated by John Simon, Head of Economic Research at the Reserve Bank of Australia, and included the following panellists:

- Michele Bullock, Reserve Bank of Australia
- Paul Conway, Reserve Bank of New Zealand
- Huw Pill, Bank of England

As the conference and panel were conducted under the Chatham House Rule, no individual comments are attributed.

The inflation outlook

Panellists began by considering the current inflationary episode. Central banks were still in ‘wait-and-see’ mode about whether the drivers of elevated inflation were transitory or persistent. There were credible arguments for both possibilities, so more evidence was needed. It was noted that from a central bank’s perspective, it was important to focus on the persistent elements of inflation, as monetary policy tools were not very good at addressing inflation caused by transitory shocks. One panellist pointed out that it was possible for a series of transitory inflationary shocks to accumulate to something that looked like (or was) a persistent shock. It was therefore important to consider how recent transitory shocks were likely to interact, and how the timing of the shocks might influence inflation expectations.

The discussion turned to the balance between common and idiosyncratic drivers of the current inflationary episode across countries. Panellists noted that while it was easy to identify unique factors that may have influenced the transmission path of inflationary shocks in specific countries, it was important not to underappreciate common drivers across countries; for example, most developed countries had forcefully stimulated their economies using monetary and fiscal policies at the start of the pandemic.

Looking forward, it was possible that countries would face more inflationary forces than they had in recent decades, for example, due to the need to spend more to address geopolitical risks and climate change.

Reflections on the conference

Panellists outlined their key takeaways from the conference. Work on wage-price spirals had suggested that although there were many instances in recent decades where both wage and price growth were elevated and moderately persistent at the same time, most episodes tended to be non-accelerating for both variables and to resolve themselves in a reasonable amount of time. This provided some comfort in light of the current bout of high inflation, where there had also recently been signs of a moderation.

Panellists expressed appreciation for the session on the distributional impacts of monetary policy. The dual mandate of central banks meant that any given policy path was likely to generate welfare trade-offs; it was important to understand how different households were impacted by these decisions. The conference had also highlighted that microdata was a valuable resource for this purpose. One panellist noted that although central banks needed to be aware of the distributional impacts of their policies, monetary policy tools were likely to be poorly suited to addressing these disparities directly. Targeted fiscal policies were likely to be more appropriate.

The panellists discussed the presentation on the fiscal theory of the price level (FTPL). One panellist noted that the presentation had been a timely reminder of the important role of sound fiscal policy in achieving monetary policy objectives, and that monetary and fiscal policies were especially potent when they worked in the same direction. Another panellist highlighted the message that fiscal stability was enhanced when productivity was stronger; this reinforced that improving productivity was beneficial for monetary policy.

The discussion turned to the implications of FTPL for institutional arrangements and inflation management. Panellists generally agreed that central bank independence remained important, even if there were sometimes clear benefits to fiscal and monetary policy coordination. One panellist noted that in the recent inflationary episode, there had been some scepticism from the public about whether high inflation was because of 'bad luck' (e.g. due to unavoidable shocks stemming from the pandemic and supply chain issues) or from monetary and fiscal policy mistakes. This had implications for ongoing public support for institutions.

Going forward, the global environment was likely to be challenging, and governments might need to rethink some institutional settings while maintaining the best parts of the current system. Policymakers needed to keep discussing the appropriateness of institutional settings, including in forums with academics. It would also be important to ensure that monetary, fiscal and financial stability authorities avoided becoming trapped in cycles of responding to each other's policies.

Inflation persistence

The discussion was opened up to all participants. One raised the issue of inflation persistence and how it was represented in inflation models. These were typically linear but there was some evidence from nonlinear approaches that inflation could be stickier when it was high and rising; if this was true, central banks should be moving more aggressively to raise interest rates in these instances.

One of the panellists sounded a word of caution about responding too quickly to rising inflation. In the recent episode, inflation had arisen from real shocks to the economy and persistence could be attributed to the occurrence of several smaller and successive real shocks in a tight labour market. Raising interest rates early and aggressively in such an environment was difficult because identifying the inflationary impulse from multiple smaller events was difficult.

Another panellist noted that nonlinear models of inflation persistence also typically suggested that central banks should drop interest rates quickly after having raised them quickly in response to an inflation breakout. In practice the delayed impact of changes in monetary policy and the relatively slow release and evolution of economic data would make abrupt policy shifts of this type very difficult for central banks to implement.

Inflation expectations

The discussion turned to inflation expectations. A participant noted that they increasingly thought of the management of inflation expectations as a 'tool' of monetary policy. One of the panellists pointed out that the public's inflation expectations were very hard to measure, requiring inference and making them challenging to manage with precision in practice. Nevertheless, panellists agreed that central banks' role in setting expectations was vital. Central bank communications were a key tool for doing this; for example, policymakers took great care in monetary policy statements to publicly communicate their commitment to the inflation target.

Participants noted that a key feature of inflationary episodes in the 1970s and 1980s was that long-term expectations became de-anchored. Subsequently, central banks could claim credit for having stabilised long-term expectations, which contributed to much better aggregate demand management in the decades after. One panellist pointed out that in the current inflationary episode, long-term expectations remained well anchored but short-run expectations had tended to track realised inflation. An important question for policymakers was the extent to which expectations formation was backward or forward looking, as this had significant implications for whether higher realised inflation was likely to be persistent.

Forecasting

A participant noted that a major issue in the current inflationary episode is that central banks had failed to forecast that a series of supply shocks would result in high inflation. Could forecasting practices be improved to reduce the likelihood of similar misses in the future? One panellist noted that much of the forecasting infrastructure of central banks was focused on modelling demand-side influences; central banks had not been well prepared to model the impact of supply-side shocks. In some instances, forecasters may also not have taken enough signal from events happening overseas.

Another panellist said that forecasting had become more difficult in recent years and that policymakers needed to be humbler as a result. It was possible that rising geopolitical and other risks meant that inflation volatility was likely to also be higher in coming years; if this was the case then central banks needed to consider communicating this expectation to the public more explicitly. Ultimately, the timing of increasingly occurring external shocks was likely to be very hard for policymakers to predict meaning forecasts would be less reliable.

Panellists noted that the forecasting process had other benefits, even if uncertainty around forecasting point estimates was hard to avoid. Chief among these was the identification and weighing of risks to the outlook, which was essential for policymaking.

Unconventional monetary policy

A participant asked for panellists' views on the performance of unconventional monetary policies in recent years. Some panellists suggested that the beneficial impact of quantitative easing policies had been less than anticipated. Other policies to manage medium-term interest rates (such as yield curve control) had been more successful in providing monetary accommodation but proved difficult to exit from. One panellist noted that some unconventional policies had been undertaken to promote multiple objectives, such as financial market functioning, financial stability and monetary policy easing; using a single tool to achieve multiple policy objectives had been challenging and may have resulted in sub-optimal policy design. On the whole, panellists agreed that unconventional monetary policies might be needed again in the future (particularly in the presence of an effective lower bound for interest rates), but that central banks would need to think through their use cases very carefully.

Public engagement

Panellists reaffirmed the vital importance of central bank communications for successful economic management. Monetary policy was made in a highly uncertain environment and central banks needed to be transparent about their decision-making and proactive in answering questions raised by the public. One panellist noted that it was also important to use communication tools to remind the public that central banks had one specific set of tools designed for a specific task, and that these tools were not typically well suited to managing other social and economic issues. Another panellist emphasised that central banks should keep working to promote general economic literacy, as the economy would work more efficiently when the public understood how central banks worked and why they took specific policy decisions. A third panellist said that central banks should remain active listeners by going out to meet with different segments of the community and hearing directly from them how they were being affected by policy decisions.