Joint Lunchtime Seminar Series

The Joint Lunchtime Series, organized by the European Central Bank, the Center for Financial Studies and the Deutsche Bundesbank, continues into its 8th consecutive year in 2008. It creates a platform for economic experts, particularly in the area of monetary policy, to present their current research findings to a selected circle of central bankers and macroeconomists. Individual meetings with the speakers before or after the seminar allow for further discussion and consultation. These meetings are highly appreciated by invited economists.

Monetary Policy Questions and Answers in the United States and the Euro-Area

9 January 2008

A lecture by Ricardo A. Reis (Princeton University)

On January 9, 2008 the organizers of the Joint Lunchtime Seminar, welcomed Prof. Ricardo A. Reis from Princeton University as a guest speaker to the seminar series. Reis presented his research paper "A Few Model-Based Answers to Monetary Policy Questions in the United States and Euro-Area", in which he reviewed past monetary policy experience as well as the design of optimal policy. In his presentation, he focused on key questions concerning policy in the United States and the Euro-area. Reis makes use of a macroeconomic model developed jointly with Greg Mankiw. A key working assumption in this model is that market participants only update their information on economic developments sporadically. In technical discussions this feature is described as "sticky information" or "rational inattention". Reis's answers derived in this model suggest a number of lessons to be learned regarding applied monetary policy.

What policy rule has best described policy?

In examining what U.S. monetary policy has been, Reis found that monetary policy shocks have had a persistent and delayed impact on the output gap and inflation. Furthermore, interest rates responded strongly to output fluctuations, which proved to be beneficial for stabilization of the economy. Assuming that all deviations from the policy rule might be understood as costly mistakes, Reis presented estimates of the welfare loss due to such deviations corresponding to 5% of consumption. He also found that announcing monetary policy shocks in advance, raises their effectiveness at changing inflation and lessens their impact on output. Moving interest rates gradually enhances their overall impact.

With respect to Euro-area monetary policy, Reis showed that monetary policy shocks have a comparable delayed and persistent effect on inflation and the output gap. Reis found that the interest rates are more sensitive to output than in the U.S.A., but the benefits from stabilization policy are smaller. The welfare effect of eliminating policy errors is smaller than in the U.S. and corresponds to 1.4% of consumption. Announcing monetary policy shocks in advance and moving interest rates gradually proved to be just as beneficial as in the United States.

What is the optimal policy design?

In the second part of his analysis, Reis investigates what monetary policy could have been. "In the United States, the optimal Taylor rule has interest rates responding much more strongly to the output gap than is currently the case and, doing so together with eliminating policy errors, could raise welfare by as much as 5.5% of consumption," wrote Reis. He found that the best performing policy rule under commitment would raise economic welfare by 6.3%. When taking into consideration parameter uncertainty, the robustly-optimal Taylor rule responds more aggressively to both output and inflation. Welfare benefits, however, relative to the optimal rule that ignores parameter uncertainty, are small.

The optimal Taylor rule reacts much more strongly to inflation, but less strongly to output fluctuations in the Euro-area. Reis discovered that "adjusting the coefficients of the Taylor rule raises welfare by 0.6% of steady-state consumption, which together with the 1.4% benefit of eliminating policy

Professor Reis received his PhD in Economics from Harvard University in 2004 and is since then Assistant Professor of Economics and Public Affairs at Princeton University. He is also an NBER Faculty Research Fellow and CEPR Research Affiliate.
He has held visiting positions at prominent universities among which, Stanford University, Columbia University and the University of Chicago.

errors, leads to an overall benefit of 2% of implementing the optimal Taylor rule." The optimal price-level standard corresponds to the strict price-level target and works almost as well as the optimal Taylor rule. Hence, the best policy rule under the assumption that the central bank would be able to commit to it in a credible manner would raise welfare by 2.7% of consumption. Robustly-optimal policy rules perform only marginally better than the rules that ignore parameter uncertainty.

Celia Wieland (CFS)

In 2008 the three organizers have again invited a number of economic professionals from academia, central banks, private institutions and consulting companies from all over the globe. In the first half of the year, the Joint Lunchtime Series expects 25 speakers, who will discuss the most recent findings of their research projects:

9 Jan 2008 — **Ricardo A. Reis** (Princeton University)
A Few Model-Based Answers to Monetary Policy Questions in the U.S. and the Euro-Area

16 Jan 2008 — **Jacek Osiewalski** (Cracow University of Economics)
Bayesian Comparison of Bivariate GARCH, SV and Hybrid Models

23 Jan 2008 — **Lars Ljungqvist** (Stockholm School of Economics & ECB Duisenberg Fellow) Taxes, Benefits, and Careers: Complete Versus Incomplete Markets

30 Jan 2008 — **Mark Carey** (Federal Reserve Board)
The Bank as Grim Reaper: Debt Composition and Recoveries on Defaulted Debt

6 Feb 2008 — **Damiano Brigo** (Derivative Fitch London)
Interest Rate Models: Paradigm Shifts in the Last Thirty Years

13 Feb 2008 — **Michael Rockinger** (University of Lausanne)
The Economic Value of Distributional Timing

20 Feb 2008 — **Franck Portier** (Toulouse School of Economics)
Gold Rush Fever in Business Cycles

27 Feb 2008 — **Florin Bilbiie** (HEC Paris Business School)
Endogenous Entry and Product Variety: Business Cycles, Welfare and Policy Implications

5 Mar 2008 — **Maximo Camacho** (University of Murcia)
Forecasting the Euro Area GDP in Real Time

12 Mar 2008 — **Lars Lochstoer** (London Business School)
Long-Run Risk Through Consumption Smoothing

19 Mar 2008 — **Frank de Jong** (Tilburg University)
Liquidity & Liquidity Risk Premia in the CDS Market

26 Mar 2008 — **Maria Nieto** (Banco de España)
Determinants of National and Cross Border Bank Acquisitions in the European Union

2 Apr 2008 — **Bauke Visser** (Erasmus University Rotterdam)
Is Transparency to no Avail? Committee Decision-Making, Pre-Meetings, and Credible Deals

9 Apr 2008 — **Samuel Reynard** (Swiss National Bank)
Modeling Monetary Policy

16 Apr 2008 — **Kjetil Storesletten** (University of Oslo)
The Macroeconomic Implications of Rising Wage Inequality in the United States

23 Apr 2008 — **Sylvia Kaufmann** (Central Bank of Austria)
Analyzing Jointly Euro Area M3 and Aggregate Loan Growth to Assess Conditional Inflation Prospects

30 Apr 2008 — **Tullio Jappelli** (Centre for Studies in Economics and Finance) Does Financial Integration Affect Consumption Smoothing?

7 May 2008 — **Charles Calomiris** (Columbia University)
Profiting from Government Stakes in a Command Economy: Evidence from Chinese Asset Sales

14 May 2008 — **Michel Strawczynski** (Bank of Israel)
Cyclicality of Fiscal Policy in OECD Countries: Permanent and Transitory Shocks

20 May 2008 — **Ayhan Kose** (International Monetary Fund)
How Does Financial Globalization Affect Risk Sharing? Pattern and Channels

28 May 2008 — **Virgiliu Midrigan** (New York University)
Inventories, Markups, and Real Rigidities in Menu Cost Models

4 Jun 2008 — **Skander van den Heuvel** (University of Pennsylvania)
Temporal Risk Aversion and Asset Prices

11 Jun 2008 — **Volker Wieland** (Frankfurt University & CFS)
Economic Projections and Rules-of-Thumb for Monetary Policy

18 Jun 2008 — **Christos Koulovatianos** (Frankfurt University)
Confronting the Robinson-Crusoe Paradigm with Household-Size Heterogeneity

25 Jun 2008 — **Gara Minguez Afonso** (Princeton University)
Liquidity and Congestion

For further information and registration please contact Celia Wieland, email: JLS@ifk-cfs.de