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THE ECB AND ITS WATCHERS

2008

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AND ITS
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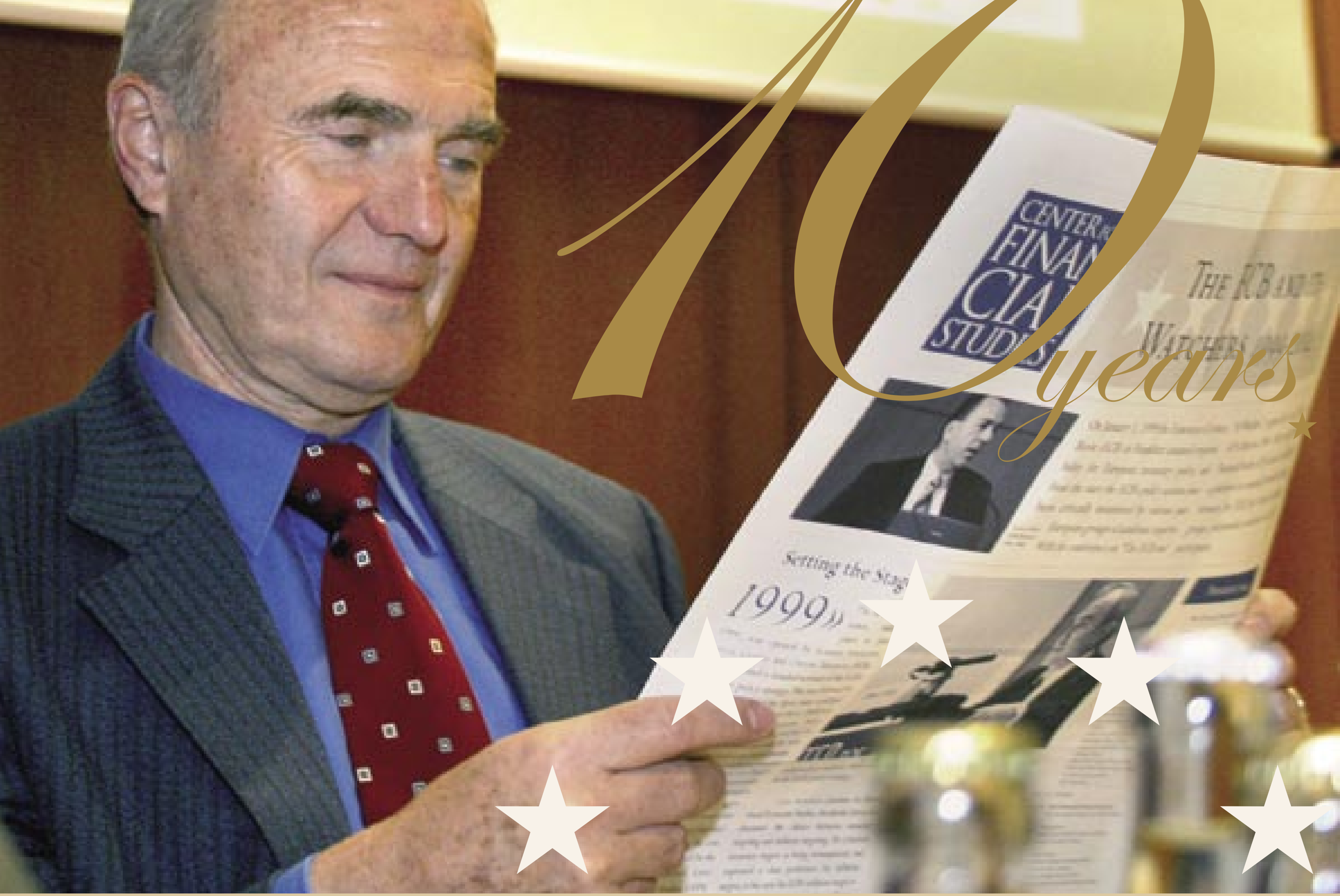

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CONFERENCE

THE ECB AND ITS WATCHERS X

Program 2008

to be held at: **Deutsche Bibliothek**
Frankfurt am Main
Friday, September 5, 2008

Organization: **Volker Wieland**
(CFS and Goethe University Frankfurt)

8:15 -8:45 Registration and Coffee

8:45 -8:50 Welcome
Volker Wieland

8:50 -9:30 President's Address
Jean-Claude Trichet (European Central Bank)

Segment 1:
Debating the Role of the Central Bank in the Financial System
Chair: Volker Wieland

9:30 -10:30 1st Debate:
Monetary policy during the financial turmoil: What have we learned?
Jürgen Stark (European Central Bank)
Marvin Goodfriend (Carnegie Mellon University)

10:30 -11:00 Coffee Break

11:00 -12:30 2nd Debate:
Solvency, systemic risk and moral hazard: Where does the central bank's role begin and where does it end?
Lorenzo Bini Smaghi (European Central Bank)
Willem H. Buiter (London School of Economics)
Harald Uhlig (University of Chicago)

12:30 -13:30 Lunch

Segment 2:
Debating the Response to Asset Prices, Inflation and Economic Weakness
Chair: Michael Binder (CFS and Goethe University Frankfurt)

13:30 -14:30 3rd Debate:
Asset price bubbles and monetary policy: What can or should the central bank do about them?
Hans Genberg (Hong Kong Monetary Authority)
Thomas Mayer (Deutsche Bank)

14:30 -15:00 Coffee Break

15:30 -16:45 4th Debate:
Looking ahead: How to reign in inflation and maintain stable growth?
Athanasios Orphanides (Central Bank of Cyprus)
Laurence Meyer (Macroeconomic Advisers)

16:00 -16:05 Closing Remarks

2008

Speaker Biographies

(IN ORDER OF APPEARANCE ON THE PROGRAM)

JEAN-CLAUDE TRICHET (ECB)

Jean-Claude Trichet is President of the ECB and Chairman of the Group of Ten Governors since 2003. Born in Lyon, Jean-Claude Trichet is a graduate of the Ecole nationale supérieure des Mines de Nancy, of the Institut d'études politiques de Paris and of the University of Paris in economics. He worked in the private sector from 1966 to 1968. He was admitted to the Ecole nationale d'administration in 1969 and appointed to the "Inspection générale des Finances" in 1971. He was assigned to various posts at the Ministry of Finance in the General Inspectorate of Finance and later in the Treasury Department, where in 1976 he became Secretary General of the Interministerial Committee for Improving Industrial Structures (CIASI). Jean-Claude Trichet was made an Adviser to the cabinet of the Minister of Economic Affairs (René Monory) in 1978, and then an Adviser to the President of the Republic (Valery Giscard d'Estaing) in the same year. In this capacity, he worked on issues relating to energy, industry, research and microeconomics from 1978 to 1981. He subsequently became Deputy Director of Bilateral Affairs at the Treasury Department from 1981 to 1984, Head of International Affairs at the Treasury and Chairman of the Paris Club (sovereign debt rescheduling) from 1985 to 1993. In 1986, he directed the Private Office of the Minister of Economic Affairs, Finance and Privatisation (Edouard Balladur), and in 1987 he became Director of the Treasury. In the same year, he was appointed Censor of the General Council of the Banque de France and Alternate Governor of the IMF and the World Bank. He was Chairman of the European Monetary Committee from 1992 until his appointment as Governor of the Banque de France in 1993. He was the Chairman of the Monetary Policy Council of the Banque de France as of 1994, a Member of the Council of the European Monetary Institute from 1994 to 1998, and thereafter a Member of the Governing Council of the European Central Bank. At the end of his first term as Governor of the Banque de France, he was reappointed for a second term. He has been awarded numerous prizes, honorary doctorates and decorations.

Jürgen Stark (ECB)

Jürgen Stark became a Member of the Executive Board of the European Central Bank in 2006. Within the Executive Board he is responsible for the Directorate General Economics, its economic and monetary analysis and the preparation of monetary policy decisions. Raised in Rhineland-Palatinate, he studied economics at the University of Hohenheim and Eberhard Karls University of Tübingen, where he received a doctorate in 1975. From 1978 to 1998 he held economic policy positions in the German Federal Government, among them First Secretary at the Permanent Representation of Germany to GATT, Head of the division "Foreign Trade and Payments, Money and Foreign Currency, and Financial Markets" at the Federal Chancellery, and Head of the department "International Monetary and Financial Relations, Financial Relations in the ECB" at the Federal Ministry of Finance. From 1995 to 1998 he was the State Secretary of the Federal Ministry of Finance and Personal Representative of Chancellor Helmut Kohl in preparations for the G7/G8 Economic Summits, after which he served two consecutive terms as Vice President of the Bundesbank from 1998 to 2006. Since 2005 Jürgen Stark is also Honorary Professor in the Faculty of Economics at the Eberhard Karls University of Tübingen.

Marvin Goodfriend
(Carnegie Mellon University)

Marvin Goodfriend is Professor of Economics at the Carnegie Mellon Tepper School of Business and is a widely cited expert on monetary policy with extensive practical experience in the U.S. Federal Reserve System. He received his Ph.D. in 1980 from Brown University in Rhode Island. His research interests focus on macroeconomic fluctuations, monetary theory and policy, banking, and financial markets, as well as economic development. He serves in a number of editorial boards including the *International Journal of Central Banking, Carnegie Rochester Conference Series on Public Policy, Journal of Money, Credit and Banking* and *Journal of Monetary Economics*. Marvin Goodfriend was a Visiting Economist to the Federal Reserve Board from 1982 to 1983 before becoming Senior Staff Economist with the Council of Economic Advisors under President Ronald Reagan in 1984. He has held positions as Senior Vice President and Policy Advisor at the Federal Reserve Bank of Richmond, frequently attending the FOMC. Additionally, he has been a Visiting Professor of Business Economics at the University of Chicago and Member of the Three-Person Panel for the External Evaluation of Research Activities at the ECB. He advises the ECB, Federal Reserve Bank of New York, the Federal Reserve Board, IMF and Swiss National Bank regularly.

Lorenzo Bini Smaghi (ECB)

Lorenzo Bini Smaghi is a Member of the Executive Board of the European Central Bank since 2005. Among other responsibilities, he is in charge of the Directorate General International and European Relations and the preparation of briefings for European and international meetings. Born in Florence, Italy, he obtained his Master's degree from the University of Southern California and Ph.D. in Economics from the University of Chicago. Lorenzo Bini Smaghi began his career as Economist in the Research Department at the Banca d'Italia in 1983 before becoming appointed as Head of Exchange Rate and International Trade Division of the Research Department at the Banca d'Italia in 1988. Engaged in developing the European monetary framework, he led the Policy Division of the European Monetary Institute in Frankfurt from 1994 to 1998. In 1998, he became the Deputy Director General for Research at the European Central Bank and, in the same year, committed to the Italian Ministry of the Economy and Finance as Director General for International Financial Relations. Lorenzo Bini Smaghi is the author of several books on international and European monetary and financial issues, including *L'Euro, Open Issues in European Central Banking* and *Chi Ci Salva dalla Prossima Crisi Finanziaria?* He has published numerous articles on the same subject in prominent journals and literature.

Willem H. Buiter

(London School of Economics)
Willem Buiter has been Professor of European Political Economy at the European Institute of the London School of Economics and Political Science since 2005. A widely read and cited author, he is one of Europe's best known commentators on central banking. Born in Gravenhage in the Netherlands, he holds both U.S. and U.K. citizenships. He received his Bachelor's in Economics from Cambridge University and completed his Ph.D. at Yale University. Willem Buiter has taught at Princeton University, the University of Bristol, the London School of Economics, Yale University, as well as Cambridge University. He was an external Member of the Monetary Policy Committee of the Bank of England from 1997 until 2000. From 2000 until 2005 he was Chief Economist and Special Counselor to the President of the European Bank for Reconstruction and Development. He has been an Adviser to and Consultant for the IMF, the World Bank, the InterAmerican Development Bank, the European Commission and a number of national governments and private financial enterprises. He has published widely on subjects such as open economy macroeconomics, monetary and exchange rate theory, fiscal policy, social security, economic development, and transition economies. Further, Willem Buiter is a Fellow of the British Academy and European Economic Association. In the past, he has received numerous awards, prizes and honors.

Harald Uhlig

(University of Chicago)
Harald Uhlig is a German Professor in Economics at the University of Chicago since 2007. Previously, he was a Professor of Economic Policy at Humboldt University in Berlin for seven years. Frequently referred to as a leading scholar in macroeconomics he has also been one of Europe's most active academic ECB watchers. He taught at prominent universities such as

Stanford University, Tilburg and Bonn Universities, University of Chicago and Princeton University. Harald Uhlig is a Fellow of the Econometric Society since 2003 and Co-Editor of *Econometrica*. He received his Ph.D. at the University of Minnesota in 1990. His current research focuses on applied quantitative theory and applied dynamic, stochastic general equilibrium theory; the intersection of macroeconomics and financial economics; Bayesian time series analysis; and macroeconomic applications.

Michael Binder

(CFS and Goethe University Frankfurt)
Michael Binder received a Ph.D. in Economics from the University of Pennsylvania in 1995. Upon completion of his Ph.D., he joined the faculty of the University of Maryland, where he was an Assistant Professor. Since 2003 he has been a Professor at Goethe University Frankfurt (holding the Chair for International Macroeconomics and Macroeconometrics), and the founding Director of Goethe University's Ph.D. Program in Economics. At the CFS he directs the research program on International Economics. Michael Binder has been a Fulbright Scholar, a Marie Curie Research Fellow and a Scholar of the German National Scholarship Foundation. He has published on a variety of topics in macroeconomics and applied econometrics, and currently is an Associate Editor of the *Journal of Applied Econometrics,* the *Journal of Economic Dynamics and Control* and *Empirical Economics*, as well as a Fellow of the Center for Economic Studies Munich (CESifo). Binder has held visiting appointments inter alia at the University of Cambridge, the IMF, the World Bank, the ECB and the Bank of Spain. His current research focuses on the investigation of econometric and computational methods for rational expectations and dynamic panel data models. Recent papers specifically address issues in consumption and saving, in economic growth, in asset pricing, and in exchange rate behavior.

Hans Genberg

(Hong Kong Monetary Authority)
Hans Genberg is the Executive Director of the Research Department at the Hong Kong Monetary Authority. As Director he heads the Hong Kong Institute for Monetary Research. He obtained his Ph.D. in Economics from the University of Chicago. He had been working as a Professor in Economics at the Graduate Institute for International Studies since 1979. Prior to joining the Hong Kong Monetary Authority and Hong Kong Institute for Monetary Research in February 2005, he was the Head of the Economics Sections of the Institute. He has also been a Visiting Scholar at the IMF and the World Bank. He has written extensively on issues related to monetary and exchange rate policy as well as the relationship between monetary policy and asset prices. His work has been published in leading economic journals including the *Journal of Monetary Economics* and the *Journal of International Economics*. He also has a keen research interest in monetary and financial developments in East Asia.

Thomas Mayer

(Deutsche Bank)

Thomas Mayer is a Managing Director and Chief European Economist at Deutsche Bank and in this role comments regularly on the ECB's policy. He also co-heads the Bank's global economic group. He and his team provide economic and interest rate forecasts for European countries and the global economy to Deutsche Bank's clients as well as to the trade and sales desks of the bank. Previously, he worked for Goldman Sachs and Salomon Brothers. Before moving to the private sector, he held positions at the IMF in Washington D.C. and Institute for the World Economy in Kiel. Thomas Mayer has published numerous articles on international and European economic issues in professional journals and commented on these issues in the media. He received a Ph.D. in Economics from the University of Kiel and is a CFA Charterholder.

Athanasios Orphanides

(Central Bank of Cyprus and ECB Governing Council)

Athanasios Orphanides has been Governor of the Central Bank of Cyprus since 2007 and a Member of the Governing Council of the European Central Bank. Prior to coming to Cyprus, Athanasios Orphanides spent seventeen years as Economist, Senior Economist, Advisor, and Senior Advisor at the Federal Reserve Board in Washington D.C. He is one of the most widely cited authors on all aspects of the design of monetary policy. His educational background includes studies at the Massachusetts Institute of Technology, where he obtained a Bachelor of Science in Mathematics and Economics as well as a Ph.D. in Economics. He has also been a Visiting Scholar and Lecturer at Georgetown University, Johns Hopkins University, Goethe University and Kiel Institute for the World Economy. Furthermore, he is a Fellow of the Centre for Economic Policy Research, the Center for Financial Studies and the Kiel Institute for the World Economy. In the past, he has also been Associate Editor of the *Journal of Economic Dynamics and Control*. He has published extensively in the leading economic journals on questions concerning monetary policy, interest rate rules, monetary history, economic growth, macroeconomic dynamics and political economy.

Laurence Meyer

(Macroeconomic Advisers)

Laurence Meyer is a former Member of the Board of Governors of the Federal Reserve System and currently Vice Chairman of Macroeconomic Advisers and a Distinguished Scholar at the Center for Strategic and International Studies in Washington D.C. While serving as a Fed Governor from 1996 to 2002, Dr. Meyer became widely known as an influential Member of the FOMC. Born in New York, he received a B.A. from Yale University and a Ph.D. from MIT. Before becoming a Member of the Fed Board, Laurence Meyer was Professor of Economics and a former Chairman of the Economics Department at

Washington University, where he taught for 27 years before joining the Federal Reserve Board, and was a Research Associate at the University's Center for the Study of American Business. He was also President of Laurence H. Meyer and Associates, a St. Louis-based economic consulting firm specializing in macroeconomic forecasting and policy analysis. The firm was renamed Macroeconomic Advisers when Dr. Meyer left to join the Federal Reserve Board. Dr. Meyer has earned a reputation as one of the nation's leading economic forecasters. He offers monetary policy insights, commentaries and analyses of the U.S. economic outlook and monetary policy prospects, through Macroeconomic Advisers, to financial firms around the world. He is a Fellow of the National Bureau of Business Economics, a Member of the Board of Directors of the National Bureau of Economic Research, a Member of the Board of Scholars of the American Council on Capital Formation, a Member of the Panel of Economic Advisers for the Congressional Budget Office, and Senior Adviser to the G-7 Group. He is also the author of *A Term at the Fed: An Insider's View*.

Volker Wieland

(CFS and Goethe University Frankfurt)
Volker Wieland is Professor of Monetary Theory and Policy at Goethe University of Frankfurt since November 2000 and Director of the Center for Financial Studies since April 2003. He has been hosting "The ECB and Its Watchers" conference for five consecutive years. Prior to coming to Frankfurt he spent five years as Economist and Senior Economist in the Division of Monetary Affairs at the Federal Reserve Board in Washington D.C. He also served as Consultant at the European Central Bank from 1999 to 2004. His educational background includes studies at the University of Wuerzburg, the State University of New York, the Kiel Institute for the World Economy and Stanford University, where he obtained a Ph.D. in Economics. He has also been a Visiting Scholar at the Center for European Integration Studies in Bonn, the Institute for International Economic Studies in Stockholm, the ECB and the Stanford Center for International Development.

His research and teaching interests include macroeconomics, monetary theory and policy, as well as international finance and trade. His research on the performance of monetary policy rules, decision-making under uncertainty, and learning has been published in leading economic journals such as the *American Economic Review*, the *Journal of Monetary Economics* and the *European Economic Review*. Volker Wieland served on the Advisory Council of the Society for Computational Economics from 1998 to 2006 and coordinated the activities of the society's special interest group in economic dynamics. He also served as Coordinating Editor of the *Journal of Economic Dynamics and Control* (2002-2006), as an Associate Editor of the *European Economic Review* (2001-2004) and as a Member of the Referee Panel of *Economic Policy* (2004-2006). In August 2008, he was awarded the Wim Duisenberg Research Fellowship by the ECB.

OTMAR ISSING

Otmar Issing is a German economist and a former Member of the Board of the Deutsche Bundesbank (1990-1998) and of the Executive Board of the European Central Bank (1998-2006). He developed the "two pillar" approach to monetary policy decision-making that the ECB has adopted. He was appointed as President of the Center for Financial Studies in June 2006. Since 2007 he has been Honorary Professor of the Goethe University Frankfurt, as well as International Advisor to Goldman Sachs. His book *Der Euro. Geburt – Erfolg – Zukunft*, about the creation of the new European currency, was published in 2008.

AXEL A. WEBER

Axel Weber became a Professor at Goethe University Frankfurt in 1998. He was also the Director of the Center for Financial Studies from 1998-2002. In 2001 he became Professor of International Economics at the University of Cologne, and from 2002 to 2004 he was a Member of the German Council of Economic Experts. From October 2002 he was a Member of the Expert Advisory Panel to the Deutsche Bundesbank. Mr. Weber has been President of the Deutsche Bundesbank and Member of the Governing Council of the European Central Bank since April 30, 2004.

Interview

WITH OTMAR ISSING AND AXEL WEBER

In 1999 Professor Issing and President Weber founded the conference in an effort to create a platform for discussing the challenges lying ahead, together with other experts, the ECB and the Center for Financial Studies. In this interview, we asked them for their views ten years later.

Professor Issing, what was your motivation in initiating the conference series "The ECB and Its Watchers" in 1999 together with then-CFS Director Axel Weber?

Issing: Before we started conducting monetary policy for the Euro area, several Watchers Groups were already established. Later, in 1999 two of them – separately – invited me for a discussion of their critical position. I realized that on the one hand we could not respond to all requests (for different places across Europe) nor discriminate between different groups. On the other hand, I did not want to give the impression that we would shy away from engaging in a serious discussion with our critics. So the idea emerged to organize a conference to provide a platform for "the ECB meeting its watchers." The CFS was a perfect host for such an event.

President Weber, what was your motivation in starting "The ECB and its Watchers" as CFS Director?

Weber: We wanted to foster an open and constructive dialogue between academics, market participants and the newly established Eurosystem. Introducing a regular annual meeting of ECB watchers and policymakers in Frankfurt was viewed by us as the ideal set-up for that.

Did the conference series live up to your expectations as a platform for a public exchange of views with ECB observers?

Issing: Absolutely. Already the first conference met great interest and triggered a lively discussion above all on the ECB's two-pillar-strategy. After this success, it was evident that we should continue. The CFS Watchers Conference is an innovation in the world of central banking that has gained global reputation.

Weber: Yes, it was well received from the very beginning since it was designed to be very interactive. No long speeches, but short presentations with plenty of scope for interesting and at times challenging discussions. And the press coverage has been exceptionally good from the start.

What did you learn from the ECB's critics as Chief Economist of the ECB?

Issing: Impossible to explain in a few sentences. The dialogue, which was initially focused on monetary policy, helped us in general and me personally to identify in real time aspects which were seen as critical. I always returned to discuss specific topics raised at the conference with my experts at the ECB.

In your view, President Weber, did the ECB's critics end up influencing the ECB's policy stance and strategy in the last 10 years?

Weber: The policy strategy and policy stance of the Eurosystem are under permanent review and scrutiny. We constantly update our models and methods to stay on top of current theoretical and econometric developments, and we permanently test how our policy framework holds up against new incoming data. Academic debates in general have had a positive impact on this process.

Did the ECB implement any changes in its policy or strategy following criticisms expressed by ECB watchers?

Issing: Changes? Not really. But, outside critique helped us to clarify our position and improve the communication.

Was the ECB able to convert critical ECB watchers to its view with regard to particular policy questions?

Weber: Again, we have constantly aimed to do so. And looking back, it has on many occasions been the case that our policy view in real time turned out to be more in line with subsequent economic developments than that of markets or academics. I take this as positive encouragement to keep on trying to convey the appropriateness of our policy strategy and our policy choices to sceptics.

Were you able to convince ECB watchers and convert them to the ECB's view in particular matters, Professor Issing?

Issing: In the beginning it was more a learning process. The ECB was a new institution with a very complex structure. Its monetary policy strategy was e.g. misinterpreted by some as a kind of monetary targeting, by others as a concept of inflation targeting. The conferences gave us a special opportunity to explain our policy and procedures. The media, which showed great interest in this event, contributed heavily to this learning process. What is also interesting to note is that even strong critics of our strategy confirmed year after year that we had conducted a successful monetary policy. One or the other finally accepted that this over time has to be seen as a confirmation of the strategy.

As Bundesbank President and Member of the Governing Council of the European Central Bank, what do you expect of this forum for public debate in the future?

Weber: In order to preserve its relevance, the Watchers Conference needs to remain interactive without becoming repetitive. Some sceptics keep replaying the same old tunes without adding much by way of new insights. What is needed instead is clear and convincing evidence that different policy choices based on a different policy framework would have systematically led to superior decisions and outcomes. I haven't seen that yet.

What future do you envision for this conference series?

Issing: Whereas at the beginning, the focus was on monetary policy in all its aspects, later the agenda was broadened to cover all fields of central banking from international issues to payments system or banking supervision. This format guarantees that new developments get proper attention.

This year's conference will focus, among other topics, on questions concerning the recent financial turmoil, the Euro-area regulatory system and the proper policy response to asset prices. What are your views on the following questions:

What are the most important lessons that we should draw from the recent experience regarding monetary policy during financial turmoil?

Issing: The fundamental lesson is: Act timely and resolutely in times of financial turmoil by providing liquidity if needed, but never lose sight of your final goal, which is maintaining price stability.

Weber: It has become clear over the past year that there is more to central banking than just taking interest rate decisions. Liquidity operations, financial stability concerns, and banking supervision issues have kept us busy. Not mixing-up these distinct issues was key. Our clear separation of monetary policy and liquidity provision has helped us to ease strains in the money markets whilst at the same time remaining alert to/on guard against the substantial inflation risks.

How should monetary policy respond when the next housing or asset price bubble comes?

Issing: A central bank must not ignore the development of asset prices. It cannot target asset prices and has to provide liquidity once a bubble bursts. But reducing its role to this "mop-up-only strategy" would create an asymmetry which might contribute to foster the emergence of the next bubble.

Monitoring closely "money" and "credit", and making this part of the monetary policy considerations – the crosschecking of the ECB – provides a basis for a symmetric approach to the problem of asset prices.

Weber: We should reduce the likelihood of re-occurances. We are using our regulatory powers to adjust the capital adequacy and liquidity management framework for banking in the light of recent events. Aligning incentive structures and reducing the pro-cyclicality of the banking and credit business is key to avoiding a new round of problems.

Is the Euro-area regulatory framework ready to deal with the collapse of a major European bank?

Weber: The Eurosystem's swift and continued intervention in money markets has substantially reduced the likelihood of such an event materializing. As for the future, I am convinced that the high degree of connectivity and established joint decision-making processes make the Eurosystem the natural nucleus for any timely and coordinated response to potential banking problems in Europe.

VIEWS FROM ECB WATCHERS

ECB WATCHERS *assess the conference series …*

JULIAN CALLOW (BARCLAYS CAPITAL):

This annual conference is a truly unique occasion which offers the entire community of "ECB Watchers" – academics, financial market participants, and the media – a special opportunity to congregate together with central bank officials from the Eurosystem and beyond, and so foster greater mutual understanding of contemporary issues in European monetary policy.

ELGA BARTSCH (MORGAN STANLEY):

The combination of academic researchers, market practitioners, financial journalists and central bank representatives makes the ECB Watchers conferences a unique event. The two-way dialogue the Watchers conferences helped to create between the ECB and those who observe, analyze and comment its actions from their different vantage points, is very stimulating.

ULRICH KATER (DEKABANK):

Nowhere else can you discuss with so many ECB experts from outside and within more effectively.

MACCARIO AURELIO (HYPOVEREINSBANK - UNICREDIT GROUP):

I have to say that proximity to ECB policymakers clearly enhanced my understanding of the bank's decision-making process as well as the theoretical and operational framework in which the ECB is actually operating. Moreover, I liked very much the heterogeneous background of the conference participants: exchanging ideas and opinions not only with other market practitioners but also with policymakers and with academics greatly stimulated my research toward non-conventional and new directions. The CFS' and ECB's effort to establish a fruitful relationship with different types of observers can only be praised.

MARKUS KRYGIER (CREDIT AGRICOLE ASSET MANAGEMENT):

Year after year the conference has provided a unique forum to gather and exchange intelligence on the ECB. The ECB's active participation has opened a valuable window to better understand the bank's policies and its communication. The conference has also provided a great opportunity to establish a network of like-minded ECB watchers.

ANGEL UBIDE (TUDOR INVESTMENT CORP):

"The ECB and its Watchers" has played a critical role in allowing a brainstorming of the relevant issues pertaining to the ECB with the participation of the key actors, policy makers, market participants and academics. One day at the conference is much more effective than weeks of individual research. It has also created a very extensive and useful network of people interested in ECB matters.

HARALD UHLIG (UNIVERSITY OF CHICAGO):

The forum has been the central open venue for communicating and discussing the results of leading ECB watchers. For example, I have had the opportunity to co-author several "Monitoring the European Central Bank" (MECB) reports for the CEPR in London. While these reports were presented elsewhere too, and while we were also particularly grateful to then-ECB Council Member and Director of Economics and Research, Prof. Dr. Otmar Issing, to always grant us an open-minded discussion about our findings with him and the ECB staff, the forum was the final, critical venue for discussion. The forum therefore played a crucial role for the debate on monetary policy in Europe.

… and give suggestions for the future

ELGA BARTSCH (MORGAN STANLEY):

Continue to be a forum for thought-leaders on different issues and angles of monetary policy making, especially foster the exchange of new ideas and themes between academic research and practical analysis. From a more hands-on point of view, the Watchers conference could probably help to further improve communication between the ECB and financial markets, where there seem to have been a few disconnects recently, and help both to learn from some of the recent episodes.

ULRICH KATER (DEKABANK):

It is extremely important to establish a true European perspective on monetary policy. The ECB Watcher Conference brings together all parts of the public – central bankers, journalists, banking experts – and thus is a cornerstone of the European monetary community.

JULIAN CALLOW (BARCLAYS CAPITAL):

I hope very much that the frank exchange of opinion on highly relevant topics of interest – which has been a hallmark of this event – will continue. The Euro area is a particular monetary union in terms of its constituent members and the evolution of its financial and official institutions, which means that it is especially important to foster this dialogue.

ANGEL UBIDE (TUDOR INVESTMENT CORP):

It is important that participation remains as wide as possible, with as much focus on debate as possible – and less on long individual interventions – in order to be able to compare the virtues of different alternatives.

UWE ANGENENDT (BHF BANK):

There is no other conference in Europe that brings together so many high-ranking experts, academics and central bankers. I expect the Watcher conference to continue to monitor the constant changes in monetary policy in the future. This conference could provide significant impetus to modify monetary policy strategy.

With regard to lessons from the period of financial turmoil, ECB WATCHERS *have some praise for the ECB ...*

ELGA BARTSCH (MORGAN STANLEY):

It's still too early to draw firm conclusions, I think, especially with respect to the different policy reactions to the crisis. However, I would already commend the ECB for its steady-hands approach and the clear separation between liquidity issues and monetary policy. Here it clearly benefited from having a comprehensive refi system in place before the start of the tensions that was able to ensure uniform access and accepts a wide range of collateral.

ULRICH KATER (DEKABANK):

The monetary framework in the Euro area is well equipped to deal with acute money market crises. But try to prevent banking crises: Watch out for bubbles – especially in the real estate sector – and never become carefree, even in the brave new world of "diversified" credit risk.

UWE ANGENENDT (BHF BANK):

In financial market crises, risks to the system can only be averted by prompt and effective monetary policy action. The major central banks proved that they have learnt from past experience by reacting speedily and flexibly to the problems in the financial sector.
The ECB's prompt action helped to ward off a liquidity crisis, and the US central bank also reacted to the dramatic developments in a flexible manner within its monetary policy framework. Without this prompt reaction, the crisis could have resulted in collapse.

MACCARIO AURELIO (HYPOVEREINSBANK - UNICREDIT GROUP):

The ECB collateral framework has provided an important cushion against the risk of abrupt fire sales of illiquid assets with the consequent contraction of banks' balance sheets. However, it is crucial that the quality of collateral improve again once the financial crisis is over, to guarantee a truly countercyclical tool of liquidity and (in tail scenarios) crisis management. Hence, targeted devices should be developed to limit the inefficiencies of this kind of behavior.

... but many also emphasize the difficulty of dealing with financial turmoil and recommend that central banks improve their capabilities for well-informed research-based policy response.

MARKUS KRYGIER (CREDIT AGRICOLE ASSET MANAGEMENT):

Monetary policy makers do not possess a "magic wand" to fend off financial turmoil. The widespread market perception (before the crisis) that determined interest cuts could quickly restore confidence has been soundly shattered during the current turmoil. A profound build-up of leverage and its subsequent unwinding has arguably been sufficient to push the financial system close to a crash. Highly integrated financial markets call for an internationally coordinated monetary policy response in times of turmoil. The perception that policy makers are not acting in synch can further fuel an ongoing crisis. The past year has provided examples of successful coordination (synchronized liquidity management by the major central banks) and examples of insufficient synchronization (interest rate policies and the effect of diverging rate policies on exchange rates).

HARALD UHLIG (UNIVERSITY OF CHICAGO):

There are always surprises in the economic policy arena, even in an arena as well-researched as monetary policy. The only good way to prepare for that is to have good, ongoing research constantly challenging established ideas and views and well-trodden paths, and to have excellent researchers as well as academically minded (and thereby inquisitive) market practitioners on the staff at central banks, as well as other economic decision-making bodies to intelligently think through the next challenging issues at hand. The next crisis will happen, and we need people trained to think through the crises of the past in order to be able to deal with the crisis of the future, avoiding the easy, but false answers. And inside private institutions, academically minded economists with a view of the whole are sorely needed. Private banks seem to have ignored the problems that occur when everyone wants to rush to the exit door at the same time. I find that puzzling, and the lack of serious macroeconomic thinking inside private banks may have been one of the causes.

MACCARIO AURELIO (HYPOVEREINSBANK - UNICREDIT GROUP):

This crisis was worsened by a lack of information, as for a long time extremely high uncertainty persisted on the overall size and distribution of potential losses in the financial system. This is what has prevented (and still prevents) a resumption of normal activity on the money and interbank markets. The central banks' task is admittedly much more complicated here, as on some issues they depend on being provided information from banks – and it is unclear how fully banks themselves have gauged the problem. Moreover, central banks may need supervisory information for the effective performance of their functions in the management of a crisis, such as money market interventions, provision of emergency liquidity and financial stability monitoring.

As to monetary policy and asset prices, many ECB WATCHERS *identify a strengthened case for leaning against the wind …*

THOMAS MAYER (DEUTSCHE BANK):

Respond in a preemptive rather than reactive way.

ULRICH KATER (DEKABANK):

Gather and distribute information. Try to gently lean against it. First by moral suasion, then by regulatory measures and at the end by interest rate-policy.

MARKUS KRYGIER (CREDIT AGRICOLE ASSET MANAGEMENT):

Monetary policy should "respond" preemptively during the build-up of an asset bubble. Given the disproportionately large risks from a disorderly global deleveraging following a bubble burst, this appears justified even if diagnosing an asset bubble during the build-up is fraught with uncertainties.

MACCARIO AURELIO (HYPOVEREINSBANK - UNICREDIT GROUP):

The recent crisis has challenged the view that the neutral interest rate might not depend on asset prices. It is now clear that this bubble has been generated by leaving interest rates too low for too long. Thus, should the resurgence of another bubble be detected, this could lead to a higher neutral policy rate than would be otherwise the case. Therefore, it is of the utmost importance that central banks should recognize that asset bubbles are a source of concern and that there is a strong need to act when such bubbles occur.

I do not subscribe to the theory that bubbles are detectable only when they burst. To this extent, the ECB monetary analysis – especially in the analysis of M3 counterparts – provides a very useful and reliable tool to gauge excessive liquidity growth.

ELGA BARTSCH (MORGAN STANLEY):

The current credit crisis underscored that cheap money eventually comes at a considerable cost. Hence, the case for 'leaning against the wind' has been strengthened. Note that the issue is not whether there is a bubble or not. It is the boom-bust sequence that central banks should be concerned about. One way to incorporate these concerns systematically into monetary policy decisions is to emphasize the role of monetary indicators, such as money and credit, more than it is currently the case. Despite having a two-pillar strategy, even the ECB seems to have been somewhat blasé regarding the risks signaled by money and credit developments for quite a while already.

JULIAN CALLOW (BARCLAYS CAPITAL):

Central banks should recognize that their influence over the short-term interest rate is a very powerful tool that can result in significant volatility in terms of activity and asset prices. Therefore, they should scrutinize particularly closely any episodes in which they are having a particularly distortionary impact on the yield curve, in order to determine rigorously that the policy is fully appropriate. Central banks should always be conscious of the credit cycle, as distinct from the monetary policy cycle. As well, central banks should do more to encourage robust regulation of bank lending and financial markets during periods of asset price volatility, in order that this does not threaten to undermine their focus on price stability.

… but some point out that bubbles are hard to identify or argue that an explicit "leaning against the wind" stance of monetary policy may simply provide false assurance of financial stability.

HARALD UHLIG (UNIVERSITY OF CHICAGO):

One of the easy but false answers is to claim to see a bubble when prices rise. The other easy but false answer is to blame the financial crisis on the fall in house prices. So, knowing whether or when bubbles are there and what exactly the nature of the implied problem is, if any, is already a huge step forward.

ANGEL UBIDE (TUDOR INVESTMENT CORP):

The key lesson is that two objectives, price stability and financial stability, cannot be achieved with one instrument, the interest rate. It is telling that in the Euro area, despite the explicit monetary pillar and 'leaning against the wind' stance of the ECB, banks problems are as deep as in the US, where the stance of policy is explicitly against 'leaning against the wind'. Clearly central banks can't control time varying risk aversion with interest rates, and need cyclically adjusted macro prudential tools to deal with it.

At the heart of this crisis was a deterioration of underwriting standards in the US mortgage market, something independent from the stance of monetary policy. During the downside these macro prudential tools have been used extensively, with ample changes in the composition of the central banks' balance sheet and extension of safety nets. The challenge remains its use during the upswing. Until better tools are designed, such as cyclically adjusted leverage ratios for banks, the statistical provisioning implemented by the Bank of Spain remains one of the most effective tools – and in hindsight it has allowed the Spanish banks to face this crisis with a solid balance sheet.

I would venture to say that the existence of a 'leaning against the wind' policy could give the false assurance of having financial stability under control, when in reality the experience has shown that it is not the case. Central banks should pursue a comprehensive risk stabilization strategy, using interest rates to achieve price stability and active macro prudential policy to achieve financial stability. Central banks have introduced plenty of new liquidity measures during this episode, the question is: Will they remove them on time, and will they also do the opposite, introduce measures to drain liquidity – beyond interest rate increases – when the upswing materializes in full force?

Is the Euro-area regulatory framework ready to deal with the collapse of a major European bank? Clearly not, according to some ECB WATCHERS:

THOMAS MAYER (DEUTSCHE BANK):

No. We need much better supervision at the European level for supra-national MFIs.

HARALD UHLIG (UNIVERSITY OF CHICAGO):

No. How should it be changed? For starters, the regulators need to stop lying to people. It is a lie to tell German bank customers that their deposits are completely protected in case of a bank failure. Suppose Dresdner Bank goes under and its assets happen to have a residual value of zero: a surely extreme case. But in that case, the depositors at Dresdner would get much less than 20 cents on each Euro from the deposit insurance system. I do not view that as a problem, but I do think it is a huge problem to tell depositors otherwise. Should they ever not see their entire money back, the trust and reputation of the banking system will be permanently damaged, with long-term consequences. Or the fiscal authorities have to do a bail-out, with ensuring moral hazard problems. Both consequences are a risk that is too high to take.

… other watchers are more optimistic or remain reluctant to judge.

ULRICH KATER (DEKABANK):

National regulatory bodies and national central banks have still a sufficient range to act if such cases arise.

UWE ANGENENDT (BHF BANK):

The collapse of a major European bank would have to be dealt with by the country concerned. The question is whether national security systems are capable of coming to the rescue of a bigger bank. If there is any doubt, the European Central Bank should be brought in without delay to help solve the crisis.

ELGA BARTSCH (MORGAN STANLEY):

We will only know in the event of major European bank failure whether the current system can cope or not. So far, such situations only arose either outside the Euro area or within a single Euro-area country. One lesson of the recent turbulences is though that where existing systems weren't able to cope, they were adapted very quickly. In addition, many issues involved in the collapse of major financial institutions are well beyond the realm of monetary policy. This holds true in particular for the costs of a potential bail-out and how these should be shared between different countries. In this context, the ESCB could perhaps provide very valuable independent insights into stress-testing the Pan-European banking system and simulating the fallout from a major bank failure.

… but many ECB WATCHERS *see a clear need for improving the current system and provide specific proposals.*

MACCARIO AURELIO (HYPOVEREINSBANK - UNICREDIT GROUP):

A problem is the risk of the collapse of a large cross-border European bank, which would not fall under the jurisdiction of a single regulator or government. Hence, I think it is extremely important to move quickly toward a form of enhanced integration on the issues of cross-border banking supervision and crisis management. Following the October 2007 ECOFIN meeting, where a number of relevant conclusions were agreed upon – including a set of common principles on cross-border financial management – and the April 2008 MOU on cross-border financial crisis situations, the next step should be the introduction of a European mandate for national financial sector authorities in line with recent IMF recommendations. Ideally, the mandate would be implemented into domestic legislation via an EU Directive in a position of natural hierarchy over national laws. This would be a milestone in pursuing a sound and efficient framework for pan-European prudential supervision.

JULIAN CALLOW (BARCLAYS CAPITAL):

The way in which the Eurosystem responded flexibly and promptly to the financial market stresses during the past twelve months demonstrates the importance for regulatory institutions to be very well integrated with very clear channels of communication. As can be seen from the UK experience with Northern Rock, a potential bank failure can potentially involve a fiscal challenge that requires a streamlined committee including finance ministry representation and is yet able to act immediately in order to reassure depositors. Regulation would be most efficiently achieved via a single pan-European institution.

ANGEL UBIDE (TUDOR INVESTMENT CORP):

The regulatory framework of the Euro area is patchy, with multiple communication lines that can easily break down under stress and lead to late responses. In addition, the lag of a clear deposit guarantee makes the task very complicated. Take the example of the recent bailout of Fannie Mae in the US. If it was the case of a major European bank with business in several EU countries, who would be the fiscal institution ready to prepare a package with an unlimited line of credit? A "college of ministers of finance"? Unlikely. Would then the ECB be ready to advance the cash until the fiscal authorities managed to reach an agreement? As I have said many times in the past, the EU should have a Euro-wide supervisory structure for systemically important banks – regional banks should continue to be supervised by national authorities – and a Euro-wide capacity to take responsibility for failed banks.

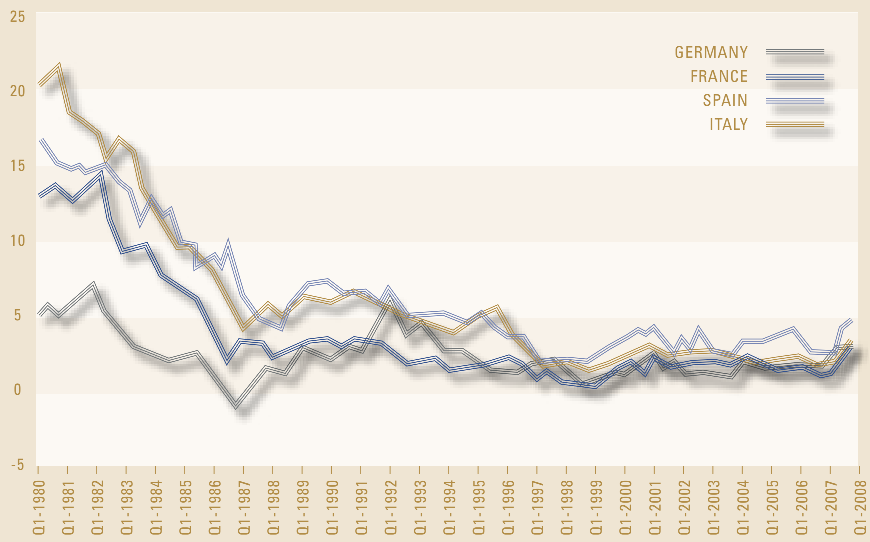

Standard
M3

10 YEARS OF ECB POLICY:

Some Facts & Figures

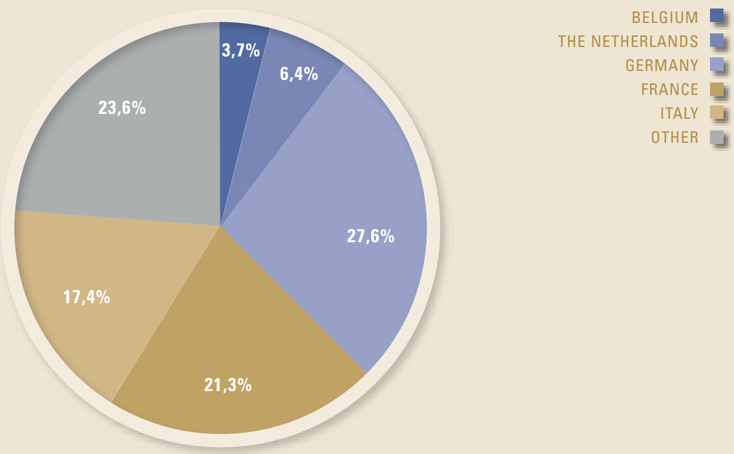
• Let us take a step back and recall European monetary policy and inflation prior to monetary union. Many European economies, such as France, Italy and Spain, entered the 1980s with double-digit inflation. The following decade witnessed a substantial reduction in inflation rates. The European Monetary System, with fixed and adjustable exchange rates, played an important role in achieving convergence of French and Italian inflation rates to German levels by the early 1990s. In spite of the EMS crisis of 1992-1993 this process of monetary coordination culminated in the successfully creation of the Euro area with a common monetary policy by 1998.

1. CPI INFLATION IN GERMANY, FRANCE SPAIN AND ITALY, 1980:1 – 2008:2



DATA SOURCE: SOURCE OECD DATABASE

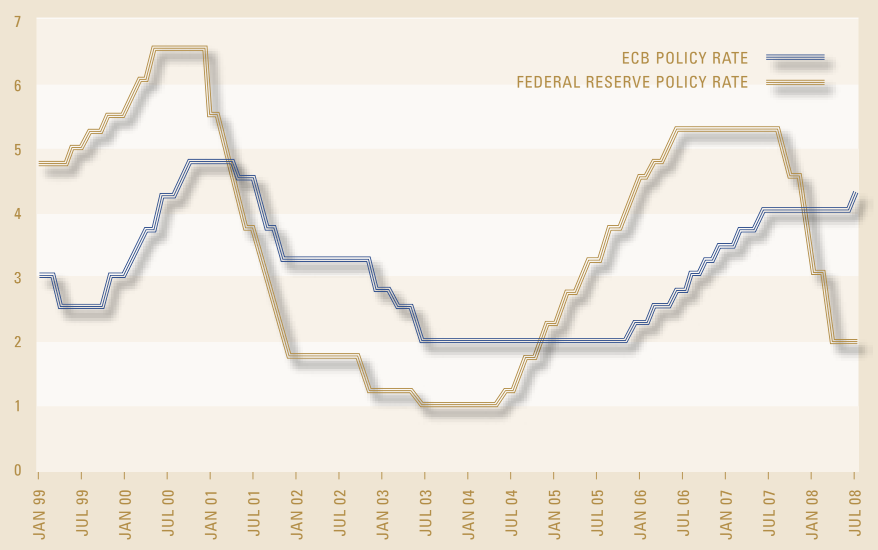
2. SHARE OF EUROLAND GDP



SOURCE: EUROSTAT

• The independent European Central Bank conducts monetary policy for an economic area that is almost as large as the United States economy. In 2007 the population of this economic area numbered 319 million (U.S. 300 million), its GDP measured € 9 trillion (U.S. € 10 trillion) and per capita GDP was equal to € 28000 (U.S. € 34000). The individual members of the ECB governing council represent economies that differ substantially in size, the biggest players being Germany, France, Italy and Spain.

3. POLICY RATE DECISIONS OF THE ECB AND THE FEDERAL RESERVE BOARD, 1999-2008

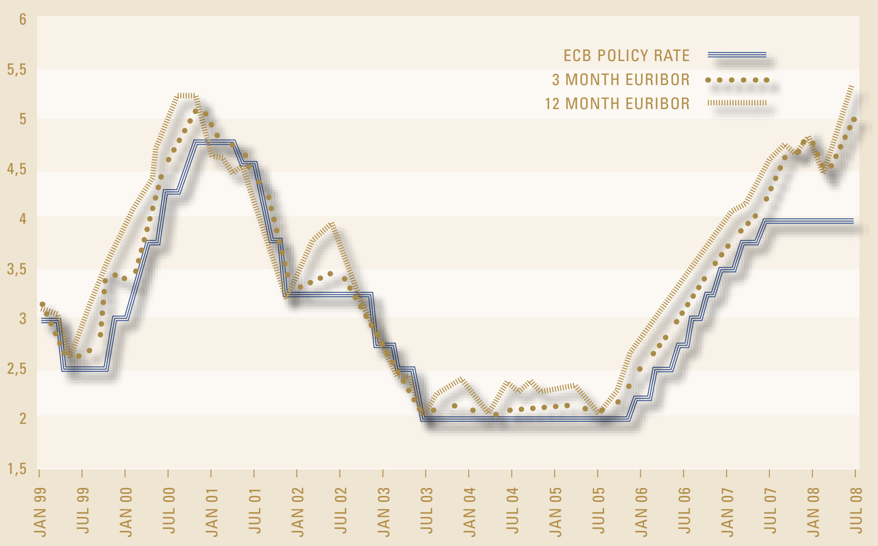


DATA SOURCE: EUROPEAN CENTRAL BANK AND FEDERAL RESERVE BOARD WEBSITES

- ECB policy decisions throughout its first 10 years were quite different from those in the United States at the same time. Perhaps most interestingly, the ECB varied interest rates less than the Fed. Moreover, in 2007 and 2008 they did not lower policy rates in response to the financial turmoil.

- Policy rates influence longer-term nominal and real interest rates, and in turn have an impact on real output and inflation. Of course, interest rates are also influenced by other factors such as term, liquidity and risk premiums. In particular, the financial turmoil of the last 12 months manifested itself in highly elevated premiums in the interbank market.

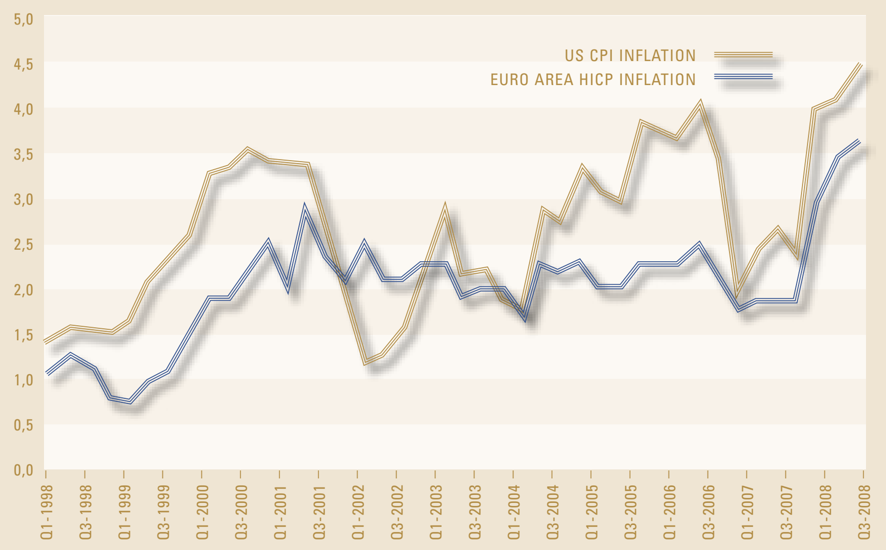
4. ECB POLICY RATE DECISIONS AND EURO AREA INTEREST RATES
(3-MONTH and 12-MONTH MATURITIES)



DATA SOURCE: EUROSTAT STATISTICAL DATABASE

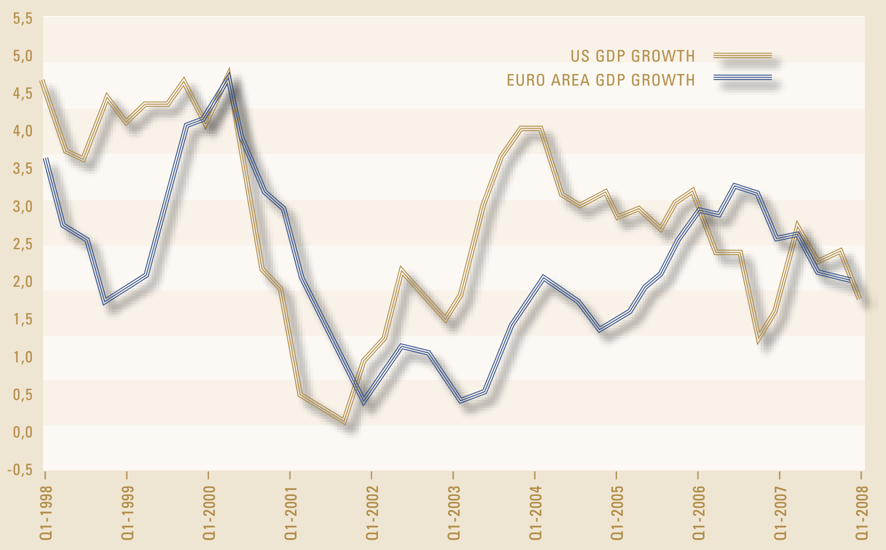
• The ECB's price stability objective was initially stated as a rate of growth of the HICP below 2 percent over the medium term. It was commonly interpreted as a range of 0 to 2 percent. After its strategy review in 2003, the ECB explained that it was aiming to achieve inflation rates of close to but below 2 percent. Until recently, the ECB succeeded in stabilizing inflation fairly close to this goal, but most of the time slightly above rather than slightly below the 2 percent rate. In mid 2008, however, Euro-area inflation has reached over 4 percent. Nevertheless, the ECB's track record on inflation compares favorably to the United States.

5. US CPI AND EURO AREA HICP INFLATION, 1998-2008



DATA SOURCE: SOURCE OECD DATABASE (US CPI DATA) AND EUROSTAT STATISTICAL DATABASE (EURO AREA HICP DATA)

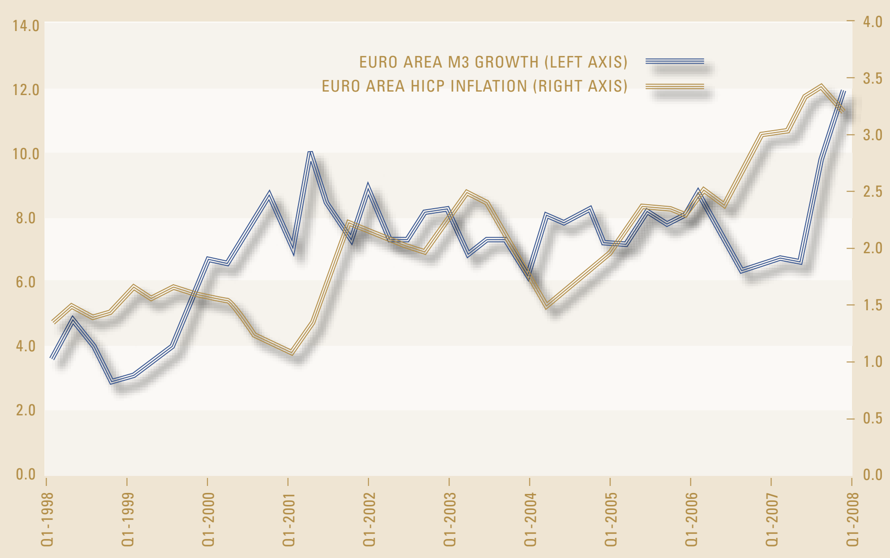
6. US AND EURO AREA GDP GROWTH, 1998-2008



DATA SOURCE: EUROSTAT STATISTICAL DATABASE

• Monetary economists largely agree these days that monetary policy can achieve long-run price stability, but is not able to influence long-term real economic growth. Furthermore, most of them believe that monetary policy has short-term real effects and may therefore reduce temporary output fluctuations. The Fed is quite explicit about its actions in this regard. The ECB's medium-term price stability objective in principle also leaves some room for such concerns. The Euro area, just like the U.S. economy, experienced rather stable output growth throughout the last decade, but a somewhat lower mean.

7. EURO AREA MONEY GROWTH AND HICP INFLATION, 1998-2008

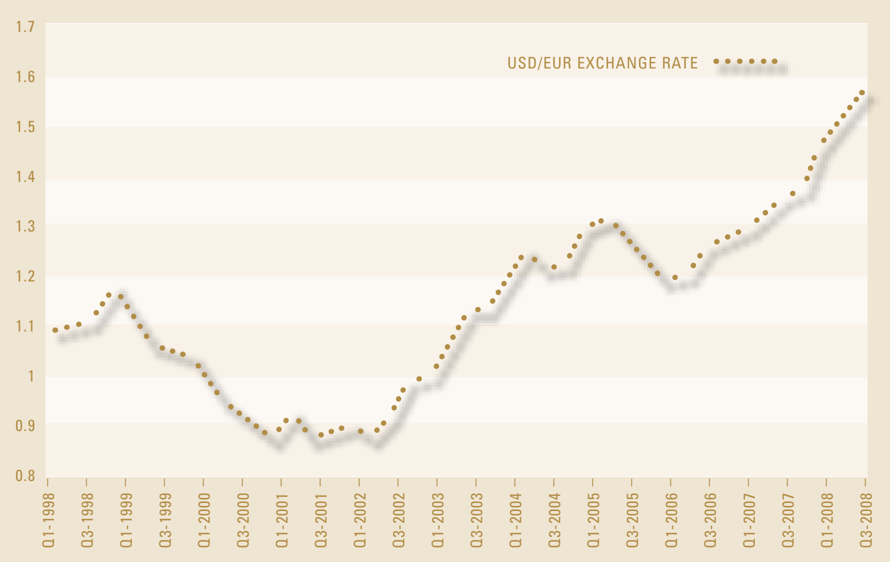


DATA SOURCE: ECB STATISTICAL DATA WAREHOUSE

- A special feature of the ECB's monetary policy strategy is the separation in two pillars that are referred to as monetary and economic analysis. In particular, the monetary pillar received much criticism in recent years simply because the upward trend in Euro area money growth did not seem to trigger subsequent increases in inflation. The ordering of the two pillars was switched following the mid-term review in 2003. Nevertheless, the ECB has confirmed that cross-checking the economic analysis with the monetary information remains crucial for its decision making.

- The ECB has always emphasized that its aim is to stabilize the purchasing power of the Euro and not its external value. This is also true for U.S. monetary policy makers. Thus, the Euro-US$ exchange rate is flexible and determined by market forces. Of course, both central banks have also explained that they assess the effect of exchange rate fluctuations on domestic inflation and then respond to achieve domestic price stability. In its early years, the ECB had to defend its policy stance in light of a substantial depreciation vis-à-vis the U.S. dollar. Since 2003, however, it has had to consider the implications of a sustained increase in the Euro's value compared to the U.S. dollar for Euro area inflation.

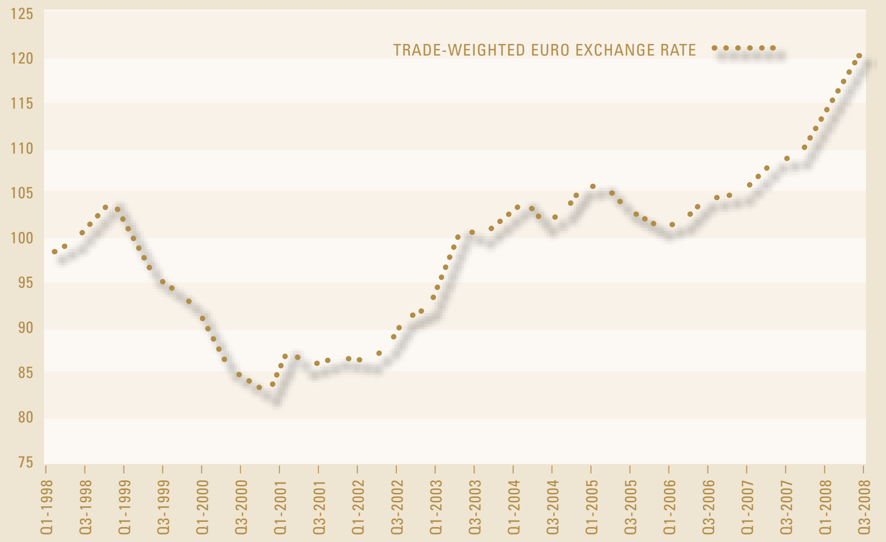
8. USD/EURO EXCHANGE RATE, 1998-2008



DATA SOURCE: OECD KEY ECONOMIC INDICATORS DATABASE

• Measured in terms of the currencies of the 12 most important trading partners the trade-weighted Euro has appreciated by 20 percent in 2008 relative to 1998. Conventional monetary theory suggests that this appreciation must have had a dampening effect on Euro area inflation and possibly saved the ECB some interest rate hikes.

9. TRADE-WEIGHTED EURO EXCHANGE RATE, 1998-2008



DATA SOURCE: EUROSTAT STATISTICAL DATABASE

10. EURO´S SHARE IN FOREIGN RESERVES

	1999*	2001	2003	2005	2006	2007
USD	71	72	66	67	66	64
JPY	6	5	4	4	3	3
EUR	18	19	25	24	25	27
GBP	3	3	3	4	4	5

* 1ST QUARTER

SOURCE: IMF

• Over the last decade the Euro’s importance as an international trade, investment and reserve currency has grown substantially. It has become the second-most important currency and is further gaining ground relative to the U.S. dollar, while the yen has lost strongly in importance. Its share in foreign reserves stands at 27 percent in 2007.

11. WHERE DO POTENTIAL MEMBERS STAND REGARDING THE CONVERGENCE CRITERIA?

	Inflation % yoy May 08	**Interest rates 1)** May 08	**Fiscal Balance** % of GDP 2007	**Public Debt** % of GDP 2007	**ERM II**	**Euro Adoption**
Reference Value	**3.6**	**6.2**	**-3.0**	**60.0**	**Tension-free participation for at least 2 years**	
Czech Republic	5.1	4.6	-1.6	28.7	Managed Float (EUR)	2012-14
Estonia	9.2	5.3	2.8	3.4	ERM II since June 2004	2011
Hungary	7.2	7.2	-5.5	66.0	Free Float	2014
Latvia	13.7	5.4	0.0	9.7	ERM II since May 2005	2012-13
Lithuania	8.6	4.7	-1.2	17.3	ERM II since June 2004	2011
Poland	3.6	5.8	-2.0	45.2	Free Float	2012-13
Slovakia	2.6	4.6	-2.2	29.4	ERM II since Nov 2005	2009
Bulgaria	10.9	4.8	3.4	18.2	Currency Board (EUR)	2012
Romania	6.7	7.1	-2.5	13.0	Managed Float (EUR)	2014

1) MAASTRICHT DEFINITION. OTHER DEFINITION: ESTONIA

SOURCE: DB RESEARCH, THE EURO TURNS TEN, JULY 23, 2008.

- **And the Euro area as well as the ECB Governing Council will continue to gain new members. We close with an overview of those who have committed to adopt the Euro once they meet the convergence criteria set for membership.**

THE HISTORY OF

The ECB and Its Watchers

CONFERENCE SERIES AT A GLANCE

The European Central Bank (ECB) was established on June 1, 1998, and became responsible for conducting monetary policy for its member countries as of January 1, 1999. At the start of monetary union, the Euro area included eleven countries: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Greece joined in 2001 to be followed by Slovenia six years later. In 2008 Malta and Cyprus are its newest members. These countries have in common that they met a series of legal and economic preconditions laid out in the Treaty of Maastricht prior to becoming members. Moreover, by joining, they gave up their responsibility over monetary policy to the European Central Bank.

The path to establishing the ECB was a long one, and dates back as far as the 1950s when Jean Monnet and others first bore the idea of a European cooperation. What followed in the years to come were a number of processes aimed at achieving further monetary and economic integration among the participating countries. With his committee report published in 1989, Jacques Delors became a decisive player in laying out specific steps to achieving a European Monetary Union (EMU) and leading to its actual establishment. Setting up the ECB, as well as launching Europe's new currency in the form of the "Euro" in January 1, 2002, has undoubtedly been a world premiere. There has never been a single economic union between sovereign nations that has gone this far. The full range of implications of this unique experiment was unknown to central bankers and economists.

From the very beginning, the ECB faced a number of challenges. For example, while Euro area members share a single monetary policy, they remain responsible for their own fiscal affairs. Furthermore, structural economic diversities persist. Thus, raising or lowering interest rates will have different implications for the individual economies.

In an effort to create a platform for discussing the challenges lying ahead with other experts, the ECB and the Center for Financial Studies, represented by OTMAR ISSING (ECB) and AXEL A. WEBER (CFS), created the conference series "The ECB and its Watchers" in 1999. Since then the conference has taken place annually, bringing together academics, central bankers, market participants, media and press representatives from around the globe for a debate on monetary policy. Moreover, the conference, which is by invitation only, encourages recommendations, new research findings and awareness, as well as criticism. The ECB has welcomed this exchange and has been ready to answer to, clarify, adopt or reject initiatives raised by participants.

As indicated by a review of the conferences from 1999 to 2007, the ECB watchers have addressed a number of key issues in line with the ECB's development and policy actions. Theses topics included, among others, ECB transparency and communication, divergence of inflation rates and deflation fears in the Euro area, the two-pillar strategy of the ECB, inflation performance, and international imbalances, as well as economic weakness and the revision of the Stability Pact.

*1999

From the very first conference in 1999, the ECB has been responsive to the continuous demand for a monetary policy that is not only more transparent, but also better communicated to the markets. For example, TOMMASO PADOA-SCHIOPPA (ECB) reassured participants of the first conference that the role of the ECB is "to have a view, to have a single view, and to make it felt."

2000

Picking up on this notion, the ECB watchers again discussed the question of communication in the second conference in 2000, and a series of recommendations were made with respect to improving the ECB communication strategy: presenting inflation forecasts, publishing the minutes of the ECB council meetings, issuing the arguments put forward at the ECB council meetings in the ECB monthly reports, and adopting a more instrument-driven monetary policy strategy as soon as the data have improved in the EU, as well as publishing a comprehensive and timely summary after every interest rate decision. A criticism was that the ECB's communication policy tried too hard to present a uniform front and single point of view. The attempt to reach unanimous decisions in an ECB Council, which was believed to be too large, was suspected to cause delays in the decision making. In its reply, the ECB agreed that there was a communication problem between the bank and the general public. Taking in consideration the suggestions made, the ECB emphasized that there were limits to how far the ECB could or even should meet these demands in the face of a complex, uncertain and changing economic environment.

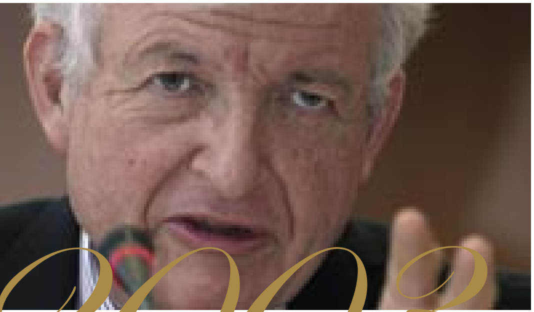
2001

The third "ECB and Its Watchers" conference focused on the divergence of inflation rates across EMU countries. HARALD UHLIG (Humboldt University and CEPR) argued that the ECB should not worry about divergent inflation rates, because they may reflect necessary relative-price adjustments. AXEL A. WEBER (CFS) presented new evidence about inflation diversity and convergence in the Euro area. He found that inflation convergence took a specific form, whereby inflation rates are mean-reverting in the sense that regions with initially high (or above average) rates of inflation tend to have subsequently lower (or below average) inflation rates. Overall, inflation diversity

should not be a concern for the ECB, since a 2% area-wide inflation ceiling is sufficiently flexible to allow for European national and even regional inflation diversity without exposing European regions to sizeable deflationary risks. HANS-WERNER SINN (University of Munich and CESifo) addressed fears of potential deflation in the Euro area and pointed to possible problems in the years to follow. If the ECB achieved its goal of a 1.5% inflation rate for the whole Euro area, this would translate into deflation in countries such as Germany, given the inflation differentials in the EMU.

OTMAR ISSING (ECB) responded to these concerns, as well as to questions regarding the ECB's definition on price stability, extensively in the fourth conference in 2002. First, he argued that the ECB's definition of price stability did not focus too much on the upper bound, but in fact the objective was symmetric, with zero being the lower bound. Second, the ECB's definition of price stability (0-2%) was not excessively ambitious. Research suggested that the risk of reaching the zero bound for nominal interest rates was quite small with an inflation target as low as 1%. Last, the definition of price stability left room for relative price movements due to the Balassa-Samuelson effect. Thus the risk was small for current EMU members. While this effect might play a bigger role for the accession countries, these economies were relatively small and the convergence criteria made sure that entrants had a low level of inflation.

An important part of the debate between academics, market professionals and the European central bankers over the first few years had also been the ECB monetary policy strategy or, specifically, the two-pillar structure of this strategy. For example, it was criticized for being insufficiently clear and nontransparent. Critics such as LARS E.O. SVENSSON (Institute for International Economic Studies and CEPR) discussed the choice between monetary and inflation targeting and concluded that the first pillar of the ECB monetary strategy contradicted inflation targeting. Svensson proposed looking only at the second pillar and to take into account the money supply as one of the many indicators used to derive a specific inflation forecast. Like others, he expressed a clear preference for inflation targeting.



2003

During the fifth conference in 2003, professionals and the ECB discussed the results of the ECB's monetary policy strategy review: specifically that the numerical inflation target was clarified to be below but close to 2% and the two-pillar structure was confirmed, albeit the order of pillars switched. OTMAR ISSING (ECB) emphasized that the ECB was not dissatisfied with the strategy. It was only natural that, after a period, the council would want to go back and reflect on the accumulated experience in a systematic way. He concluded that the ECB's reflection on monetary policy was an ongoing process.

2004

The longer-term performance of inflation in the EMU became an issue for discussion in 2004. HARALD UHLIG (Humboldt University and CEPR) based his presentation on the fifth MECB (Monitoring the European Central Bank) report of the CEPR's ECB watcher group. Uhlig criticized the ECB for failing to keep inflation below 2% for most of the time.

He considered the ECB's inflation target too ambitious and suggested replacing it with a range from 1% to 3%. OTMAR ISSING (ECB), in turn, considered Euro-area inflation performance of roughly 2% in earlier years a great achievement of

the ECB. While recognizing the repeated underestimation of inflation mentioned also by MANFRED J.M. NEUMANN (University of Bonn), Issing also rejected possible suggestions that this might have been deliberate and stated that the ECB's inflation projections were made objectively using state-of-the-art techniques.

International macroeconomic imbalances – another topic that was on the agenda for several years – still loomed large at the sixth conference held for the ECB and its watchers. In particular, discussion focused on the U.S. current account deficit and its implications for

the Euro area. TED TRUMAN (Institute for International Economics) argued that the U.S. current account deficit was unsustainable, but that the extent and timing of its adjustment were uncertain. As to fiscal policy, he urged the U.S. to address its fiscal imbalances, but saw less cause for compensating fiscal action in the Euro area. Instead, he indicated a major responsibility for the ECB in sustaining growth and stimulating demand.

CARLO MONTICELLI (Ministero dell'Economia e delle Finanze) also pointed to the uncertainty about the size of the required adjustment in the U.S. economy. In response, OTMAR ISSING (ECB) noted that a temporary current account deficit – or surplus – should be regarded as a natural phenomenon in an increasingly integrated world economy, but the U.S. current account deficit may become a matter of concern. He indicated that the role of monetary policy in resolving international imbalances was to provide a stable environment in which structural reforms could develop their fullest potential.

2005

Conference organizer VOLKER WIELAND (CFS) once again gave various ECB watchers the opportunity to express their views about the current stance on monetary policy at the beginning of the seventh conference in 2005. THOMAS MAYER (Deutsche Bank) stated that the ECB was caught between a rock, i.e., economic weakness, and a hard place, i.e., strong liquidity growth. In his opinion the ECB had paid more

attention to near-term economic weakness so far. As inflation was mainly a monetary phenomenon, the recent liquidity development represented a major danger for price stability in the Euro area. Insufficient investment growth and a relative total factor productivity decline were identified as major reasons for a decline in output growth in Europe by DANIEL GROS (CEPS).

2006

At the eighth conference of the CFS series "The ECB and Its Watchers," GIANCARLO CORSETTI (European University Institute and CEPR) reviewed the ECB's current performance and new challenges, and suggested that the ECB long-run inflation target be raised if the European trend growth were to remain low and if the Stability and Growth Pact would not be changed. The consequences of limited knowledge and imperfect measurement for the conduct of monetary policy were discussed by ATHANASIOS ORPHANIDES (Federal Reserve Board) in a review of the ECB's strategy and alternative approaches.







In his opinion, these issues are more controversial than other elements of good policymaking such as giving primacy to the objective of price stability. Given the constraints on information, simple rule-based policies have a clear advantage over policies based on optimal control experiments. LARS CALMFORS from Stockholm University stated that the Stability and Growth Pact was working in general, although some of the revisions had weakened fiscal discipline in some countries.

While, the legitimacy of the pact may have increased by allowing for more sensible judgment, the widened scope for discretionary fiscal policymaking at the national level may ultimately lead to a loss of credibility. LUCAS PAPADEMOS (ECB) stressed the progress in convergence of all new member states. He underlined the need to differentiate between structural measures with a permanent effect on the economy and short-term measures. In addition to nominal convergence, real convergence is also of great importance.

2007

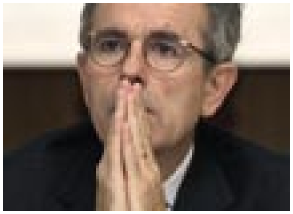
The ninth ECB and Its Watchers Conference held on September 7, 2007, was the first conference without Otmar Issing on the ECB side of the debate. Compared to previous years, in which panel discussions dominated the agenda, the program followed a new format with a series of debates between two or three speakers, in all but one case involving a European policy maker. In fact, the conference took place at a significant time concerning the discussions on ECB monetary policy strategy, adequate policy responses to diverging unit-labor costs, and budget consolidation in Europe. Importantly, the ongoing liquidity crisis and credit crunch in the U.S. and Europe and respective policy recommendations received particular attention.

ECB President JEAN-CLAUDE TRICHET addressed the audience with a presentation on the "Euro Area and its Monetary Policy". Trichet began by explaining that from time to time, exceptional situations may require exceptional decision making by central banks such as "refinancing the money market to help it normalize its functioning" with respect to the liquidity crisis. In such a situation, Trichet encouraged critics to "resist the temptation to focus on the drama of emergency medicine," and trust the policy makers' ability to monitor the "new facts" (i.e. economic shocks) as well as the "regularities" (i.e. the deep structure of the economy), which could lead to possible adjustments in the long run.

In the debate about the role of money in monetary policy, JÜRGEN STARK (ECB) stressed enhancing the ECB's monetary analysis, because it has proved the best possible strategy to conduct policy for the Euro area. In response to Jürgen Stark, PAUL DE GRAUWE (K.U. Leuven) took the opposite stance on the role of money in monetary policy. Although he admitted, that it had been a great success of the ECB to anchor the inflation rate at around 2% since 2000, De Grauwe observed that money growth fluctuated to a great extent during the same period.

On signalling the future interest rate path, AXEL A. WEBER (Deutsche Bundesbank) questioned the case for publishing future interest rate intentions. Central bankers rightly hesitate to communicate an interest rate path due to the risks involved in making a premature commitment, due to the complications in achieving consensus in decision making by committee, and due to complications in ensuring that the path is consistent with the overall process implied by the chosen strategy. Weber noted that if proper signaling of future intentions fails due to these complications, then policy effectiveness may deteriorate substantially.

LUCAS PAPADEMOS(ECB) opened the debate on the implications of diverging unit-labor costs in Europe and the proper policy response by focusing on the causes and consequences of inflation and competitiveness divergence in the Euro area and discussing needed policy responses. He emphasized that the dispersion of unit-labor cost growth in the EMU has declined substantially in the last fifteen years and "although it is still appreciable, it is not unusually large and it is broadly in line with that observed in other monetary union." Nevertheless, there exist unfavorable trends regarding competitiveness for some EMU countries, where unit-labor growth divergences are considerable and such developments will, in turn, affect growth and employment. According to Papademos, these unit-labor cost growth divergences are significant and a clear understanding of their causes is required. This can be achieved by first analyzing the individual components of unit labor costs – typically exceptionally strong wage growth, low productivity growth or both combined. Understanding the causes of diverging labor-unit growths, as well as considering its consequences allows policy makers to respond accordingly.



From the Ministero dell'Economia e delle Finanze, IGNAZIO ANGELONI reviewed the significant stabilization of unit-labor costs after the implementation of the Euro. "There is an issue not a problem," according to Angeloni, who sees not only price but also quality competitiveness among the EMU countries. Some countries have picked up on the rules of monetary union, while others have not.

In the fourth debate on successful budget consolidation in Europe, PERVENCHE BERÈS (European Parliament and Committee on Economic and Monetary Affairs) stated that before the Stability and Growth Pact had been reformed, exactly thirteen countries had to follow an Excessive Deficit Procedure in 2005. At this point, only seven countries must follow such a course of action, namely Italy, Portugal, the U.K., the Czech Republic, Hungary, Poland, and Slovakia. She further highlighted that in 2006, the EMU's average budget deficit had been 1.6% compared to the 2.5% in the previous year. Despite such progress, Berés questioned whether such improvements can be achieved in the future, particularly given the financial unrest of the past months. An important item on the 2007 ECB and Its Watchers agenda was the concluding debate on the recent financial disruptions in the United States and Europe. STEPHEN CECCHETTI (Brandeis University) opened the discussion. He termed the crisis "the crisis of collateral" or "crisis of un-collateralized lending," in which nobody knows what the collateral really is anymore. Its warning signals are mounting risk premiums, the dramatic decline in the readiness to accept collateral of uncertain quality, and the move of borrowers from direct issuance to bank credits. However, for Cecchetti the origins of the crisis were badly functioning supervision, inadequate regulation of sub-prime mortgage creators and the complicated design of securities too complex to assess.

At the 2007 conference, the CFS welcomed 16 renowned speakers from government, academia, private banks and institutions, international organizations and central banks to present their answers to these key issues. More than 200 participants actively took part in the conference along with a new record number of 60 media and press representatives to report on the event.

Today

The Center for Financial Studies has now hosted the event for 10 consecutive years. The "ECB and Its Watchers" conference has evolved into a unique and well-established forum for the public exchange of opinion between leading central bank critics and central bank decision makers. It was and remains of vital importance to the organizers to reflect the ongoing processes, developments and challenges of the ECB.

LIST OF

Conference Speakers

1999-2007

(IN ORDER OF APPEARANCE ON THE PROGRAM)

1999

Axel A. Weber (CFS and Goethe University Frankfurt)

Ignazio Angeloni (ECB)

Vítor Gaspar (ECB)

Oreste Tristani (ECB)

Davig Begg (Birkbeck College)

Jürgen von Hagen (ZEI and University of Bonn)

Daniel Gros (CEPS)

Thomas Mayer (Goldman Sachs)

John Taylor (Stanford University)

Charles Bean (London School of Economics)

Stefan Gerlach (Bank for International Settlements)

Lars E.O. Svensson (Institute for International Economic Studies)

David Vines (Oxford University)

Frank Smets (ECB)

Otmar Issing (ECB)

Ernst Welteke (Landeszentralbank in Hessen)

Harald Benink (University of Maastricht)

Reinhard H. Schmidt (Goethe University Frankfurt)

Philip Hartmann (ECB)

Marvin Goodfriend (Federal Reserve Bank of Richmond)

Kunio Matsuda (Bank of Japan)

Michael Artis (European University Institute)

Gerd Jan Hogeweg (ECB)

Mathew B. Canzoneri (Goergetown University)

Ignazio Visco (OECD)

Tony Yates (Bank of England)

Jürgen Kröger (European Commission)

Manfred J.M. Neumann (University of Bonn)

Tommaso Padoa-Schioppa (ECB)

Edwin M. Truman (Institute for International Economics)

2000

Axel A. Weber (CFS and Goethe University Frankfurt)

Axel Siedenberg (Deutsche Bank Research)

Carlo Favero (CEPR and Bocconi University)

Xavier Freixas (CEPR and Universitat Pompeu Fabra)

Daniel Gros (CEPS)

Thomas Mayer (Goldman Sachs)

Jürgen von Hagen (ZEI and University of Bonn)

Manfred J.M. Neumann (University of Bonn)

Lars E.O. Svensson (Institute for International Economic Studies)

Vítor Gaspar (ECB)

André Sapir (European Commission)

Marco Butti (European Commission)

Matthew Conzoneri (Georgetown University)

Paul De Grauwe (University of Leuven)

Jacques Mélitz (INSEE and University of Strathclyde)

Michael Hüther (DGZ · DekaBank)

Otmar Issing (ECB)

Christa Randzio-Plath (European Parliament)

Francesco Giavazzi (Bocconi University)

David Wessel (Wall Street Journal Europe)

Claus Tigges (Frankfurter Allgemeine Zeitung)

Michael Heise (DG Bank)

John Lipsky (Chase Manhattan Bank)

Ignazio Angeloni (ECB)

Peter Kenen (Princeton University and International Finance Section)

Barry Eichengreen (University of California, Berkeley)

Giancarlo Corsetti (Yale University and University of Bologna)

Norbert Walter (Deutsche Bank Research)

Marc-Olivier Strauss-Kahn (Banque de France)

Martin Hüfner (HypoVereinsbank)

2001

Axel A. Weber (CFS and Goethe University Frankfurt)

Otmar Issing (ECB)

Christa Randzio-Plath (European Parliament)

Francesco Giavazzi (CEPR and Bocconi University)

Harald Uhlig (CEPR and Humboldt University)

Daniel Gros (CEPS)

Guido Tabellini (Bocconi University)

Jürgen von Hagen (ZEI and CEPR)

Manfred J.M. Neumann (University of Bonn)

Lars E.O. Svensson (CEPR and Institute for International Economic Studies)

Hermann Remsperger (Deutsche Bundesbank)

Ignazio Angeloni (ECB)

Paul De Grauwe (University of Leuven)

Juan J. Dolado (Universidad Carlos III de Madrid)

Sylvester C.W. Eijffinger (CentER and Tilburg University)

Carlo Monticelli (Deutsche Bank AG)

Thomas Mayer (Goldman Sachs)

Tommaso Padoa-Schioppa (ECB)

Giancarlo Corsetti (Yale University and University of Rome III)

André Sapir (European Commission)

Niels Thygesen (EPRU and Kopenhagen University)

Norbert Walter (Deutsche Bank Research)

Jürgen Pfister (Commerzbank AG)

Vítor Gaspar (ECB)

Matthew B. Canzoneri (Georgetown University)

Francesco Giavazzi (Bocconi University)

Bennet T. McCallum (Carnegie Mellon University)

Hans-Werner Sinn (CESifo and University of Munich)

2002

Axel A. Weber (CFS and Goethe University Frankfurt)

Francesco Giavazzi (IGIER and Bocconi University)

David Begg (Birkbeck College)

Fabio Canova (Universitat Pompeu Fabra and London Business School)

Daniel Gros (CEPS)

Carlo Monticelli (Deutsche Bank Research)

Juan J. Dolado (Universidad Carlos III de Madrid)

Marco Mazzucchelli (San Paolo IMI)

Steven Cecchetti (Ohio State University)

Otmar Issing (ECB)

Vítor Gaspar (ECB)

Christian Thimann (ECB)

Carlo Bastasin (La Stampa)

Riccardo Barbieri Hermitte (Morgan Stanley)

Ilian Mihov (INSEAD)

László Halpern (CEPR and Institute of Economics)

Ignazio Angeloni (ECB)

Guido Tabellini (IGIER and Bocconi University)

Martin Eichenbaum (Northwestern University)

John Lipsky (JP Morgan)

Daniel Gros (CEPS)

2003

Axel A. Weber (CFS and University of Cologne)

Otmar Issing (ECB)

Daniel Gros (CEPS)

Manfred J.M. Neumann (University of Bonn)

Niels Thygesen (EPRU and University of Copenhagen)

Jürgen von Hagen (ZEI and University of Bonn)

Matthew Canzoneri (Georgetown University)

Gert Jan Hogeweg (ECB)

Joachim Fels (Morgan Stanley)
John Lipsky (JP Morgan Securities)
Thomas Mayer (Deutsche Bank Research)
Paul Mortimer-Lee (BNP Paribas)
Thorsten Polleit (Barclays Capital Plc)
Angel Ubide (Tudor Investment Corp)
Lars E.O. Svensson (Princeton University)
Bernhard Winkler (ECB)
Christian Burckhardt (Börsen Zeitung)
Jörg Eigendorf (Die Welt)
Beda Romano (Il Sore-24 Ore)
Tom Sims (The Wall Street Journal)
Pam Woodall (The Economist)
Vítor Gaspar (ECB)

2004

Volker Wieland (CFS and Goethe University Frankfurt)
Otmar Issing (ECB)
Harald Uhlig (Humboldt University)
Daniel Gros (CEPS)
Roberto Perotti (IGIER and Bocconi University)
Jürgen von Hagen (ZEI and University of Bonn)
Manfred J.M. Neumann (University of Bonn)
Angel Ubide (Tudor Investment Corp)
Jose Alzola (Citigroup)
Vítor Gaspar (ECB)
Gertrude Tumpel-Gugerell (ECB)
David Wright (European Commission)
Rudolf Ferscha (Eurex)
John Lipsky (JP Morgan Chase)
Claudio Borio (Bank for International Settlements)
Michael Wickens (University of York)
Edwin M. Truman (Institute for International Economics)
Carlo Monticelli (Ministero dell'Economia e delle Finanze)
Ignazio Angeloni (ECB)
Takatoshi Ito (University of Tokyo)
Charles Wyplosz (Graduate Institute of International Studies)
Joachim Fels (Morgan Stanley)
Thorsten Polleit (Barclays Capital Plc.)
Jörg Krämer (INVESCO Asset Management Deutschland GmbH)

2005

Volker Wieland (CFS and Goethe University Frankfurt)
Jordi Galí (CREI, CEPR and Universitat Pompeu Fabra)
Giancarlo Corsetti (CEPR and European University Institute)
Daniel Gros (CEPS)
Joachim Fels (Morgan Stanley)
William Dickens (Brookings Institution)
Laurence Meyer (Meyer's Monetary Policy Insights)
Thomas Mayer (Deutsche Bank)
Ulrich Kater (DekaBank)
Otmar Issing (ECB)
Manfred J. M. Neumann (University of Bonn)
Caio Koch-Weser (German Federal Ministry of Finance)
Lucas Papademos (ECB)
Klaus Regling (European Commission)
Willem H. Buiter (EBRD)
Michael Deppler (IMF)
Lucrezia Reichlin (ECB)
Marcel Fratzscher (ECB)
Richard Clarida (Clinton Group and Columbia University)
Vincent Reinhart (Federal Reserve Board)
Lars E.O. Svensson (Princeton University)
David Walton (Goldman Sachs)

2006

Volker Wieland (CFS and Goethe University Frankfurt)
Elga Bartsch (Morgan Stanley)
Giancarlo Corsetti (CEPR and European University Institute)
Peter Hooper (Deutsche Bank)
Angel Ubide (Tudor Investment Corp)
Manfred J.M. Neumann (University of Bonn)
Huw Pill (ECB)
Jan Qvigstad (Bank of Norway)
Richard Clarida (Pimco and Columbia University)
Athanasios Orphanides (Federal Reserve Board)
Otmar Issing (ECB)
Axel A. Weber (Deutsche Bundesbank)
Wolfgang Schill (ECB)
José Manuel González Páramo (ECB)
Michael Hüther (Institut der Deutschen Wirtschaft)
Lars Calmfors (Stockholm University)
Servaas Deroose (European Commission)
Lucrezia Reichlin (ECB)
Lucas Papademos (ECB)
György Szapáry (Central Bank of Hungary)
Willem H. Buiter (London School of Economics)
Daniel Gros (CEPS)

2007

Volker Wieland (CFS and Goethe University Frankfurt)
Jean-Claude Trichet (ECB)
Jürgen Stark (ECB)
Paul De Grauwe (University of Leuven)
Axel A. Weber (Deutsche Bundesbank)
Charles Wyplosz (Graduate Institute of International Studies)
Julian Callow (Barclays Capital)
Michael Binder (CFS and Goethe University Frankfurt)
Lucas Papademos (ECB)
Ignazio Angeloni (Italian Ministry of Economy and Finance)
Joachim Fels (Morgan Stanley)
Pervenche Berès (European Parliament)
Teresa Ter-Minassian (IMF)
Wolfgang Münchau (Eurointelligence)
Stephen Cecchetti (Brandeis University)
Michael Dicks (Barclays Wealth)

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