# Comments on
# "In Search of Monetary Stability: the Evolution of Monetary Policy"
# by Otmar Issing*

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# Issues

1. Introduction: causality, neutrality and monetary policy strategy

2. Money in an inflation target regime

3. Financial stability and bubbles

4. Concluding remarks

# 1. Introduction

- *Inflation is always and everywhere a monetary phenomenon* (Friedman, 1963).

- **(1) Causality vs. (2) neutrality**

- From (1) $k$-rule: long-term price stability with short and medium term monetary stability (Friedman, 1960).

- (2) is fully consistent with using the interest rate as the instrument for monetary policy, without violating monetary neutrality. However, there is no causal relationship from money to inflation.
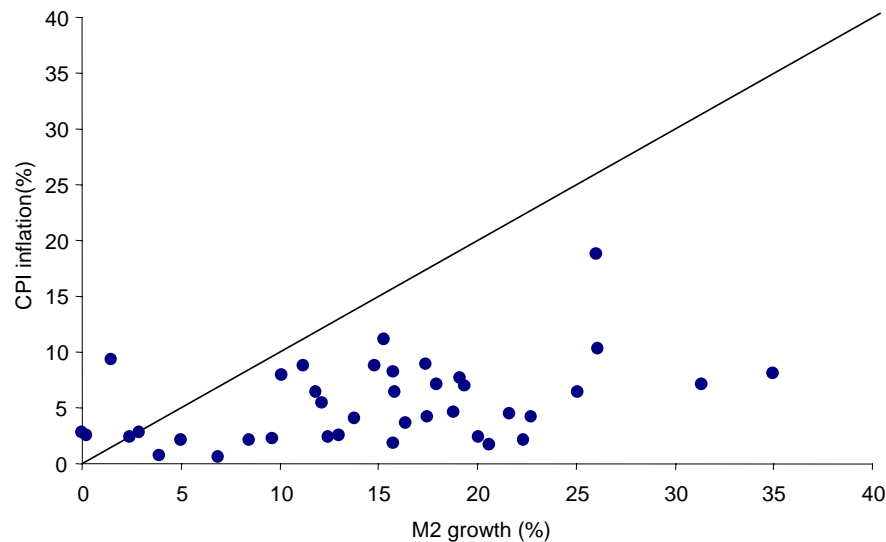
# M1 growth and inflation
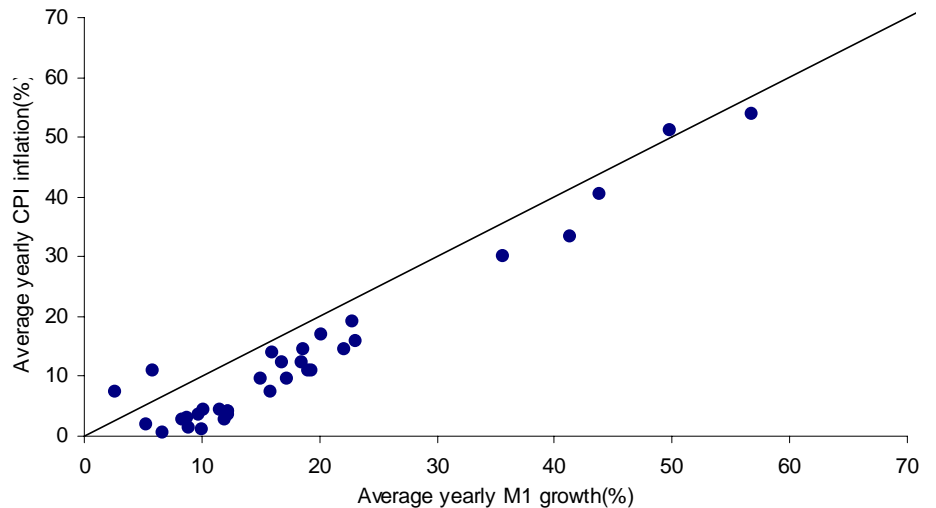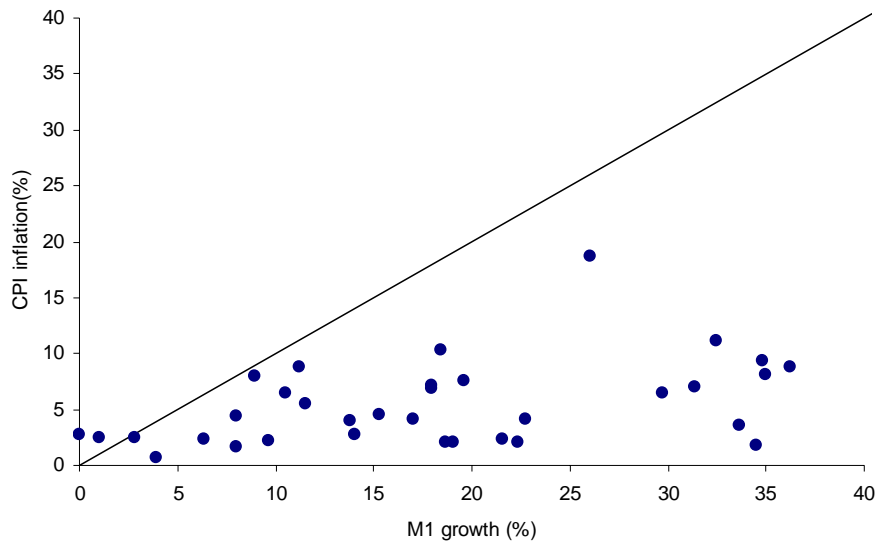
2007

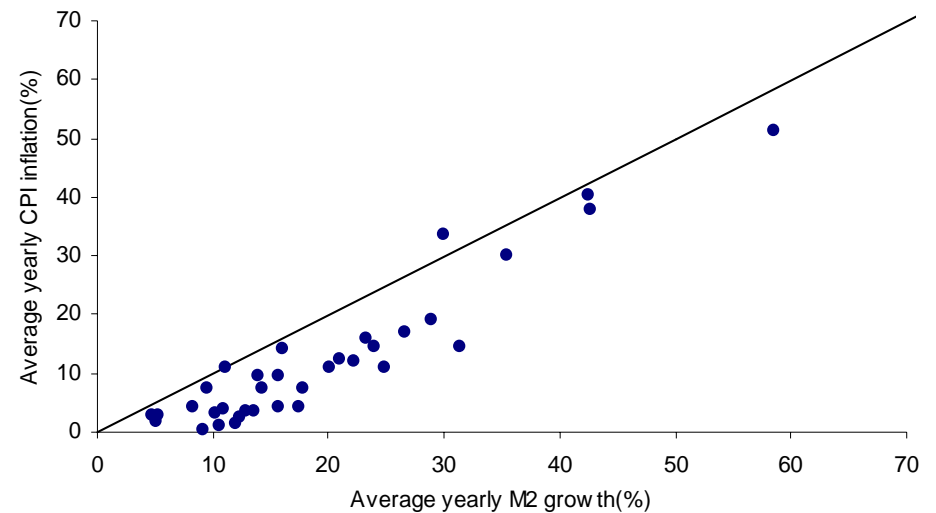Average 1984–2007



Source: IFS, IMF.
Countries included are 50 that have complete data records.

4

# M2 growth and inflation

## 2007



## Average 1984–2007



Source: IFS, IMF.
Countries included are 50 that have complete data records.

# 1. Introduction

- Must differentiate between:

  - **Objectives:** monetary, financial, output, or price stability.

  - **Strategies:** inflation, monetary aggregates, nominal income targeting. Or a combination (example, escape clauses).

  - **Instruments:** interest rates, money, etc.

  - **Information:** indicators to adjust instruments.

- But two strategies (similar to two instruments), and one objective is unclear (Kilponen and Leitemo, 2006).

- There is a need to separate between strategies and indicators, which I think is in the spirit of current theoretical developments and in the spirit of this paper and the two-pillars.
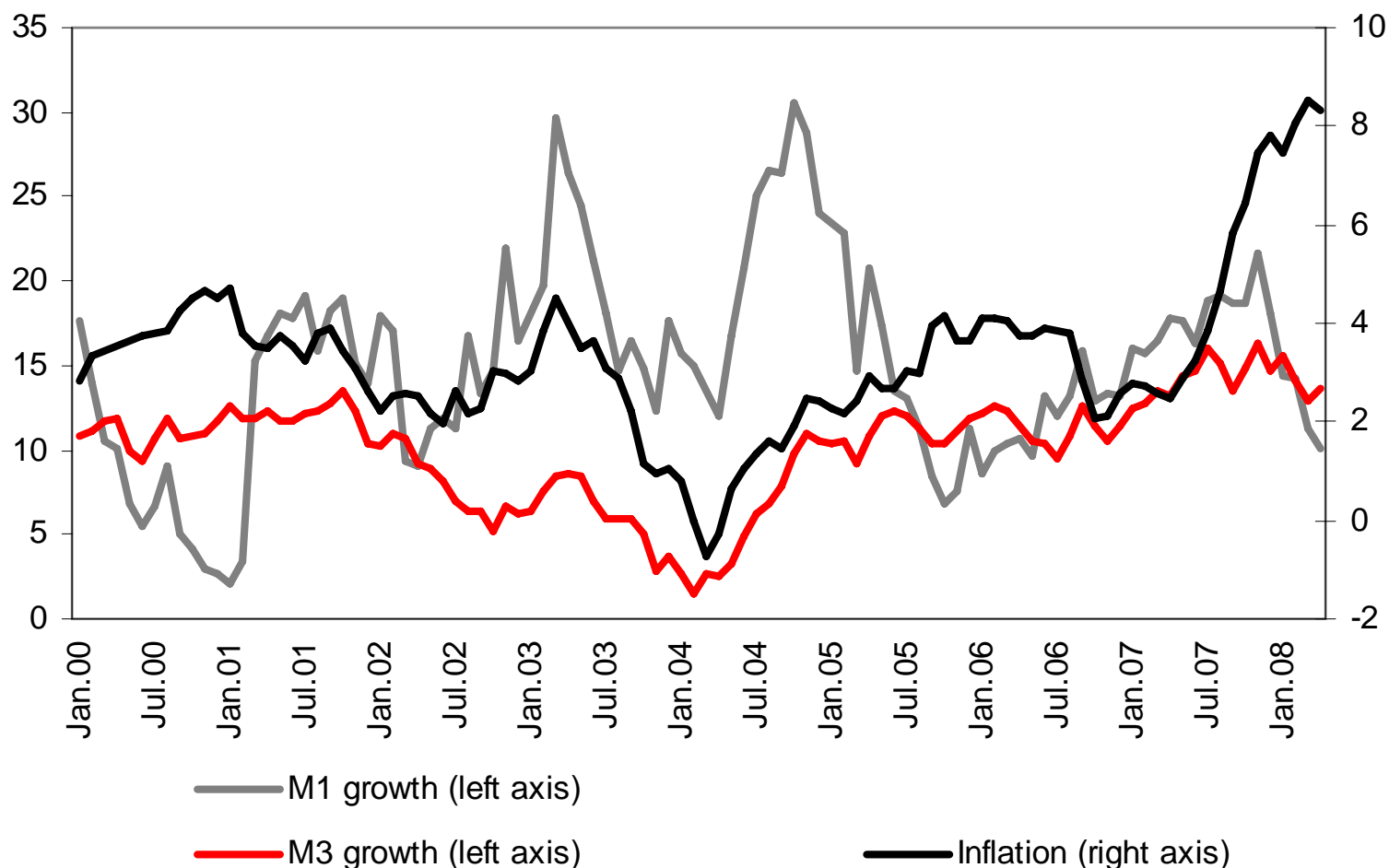
# 2. Money and Inflation Targets

- Taylor rule vs. inflation forecast: A first approach is what to include in the Taylor rule. A more realistic, and fruitful approach is on which are the determinants of future inflation.

- Inflation forecast targeting: Models and judgment. Models are powerful tool but very limited. Judgment and auxiliary evidence are essential.

- Example: exchange rates are a common concern in developing countries. Same is true for monetary aggregates.

# 2. Money and Inflation Targets

- Indeed, most recent development consider monetary aggregates as indicators for inflation perspectives or stabilization goals (banking credit and money: Christiano, Motto and Rostagno, 2007; McCallum and Goodfriend, 2007)…not as the cause of inflation.
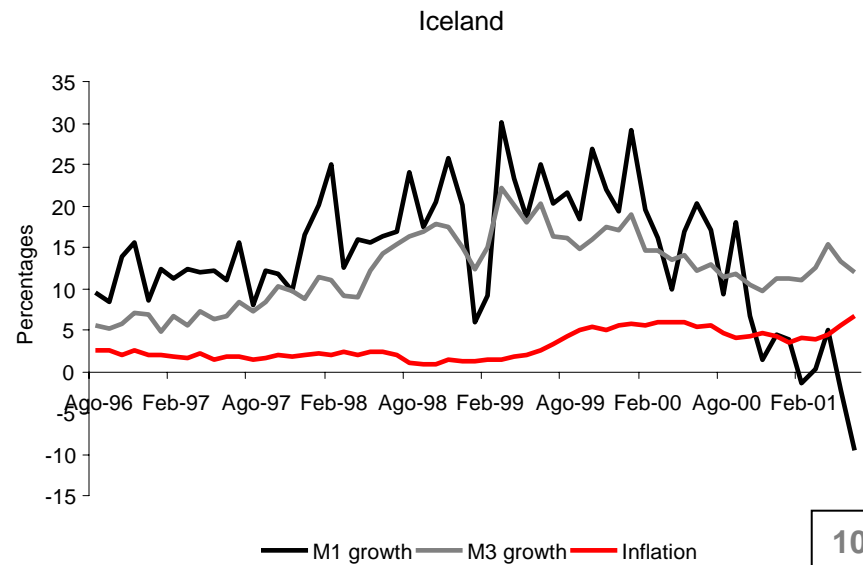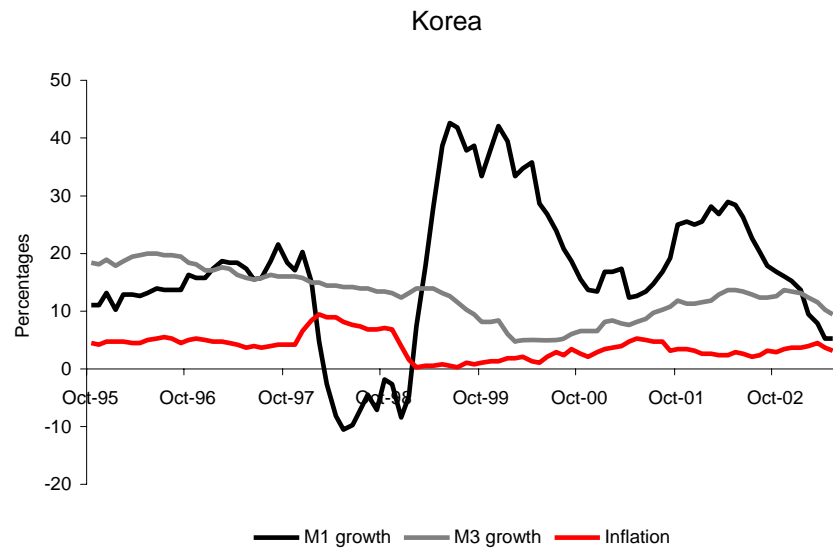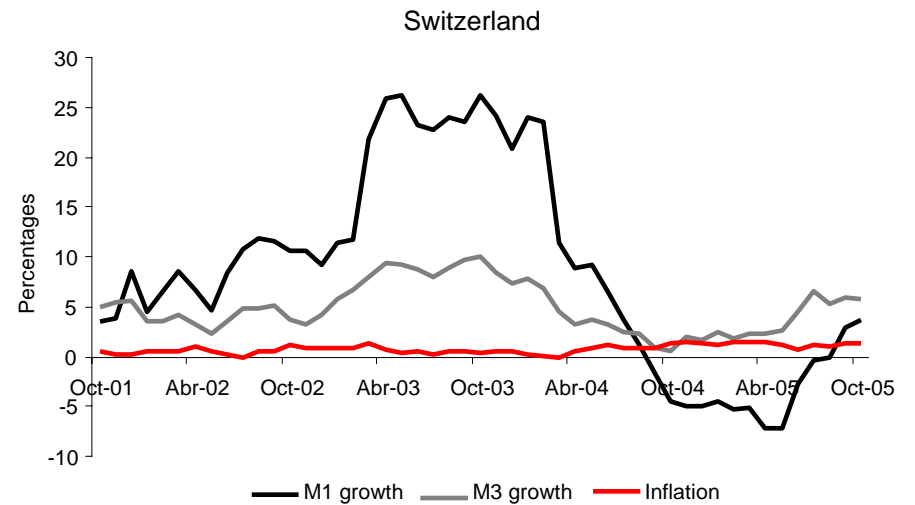
- But they could also be misleading.

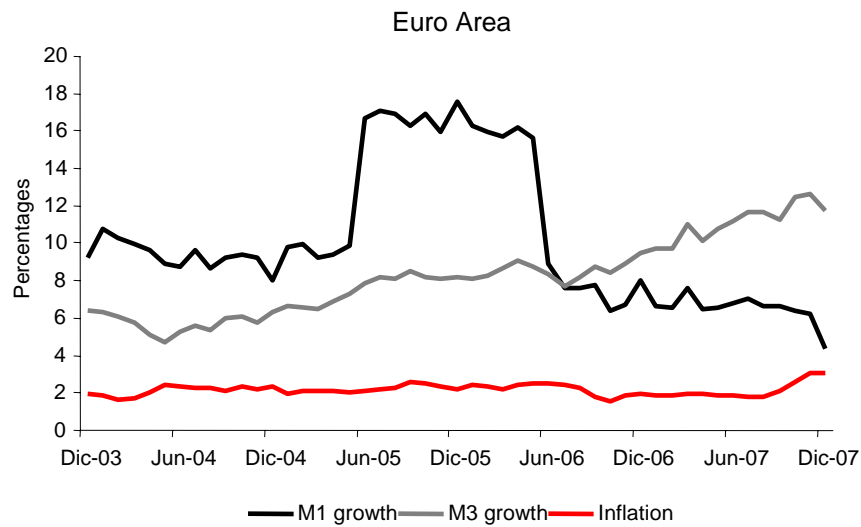# Chile: Monetary aggregates growth and inflation

## (12 month growth rates, percentage)



M1 growth (left axis)

M3 growth (left axis)　　　Inflation (right axis)

Sources: Central Bank of Chile and National Statistics Institute.

# Money and inflation



Euro Area

Switzerland

Korea

Iceland

# Euro Area: M3 growth and one year ahead inflation

## (monthly data from January 1997 to August 2007)
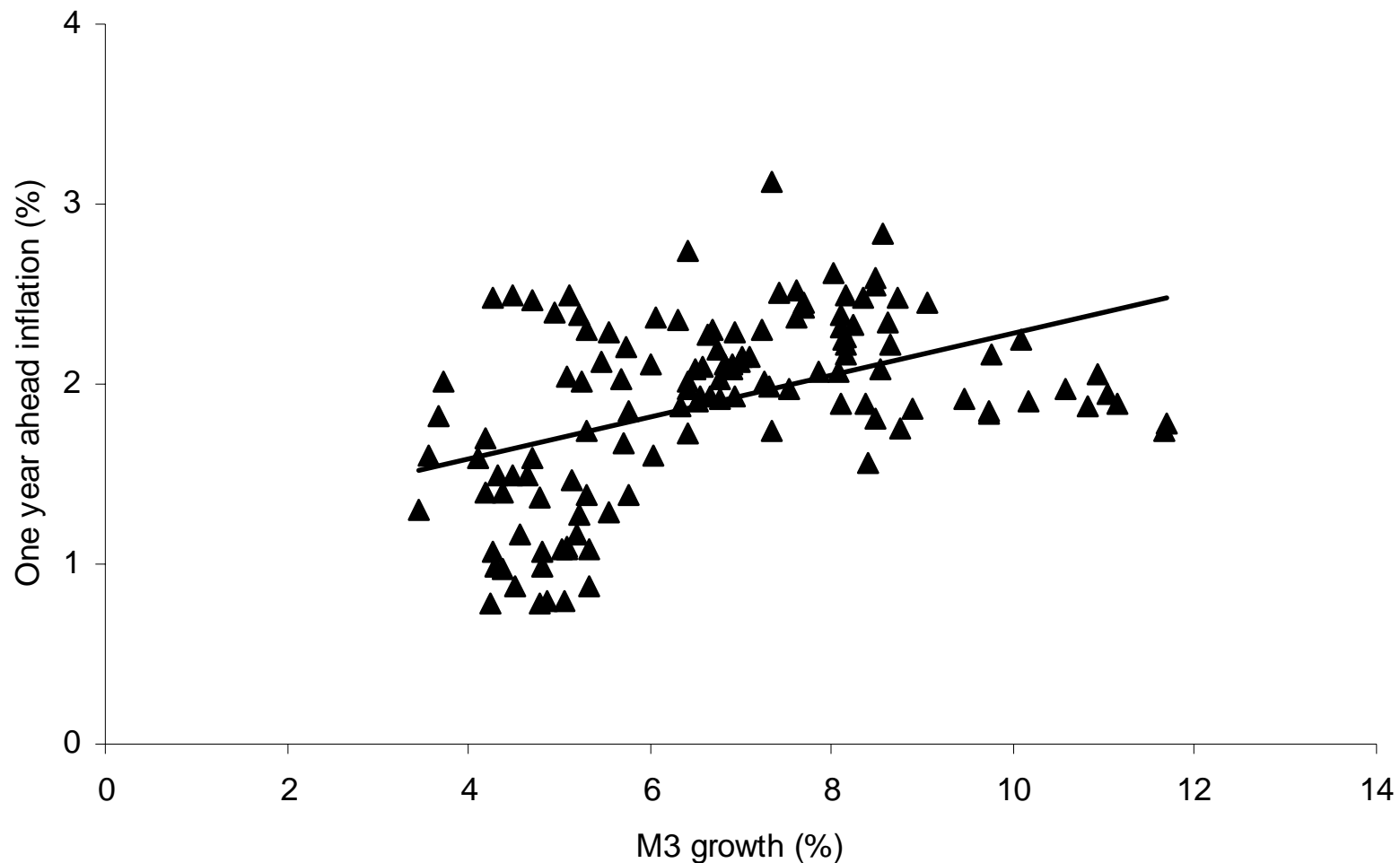


Sources: IMF, Bloomberg and Central Banks.

# 3.   Financial stability and bubbles

- Financial stability and price stability are, in general, complements.

- Sometimes they collide: USA today.

- Monetary aggregates and credit as leading indicators of financial problems.  But also of inflation (Roffia and Zaghini, 2008).

# 3.   Financial stability and bubbles

- "Wide consensus"

  1. *Central Banks should not target asset prices*

  2. *Central banks should not try to prick a bubble*

  3. *Central banks should "mop up" disasters*

- Not quite.

- Because of moral hazard 3 cannot be consistent with 1.  Indeed, 3 may be the cause of bubbles and financial distress.

# 3. Financial stability and bubbles

- What to do about bubbles and financial distress:

  - Difficult to identify bubbles (Gurnayak, 2005).

  - Continuous financial stability assessment. Strengthen regulations, when necessary.

  - Avoid, as much as possible, bailouts because of moral hazard.

- The jury is still out.

# 4. Concluding remarks

- Money in modern central banking: need to clarify why and where? Money growth is not the cause of inflation. In a world of monetary neutrality and interest rate rules, money is endogenous. However, inflation is always and everywhere a monetary policy problem.

- Credit channel and banking: money could be an indicator of future inflationary pressures.

- Financial stability focus: need to look at financial aggregates and asset prices.

# 4. Concluding remarks

- Current very high world inflation. What went wrong? Did we miss money? Not quite, Taylor (2007).

- Need to tackle world inflation, while distortions in emerging markets are mounting.