Introduction

Monetary policy is and remains a challenging policy area – even if the calm monetary environment at the moment may be taken to suggest that things are running according to plan. Monetary history shows us that just when we start to believe we had arrived at a stable routine of keeping inflation at bay, new issues for monetary policy arise. Monetary policy is all about expectations, and “expectations” means past developments plus an error term. It is the error term that all of us are most interested in – unexpected risks, our failure to assess future developments. And this is why discussions between academics and market practitioners, like on this panel, are so important. Let me address four key issues that I believe will occupy us in the future:

The Ostensible Success of Monetary Policy

If I was to make an executive summary of monetary policy in Europe and the U.S. in the past years, I would underscore its ostensible achievements. At least broadly speaking. Importantly, central bankers have succeeded in anchoring inflation expectations at historically low levels in a large number of countries. This is all the more remarkable considering the many hurdles fiat money regimes need to overcome on the way. The temptation of printing money to pursue short-term political ends is the central difficulty for such systems. There is little doubt that making central banks as independent from electoral politics as possible in democratic societies has become widely accepted and has greatly contributed to the recent stability.
Today, this seems like an obvious observation, but it is worthwhile recalling that only two or three decades ago, this was a very contended issue.

The establishment of the European Central Bank and its integration into the E.U.’s legal order as an independent authority so far marks the culmination in the long march of practically implementing a theoretical postulate that can be traced back to David Ricardo and has been advocated by monetary economists in varying forms ever since. I am hopeful and confident that this approach will prevail – to the benefit of our societies.

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### The Importance of the Economic Environment

As essential as institutional arrangements are as a precondition for stable monetary policy, the economic environment in which monetary policy is conducted remains an important co-determinant for its success or failure.

The current state of the global economy is a suitable example. The era of globalization, the opening-up of markets and increasing competition has been an easy time for central banks to keep inflation low and anchor expectations. The recent years have been a period when a lot of additional relatively skilled labour entered the market. As a result, cost pressures have been less pronounced than in earlier periods. Of course, this benign environment also goes back to groundbreaking political initiatives. In particular, I am thinking of the creation of the single market in the E.U., which has proven an indispensable condition for stable growth in Europe, and therefore for monetary union. Another example is the increasingly free flow of goods, services, and capital around the world, which has been facilitated by an unprecedented liberalization of markets between the key economies in this world, including the U.S., the E.U., and many key emerging markets. The line of causation may not be a direct one, but dismantling artificial market barriers and promoting free and efficient markets are for all we know key elements of a stable macroeconomic environment, and policymakers are well-advised to maintain and actually reinforce their commitment to open markets. This prominently includes policy initiatives such as the Doha trade round, the liberalization of investment flows, or the global convergence of financial market regulation.

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### Global Risks to Monetary Stability

All these factors cannot belie the fact that substantial risks to monetary stability remain. In fair weather, most systems tend to function, some better than others. What we need to ensure, of course, is that our monetary order functions as smoothly once market events or external effects rock the boat. Let me be explicit on this point: This is no fear-mongering. Our economies are vulnerable to a variety of shocks, the sources of which may range from geopolitics, to market inefficiencies, to natural catastrophes. Some of them are very real, and monetary policy must need to be prepared. On the economic side, they include:

- Easy money in the first years of this decade, and its implications for price stability and financial asset prices,
- the global imbalances in current accounts,
- the huge swings of the major global currencies the Euro and the U.S.-Dollar,
- and the danger of irrational exuberance on financial markets, as exemplified by the sub-prime lending market in the U.S. and its recent collapse.