# Interview to Prof. Martín Uribe

Martín Uribe is a professor of Economics at Columbia University and a Research Associate of the National Bureau of Economic Research (NBER). Before joining Columbia, Uribe taught at Duke University and the University of Pennsylvania, and was a Staff Economist in the Division of International Finance of the Board of Governors of the Federal Reserve System. Uribe obtained a Ph.D. in economics from the University of Chicago, a Master degree from CEMA (Buenos Aires, Argentina) and a BA degree from Universidad Nacional de Córdoba (Córdoba, Argentina). He has made scientific contributions in the areas of International Economics, Monetary Economics, and Public Finance. His research focuses on understanding the sources and propagation of macroeconomic shocks within and across countries and on the design of monetary, fiscal, and exchange-rate-based stabilization policies. His work has been published in academic journal including the American Economic Review, the Journal of Political Economy, and Econometrica and has received financial support from the National Science Foundation. Uribe co-authored the books `Open Economy Macroeconomics' (Princeton University Press) and `International Macroeconomics' (under contract, Princeton University Press). He has held visiting research positions at the Federal Reserve Bank of Philadelphia, the European Central Bank, Goethe University (Germany), University of Bonn, and Princeton University and has consulted for the World Bank. Uribe is a Co-editor of the Journal of International Economics, an Associate editor of the Journal of Money, Credit and Banking, and an editorial advisor of the Canadian Journal of Economics.

**You stressed recently the importance of distinguishing between permanent and temporary monetary policy shocks; the current low inflation environment, along with reduced slack and robust recoveries could be understood in light of the stimulus measures adopted by major central banks, in the sense that nominal interest rates so low for so long (changing the average rate for some years, likewise a permanent monetary policy shock) could indeed be associated with low inflation outcomes. Are the euro area and Japan (perhaps soon the U.S.?) in a policy trap, something you suggested could happen almost 20 years ago [“The Perils of Taylor Rules”, JET, 2001, with Jess Benhabib and Stephanie Schmitt-Grohé]?**

I think the three cases are a bit different. Japan seems to be stuck in a liquidity trap. The nominal interest rate is low because the BOJ is trying to boost inflation, and inflation is low because people expect the interest rate to be low in the indefinite future. By contrast, in late 2015, the U.S. Fed stated that the crisis was over and announced a process of normalization of the nominal interest rate, which consisted in raising rates gradually from technically zero to 3.5 percent. Notably, the Fed made this announcement when the inflation rate was still 1 percentage point below the official target. In the few years since the normalization process began, inflation has risen to its intended target. The situation in Europe is in between those of Japan and the United States. If the ECB continues to convey the idea that zero rates are here to stay, inflationary expectations might begin to solidify at a below-target range. At that point the eurozone will have fallen in a Japan-style liquidity trap. On the other hand, if in the near future the ECB declares the great contraction over and begins to normalize rates, I think the path of prices and quantities will begin to look more like in the post 2015 United States. The monetary policy in the eurozone is at a critical bifurcation point. It will be interesting to see which direction policymakers will choose.

**It seems that during the 1970´s monetary policy was actively trying to stimulate the economy, achieving high inflation and high unemployment… Currently, given low inflation outcomes, monetary policy seems to want to avoid any sort of tightening, leading policy rates towards the Friedman rule, perhaps preventing inflation from rising. Markets currently expect the Fed to cut interest rates before the end of the year, amidst an economy that remains fairly strong (though slowing). Are we, in some sense, on the good side of monetary policy miscalculations?**

I think that the Fed has been doing a good job at conveying the idea that monetary policy is in the process of normalizing. This process is perfectly compatible with pausing and even easing if called for by business conditions. I think this is precisely what we are seeing now. A cut in rates in the near future will most likely be understood as a temporary move, which is precisely what the Fed would like if the cut is to achieve its goal of providing stimulus.

**You suggested ["Downward Nominal Wage Rigidity, Currency Pegs, and Involuntary Unemployment", JPE 2016] using fiscal policy and, perhaps more feasible, "prudential" capital controls to fight (or avoid) deep recessions such as the ones characterizing the eurozone periphery some years ago, given the externality that downward nominal wage rigidities impose within a monetary union. Looking at the particular case of the euro area, do you think a true Banking Union (seen as a true European banking system, in particular with all the risks stemming from the banking sector fully mutualized) and a true Capital markets union mitigate the need for such controls? In the sense that financial shocks are absorbed at a euro area level? Or is a fiscal union still a necessary step to avoid the kind of crisis we witnessed?**

I think a fiscal union is an essential element of a monetary union. When Kentucky enters in recession, a number of automatic stabilizers kick in (unemployment insurance, food stamps, medical services for the needy, etc.). These programs are to a large extent (directly or indirectly) funded by the Federal government. This means that tax payers in New Jersey are helping Kentucky weather the recession. A critic might argue that Germany did help Greece during the GFC in spite of the fact that no fiscal union was in place. This is true. However, the key difference is that Kentucky does not have to ask New Jersey for help. No need for lengthy negotiations. Moreover, Kentuckians don't realized that they are being helped and New Jerseyites don't realize that they are helping Kentucky. This puts out of the way a lot of the negative political factors and stigma we saw during the Eurozone crisis (the rich helping the poor, or the orderly helping the basket case sort of rhetoric). I think that a banking union can also help in this regard, but I don't think it is a replacement for some sort of fiscal union.

**What do you think are the most important lessons from the financial crisis and the sovereign debt crisis [in Europe]? Which critical aspects have been missed before the crisis and which aspects deserve further attention from macroeconomists?**

I think that one of the most important lessons we learned from the euro crisis is the need to demand sound fiscal policies from all country members before the crisis occurs, as opposed to calling for fiscal austerity in the midst of the crisis. In this regard, I think that the role of the European Commission must be rethought. The economic principles at play are simple and well understood since the work of Keynes and Hicks: fiscal policy must be tight during booms and loose during recessions. Many countries in the periphery of Europe have done exactly the opposite. This was not that bad before 1999, because countries still had monetary policy to play with. The crisis taught us that misguided fiscal policy can have disastrous consequences when monetary policy is out of the control of the local governments.

**In your opinion, over the next years, what are the most promising and challenging topics of research with relevance for policymakers, especially central bankers?**

One area of research in monetary economics that in my opinion deserves much more attention than it has received thus far is what I would call "the theory of monetary normalization." The United States has embarked in such a process since 2015, while Japan and the Eurozone are still keeping rates at zero. What do we know about the process of policy normalization? At the heart of this questions I think is the need to understand the differences between the effect of temporary and persistent changes in monetary policy. I have the impression that central banks around the world conduct policy under the understanding that a movement in the interest rate always has the same effect, regardless of whether it is interpreted by the public to be temporary or persistent. They seem to believe that monetary policy shocks come in just one flavor: A cut in interest rates always causes the inflation rate to increase, and, similarly, a tightening always causes inflation to fall. In my opinion, this kind of logic has had deleterious consequences for inflation outcomes around the world. For example, in Japan the nominal rate has been zero for the past quarter century and inflation has been significantly below target. Yet, the BOJ continues to hope that keeping the interest rate at zero indefinitely will help boost inflationary expectations. The polar case is Argentina. Its central bank has been keeping rates above 40 percent for the past decade, hoping that this will bring inflation down. I think that at the root of this problem is a lack of understanding of the fact that transitory and permanent movements in the nominal interest rate can have different effects. Of particular importance is the need to better understand the short-run effect of permanent (or persistent) movements in monetary policy. To go back to the example of the BOJ. What do theory and evidence tell us about the short-run effect of a hypothetical policy change in which the BOJ announces a gradual normalization of its policy rate to its pre-1995 historical average of about 5 percent? What empirical and theoretical tools do we have to gauge the short-run and long-run consequences of such a change in policy regime? Under the one-flavor view, this policy would create more deflation and recession. But incipient empirical and theoretical work has begun to challenge this view. I think that much more work is needed until we can confidently say that we understand the process of monetary policy normalization.